CHAPMAN TRIPP

To: The Treasury

On: Overseas investment in New Zealand

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ABOUT CHAPMAN TRIPP

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Introduction

1 Thank you for the opportunity to submit on the Treasury April 2019 Consultation document "*Reform of the Overseas Investment Act 2005*" (***Consultation Paper***). Chapman Tripp frequently advises on the application of the Overseas Investment Act (***the Act***), knows the issues that tend to arise, and has an interest in ensuring the Act functions well.

2 Treasury has accurately identified most of the problems with the current regime and is proposing many effective options for change. We welcome particularly Treasury's recognition of the issues around the application of the Act to listed companies, the tipping point for acquiring consent, and open-ended timeframes.

3 In our view, the Act is overbroad in its application, capturing a range of transactions that are not plausibly within its policy objectives. The Consultation Paper proposes a number of solutions to this problem which would have the potential to create a workable and effective regime.

4 Our submission mirrors the structure of the Consultation Paper. Our submission has been prepared by partners and senior lawyers expert in this area and does not purport to represent the views of our clients.

Executive summary

5 Chapman Tripp supports the following options/solutions as part of Treasury's proposed reform of the Act.

a) ***Sensitive adjoining land:*** the current definition of sensitive adjoining land is too broad. Treasury's proposed Option 1 deals to this problem, narrowing the definition in a material way while still retaining exceptions to protect adjoining land where actually needed.

b) ***Leases***: leases should only be screened if they are residential leases over 12 years or leases over 35 years for all other categories.

c) ***Definition of overseas person:*** issuers with a primary listing of their equity securities on a licensed financial product market (such as the NZX Main Board) should be treated as an overseas person only if at least one overseas person (alone or together with its associates) has obtained a shareholding of 25% or more in the issuer.

d) ***Portfolio investors:*** a class exemption should be adopted, to be granted to portfolio investors that are beneficially owned and controlled by New Zealanders (i.e. with at least 51% of the entity's funds under management invested on behalf of New Zealanders).

e) ***Tipping point:*** consent should be required only for a transaction in an entity that owns or controls an interest in sensitive land where an overseas person acquires a class of securities in that entity such that, when the transaction is complete, the acquirer will hold shares giving them a control interest in the entity; and as a result of that transaction, the entity invested in will be an overseas person.

f) ***Investor test:*** the business experience and acumen, financial commitment and immigration eligibility criteria should be removed from the test. In respect of the good character criterion, we support the simplifications proposed by Treasury's Option 1 or Option 2, and believe either would streamline the character assessment in a manner that does not undermine materially its purpose or scope.

g) ***Impact of investments****:* a national interest test should be adopted to operate alongside a simplified benefit to New Zealand test. The onus of the test should be on decision-makers to identify a reason why the national interest would be harmed by the proposed transaction, rather than requiring applicants to demonstrate that the transaction would benefit national interest.

h) ***Timeframes****:* deadlines that are tailored to each of the Act's consent pathways should be introduced. This should be supported by increased resources for the Overseas Investment Office (***OIO***).

6 We have not commented on all of the proposals Treasury has put forward, choosing instead to focus on those on which we have a particular view. We have also proposed some additional changes, not discussed in the Consultation Paper, from paragraph 105.

7 We strongly recommend that any proposed changes following this consultation be captured in exposure drafts of the legislation and regulations. This is a technical area of the law where the drafting can be as important to the outcome as the policy intention that informs the legislation, and can even defeat that intention by setting up unforeseen consequences.

Part A: What assets do overseas persons need consent to invest in?

Sensitive adjoining land (from page 20 of the Consultation Paper)

8 The current definition of sensitive adjoining land is overly broad. We consider that there are sufficient other regulatory mechanisms (such as the Resource Management Act 1991 (***RMA***)) to protect adjoining land and that the Act contributes little in the way of additional protection.

9 For example, consent could be obtained to acquire land that is sensitive because it adjoins a property that includes a listed historic place on the basis that the acquisition would provide new jobs and investment for development purposes – neither of which bear any relationship to the historic place on the adjoining land. There is no clear policy reason why this land is caught by the Act.

10 Chapman Tripp worked recently on a transaction that required consent because the heavy industrial site owned by the New Zealand subsidiaries adjoined a regional park. The client incurred over $100,000 in external costs to obtain that consent. There is no clear policy reason why such land is caught, particularly given none of the benefits claimed were (or, in fact, could have been) in any way related to the regional park.

11 Of the two options Treasury has proposed, we prefer option 1 (page 22 of the Consultation Paper). Removing Table 2 land from the definition of sensitive land will narrow the definition in a material way, while still retaining exceptions to protect adjoining land where needed.

12 Alternatively, adoption of Option 2 would still be a significant improvement to the current Schedule 1 to the Act. In particular, we support removing the section 37 'list' land from Table 2. The 'list' is difficult to interpret and apply and there is no clear policy reason for it. Chapman Tripp has worked on a number of transactions where sensitivity has been triggered due to section 37 land. The section 37 'list' artificially distinguishes between reserve/public and open space land for no apparent policy reason. In a number of cases, our clients' properties have been assessed as sensitive, where a district plan requires provision of an esplanade reserve, but only upon future subdivision.

Leases of sensitive land (from page 25 of the Consultation Paper)

13 We agree that overseas investment is being deterred by the disproportionate cost, time and stringency of the screening process for leases. We are aware of offshore transactions involving multinational businesses, which needed consent solely because leases were involved, where the investors considered shutting down the New Zealand operations or moving premises to avoid the delays associated with the consenting process.

14 In our view, leases should only be captured by the Act where they are of sufficient duration that they confer a degree of lasting influence or control comparable to freehold ownership.

15 We support an amended version of Treasury's option 2 (page 26 of the Consultation Paper). We support creating a split category of screening but think consent should be required only for leases of more than 12 years for residential and non-urban land over five hectares and of more than 35 years for all other classes of land (consistent with the subdivision requirements of the ***RMA***). We do not agree that leases of non-urban land should be screened in the same way as residential land and consider that the 10 year threshold should apply only to residential land.

Part B: Who needs consent, and when, to invest in sensitive assets?

The definition of overseas person as it applies to bodies corporate

(from page 31 of the Consultation Paper)

16 Many listed bodies corporate in New Zealand are categorised as "overseas persons" under the Act although they have a large proportion of New Zealand ownership, they have local incorporation, their headquarters, boards and senior management are in New Zealand, and they have primarily New Zealand employees. Furthermore, as they are listed entities, New Zealanders have the ability to buy interests in them at any time.

17 The need to redefine the application of the Act for New Zealand controlled listed bodies corporate is one of the key recommendations of the late Rob Cameron's *Capital Market Development Taskforce* that has not yet been implemented (see *Progress Report* 31 July 2009, and final *Capital Markets Matter* report, December 2009).

18 The current definition of "overseas persons" imposes significant regulatory and commercial burdens, including:

18.1 some listed entities making upwards of four sensitive land applications a year, often costing more than $100,000 in external costs (lawyer and OIO fees) in addition to the large burden placed on executive time and focus, sometimes exacerbated by significant delays in completing transactions;

18.2 committing capital to less attractive projects to help demonstrate a "benefit to New Zealand" in the context of a sensitive land consent application;

18.3 disadvantaging listed entities' commercial position in a competitive sales process because:

- vendors prefer unconditional offers (allowing much quicker timeframes and greater certainty); and
- particularly in respect of sensitive land applications, the cost of an OIO application can have a material effect on the value of the offer and its ultimate success;

18.4 pushing projects into sub-optimal premises because the preferred location would require an OIA application; and

18.5 disadvantaging listed entities' commercial position when renewing leases over land, particularly in the agriculture sector.

19 Listed entities near the 25% threshold also face significant costs. They must monitor their level of overseas ownership, including undertaking share register analysis and issuing tracing notices to shareholders to determine both legal and beneficial holdings. They are also more likely to "over comply" and seek consent when there is doubt about their extent of overseas ownership, or their extent of overseas ownership may change in the lead up to a transaction.

20 Adopting a sensible definition of "overseas person" that excluded New Zealand listed entities with a genuine New Zealand presence would eliminate a large amount of compliance burden, both cost and management time, and thereby increase competitiveness and productivity. Chapman Tripp

considers it important that the definition of overseas person, as it applies to entities with a primary equity listing on a licensed market, recognise:

20.1 that their day-to-day ownership profile is outside their control as their shares are freely tradeable

20.2 the limited impact on "control" of small (less than 25%) shareholdings by "overseas persons" even where the combined holdings held overseas represent a majority, and

20.3 the practical difficulties of ascertaining beneficial ownership given the day to day variability in shareholdings (and deferred settlement of on-market trades on a T+2 basis), as well as the routine use of custodians, nominee companies and trusts.

21 A significant component of overseas ownership is passive portfolio ownership. A recent analysis by JBWere of New Zealand listed issuers (representing 95.6% of the S&P/NZX All Index on total market capitalisation) found only 7.8% ownership by "offshore strategic stakes" against 31.1% ownership by "other offshore owners" – primarily managed funds, with a small portion of offshore retail investors.

CHAPMAN TRIPP'S RECOMMENDED SOLUTION

22 Chapman Tripp's solution (the ***Recommended Solution***) is set out below:

An overseas person means, in relation to a body corporate with a primary equity listing a licensed market (A), if an overseas person has obtained (either alone or together with its associate(s)) a 25% or more ownership or control interest in A and:

(a) the overseas person obtained consent for that transaction under section 12(b)(i) or 13(1)(a); or

(b) *the overseas person has notified A that it has obtained (either alone or together with its associate(s)) a 25% or more ownership or control interest in A in accordance with [reference to new section below introducing a primary obligation on overseas person to notify the listed company]*.

A ***licensed market*** would have the same meaning as in the Financial Markets Conduct Act 2013.

23 The section referenced above imposing a primary obligation on overseas persons would be drafted as follows:

An overseas person who (either alone or together with its associate(s)) has an 25% or more ownership or control interest in a listed issuer must disclose that fact to the listed issuer, within 5 trading days of this section becoming applicable as a result of—

(i) the listing of the listed issuer; or

(ii) *the overseas person (either alone or together with its associate(s)) obtaining the 25% or more ownership or control interest in the listed issuer.*

24 The Recommended Solution would exclude New Zealand listed bodies corporate from the definition of "overseas person" if no one "overseas person" (alone or together with its associates) holds more than 25% of the shares in the NZ listed entity (or the NZ listed entity had not been notified of such holding, whether directly or through the OIO consent process).

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25 The definition of "associate" in the Act is broad. To make it work, there would need to be some exclusions for the types of relationship excluded from the definition of "relevant interest" provided for in section 238 of the Financial Markets Conduct Act 2013 (***FMCA***) or section 6(3) of the Foreign Acquisitions and Takeovers Act 1975 (Cth of Australia).

26 The Recommended Solution could be subject to a "call in" right by the OIO or responsible Ministers. This would allow the OIO/Ministers to notify a listed entity that they consider it to be an "overseas person" for the purposes of the Act on the basis that it is controlled by overseas persons. Exercise of the call in would require statutory guidance, and procedural protections. An appropriate model for such a regime is Sub-Part 3 of Part 9 of the FMCA.

27 The key benefits of the Recommended Solution include:

27.1 only treating listed bodies corporate as "overseas persons" if they are in fact effectively controlled by a single, identifiable "overseas person", consistent with the concept of "control" under the Takeovers Code;[1]

27.2 providing more certainty to listed bodies corporate when considering whether they are an "overseas person". A listed body corporate (A) will only become an "overseas person" if another "overseas person" (B) obtains a controlling stake. This would generally require B to obtain consent under the Act. In obtaining consent, B effectively notifies A that it is now an "overseas person". In circumstances where B was not required to obtain consent (e.g. where the value of A's shares and assets was less than $100 million and it did not hold sensitive land), B would instead be required to directly notify A of its controlling stake; and

27.3 removing the issues identified by Treasury in relation to the 'tipping point' regime.

28 As set out in detail below, while an improvement to the current definition of "overseas person", we believe that the Options considered in the Treasury Paper would leave listed entities subject to continuing uncertainty as to whether they might be an overseas person at any given time (or may at any moment become an "overseas person") and do not accurately capture when a listed entity becomes controlled by an "overseas person".

CHAPMAN TRIPP'S ALTERNATIVE SOLUTION

29 Chapman Tripp strongly supports the Recommended Solution but, if it is not adopted, our preference would be to combine Options 1 and 2 in the Consultation Paper (at page 32) such that a listed body corporate will only be an "overseas person" if:

29.1 more than 49% of a class of voting financial products is overseas owned, and

29.2 the cumulative substantial holdings by overseas persons total 25% or more.

30 However, as foreshadowed above, Options 1 and 2 in in the Treasury Paper give rise to various practical difficulties for listed bodies corporate.

[1] Under the Takeovers Code, control is deemed to pass once a person holds or controls more than 20% of the voting rights in the company. A person cannot acquire more than 20% of the voting rights in a code company except in accordance with one of the permitted exceptions under the Takeovers Code (being a full or partial takeover offer or an acquisition or allotment approved by disinterested shareholders).

31 Practical difficulties with Option 1:

31.1 Given the widespread use of custodians, nominee companies and trusts for listed company share ownership, the share register for a listed company does not enable the company to identify the geographic location of the beneficial owners.[2]

32 Practical difficulties with Option 2:

32.1 Listed entities may not be able to identify from substantial product holder disclosures whether a person with a substantial holding is an overseas person or not. In addition, substantial product holder disclosures require disclosure of "relevant interests" in financial products, which may not in fact accord to ownership or control interests for the purposes of the Act. Absent changes to the substantial product holder disclosure regime requiring persons to identify whether they are an overseas person, and whether or not they have an ownership or control interest for the purposes of the Act, Option 2 leaves listed entities uncertain as to whether they are an overseas person or not.

33 It is important that both Option 1 and Option 2 need to be satisfied before a listed entity becomes an "overseas person". This is because:

33.1 in relation to Option 1, a number of listed entities (particularly larger entities with significant indexed funds as shareholders) will still have more than 49% overseas ownership and this Option alone ignores the fact that those overseas shareholdings may comprise many unrelated de-minimis holdings; and

33.2 in relation to Option 2, given the relatively concentrated nature of shareholdings of New Zealand listed bodies corporate, having an interest of 5% or more would not be uncommon. Indeed, we noted in our New Zealand Equity Capital Markets Trends and Insights report in February 2019 that approximately two thirds of issuers in the S&P/NZX 50 index had at least one person who holds or controls more than 10% of their securities. As global passive fund management continues to aggregate it is likely over time that fund managers such as Blackrock or Vanguard could routinely hold passive positions in S&P/NZX10 and NZX20 issuers well above a 5% level.

34 As noted above, Chapman Tripp's strong preference is the Recommended Solution, rather than combining Options 1 and 2.

COMPLEMENTARY EXEMPTION / OPTION 4

(as considered in the Consultation Paper at page 34)

35 Irrespective of the definition of overseas person which is ultimately adopted, Chapman Tripp considers it important and most beneficial to New Zealand that Option 4 in the Treasury Paper is also implemented, with clear guidelines and requirements as set out in more detail below.

36 Option 4 is an exemption (on the grounds of a strong connection to New Zealand), rather than a solution to the definition of overseas person. Chapman Tripp supports an exemption of this nature alongside a solution to the definition of overseas person (the options for which are discussed above). Exemptions provide flexibility that the definition of overseas person test cannot.

[2] Although the 'tracing' regime in ss 289-291 of the FMCA provides a listed issuer with certain powers to request details of beneficial ownership under the Financial Markets Conduct Act, these powers are time consuming and costly and impractical to use on a regular basis. Accordingly Chapman Tripp does not believe that they provide a practical solution to the problem identified.

37 Option 4 should include positive factors that by definition evidence a "strong connection to New Zealand", with no further enquiry needed. For example, "mixed ownership model" businesses in which the Crown owns a majority and controlling share should be automatically exempted by Option 4.

38 For cases where more OIO/Ministerial judgement is required, Chapman Tripp strongly recommends that tests for Option 4 exemptions do not require previous consents or a previous record of compliance with the Act (which itself requires that previous consent or exemption conditions have been followed). Some entities which ought to be exempted on the basis that they are reliable businesses with a "strong connection to New Zealand" may not have required consent in the past, for example because they are new entrants or previously sat below the 25% threshold.

39 There are currently only two entities listed in Schedule 4 of the Regulations. By contrast, at the time the Regulations were first made, five persons were listed in Schedule 4 and the predecessor Overseas Investment Exemption Notice 1995 excluded 10 persons.

40 As an interim solution, we would urge Treasury and the Minister to amend regulation 49, and Schedule 4 of the Regulations, to add usual conditions to ensure the current exemption is not abused, such as disapplying the exemption if the listed issuer has a single shareholder (with its associates) that holds or controls more than 25% of its specified securities – in the same way that regulation 48(3) contains conditions for the portfolio investor exemption.

41 This would enable additional listed issuers to seek to be added to Schedule 4, pending implementation of the Recommend Solution by changes to the Act.

Screening of portfolio investors (from page 38 of the Consultation Paper)

42 As Treasury has correctly identified, portfolio investors are generally professional investors that invest on behalf of groups comprised predominantly or exclusively of New Zealanders. Portfolio investors that are genuinely passive are still often treated as "overseas persons" because their managers are overseas - for example, KiwiSaver funds administered by the large Australian-owned banks in New Zealand.

43 The existing mechanism in regulation 48 and Schedule 3 of the Regulations which excludes portfolio investors from being counted in the assessment of the "overseas person" test no longer has any utility, as no portfolio investors are listed. By contrast, at the time the Regulations were first made, 11 portfolio investors had exclusions and the predecessor Overseas Investment Exemption Notice 1995 excluded 81 portfolio investors.

44 There is no direct incentive for portfolio investors to become listed on Schedule 3 as they are required to pay an application fee to do so, and annual fees thereafter, but the benefit from being listed accrues to the entities they invest in. Moreover, with significant changes on corporate form, M&A activity and other rationalisation of fund management over the years, a number of the portfolio investors listed in 1995 and 2005 are now in a different form (albeit a significant number are still in existence).

45 Although the current exclusion has fallen into disuse, it has long been recognised as a matter of policy that excluding portfolio investors from being counted in the assessment of the "overseas person" test is appropriate.

46 We note that under the current framework:

46.1 New Zealand entities have been treated as overseas persons because of a portfolio investment even though the investors are New Zealanders and the ownership threshold would not have been triggered had they bought their shares directly, and

46.2 there is a failure to recognise the passive nature of investments where no control or degree of influence is held, or sought, by portfolio investors.

47 As a result of this treatment, a number of listed issuers such as Meridian, Genesis, Mercury, Metlifecare, Ryman, Spark and Chorus, are, or are very close to the tipping point of being, treated as "overseas persons".

48 We support the adoption of a class exemption for portfolio investors that are beneficially owned and controlled by New Zealanders (ownership and control for this purpose being at least 51% of the entity's funds under management being invested on behalf of New Zealanders) as in the first half of option 2 put forward by Treasury (at page 40 of the Consultation Paper).

49 However, we do not support the second half of option 2, and suggest that it should be redrafted so that the portfolio investor itself may not have control rights greater than 25% in any single holding without obtaining consent. This would align with the threshold proposed above for when an issuer with a primary equity listing on a licensed market should be an overseas person, or this requirement removed entirely. Placing a restriction on the control rights that may be held, in aggregate, by unrelated investors in the same company would be problematic as:

49.1 for the reasons outlined above, it is impossible for a listed issuer to ascertain the percentage of overseas ownership – a portfolio investor has access to significantly less information than the listed issuer, so is in an even worse position to ascertain this; and

49.2 this would place an undue restriction on the universe of investable options for such portfolio investors, as there are many NZX Main Board listed issuers where overseas persons have negative control over the entity – indeed, JBWere calculated the overall level of overseas ownership in New Zealand listed equities at 39%, highlighting how common this scenario is

50 In our view, this amendment would address the issue identified by the Treasury.

Tipping point for requiring consent (from page 42 of the Consultation Paper)

51 An overseas person acquiring a non-controlling interest in an entity should not require consent. As the Consultation Paper identifies, acquisition of a non-controlling stake does not put assets at risk and the Act's intent would not be undermined if these transactions were not screened. It is also arbitrary to require the marginal investor who takes an entity over the 25% threshold to obtain consent. In many cases, and especially when acquiring listed shares, the investor cannot even be aware at the time of the transaction that they require consent. This may have a cooling effect and undermine passive investment in listed companies when they near the 25% threshold.

52 Consent should only be required in an entity that owns or controls an interest in sensitive land where, at the completion of the transaction:

52.1 the overseas person will hold a controlling interest in the entity with the effect that,

52.2 the entity will be an overseas person.

53 This is different to Treasury's option 2 (at page 43 of the Consultation Paper), which would require consent if the acquirer would hold at least 5% of the total number of securities in the class. We think the test should be not the size of the shareholding but whether it creates a controlling interest.

54 There is no material difference between an overseas person acquiring 1% or 5% in an entity as neither will give them control. Creating a de minimis threshold of 5% will not resolve the problems in the current regime.

Incremental investments above a 25% interest

(from page 45 of the Consultation Paper)

55 We agree with Treasury that there is no reason to screen incremental investments that do not cross important thresholds.

56 We think that a combination of Treasury's Options 1, 2 and 4 (page 47 and 48 of the Consultation Paper) is the best solution to improve the existing exemption. Overseas persons should be able to increase their interest as long as they remain below the relevant key control threshold, upstream or downstream shareholders ought to qualify for the exemption, and there should not be any time limit to the exemption.

CLASSES OF SECURITIES

57 Under s 7(2)(c)(i) of the Act, a body corporate is an overseas person if an overseas person or persons "have" 25% or more of any class of A's securities. This gives rise to two issues:

57.1 The word "have" is clear when applied to s 7(2)(c)(ii) (having "the power to control…") and 7(2)(c)(iii) (having "the right to exercise or control…"), but is ambiguous when used in the context of securities, as it is unclear whether this is referring to legal title or beneficial ownership. We understand the OIO's view is that it captures both and suggest the wording for this limb should be made unambiguous (given issues caused by custodians being treated as "having" securities have now been ameliorated through class exemptions in the regulations).

57.2 Securities includes convertible securities that do not give rise to an ownership or control interest. For example:

(a) Issuer A has 100m ordinary shares on issue. Issuer A then issues 10m options to an overseas person (which will convert to ordinary shares on a one for one basis).

(b) The overseas person does not obtain a 25% or more ownership or control interest as it does not have a 25% or more beneficial entitlement to Issuer A's securities (in aggregate), and therefore does not require consent to obtain the options (other than under s 12(b)(iii) if Issuer A owns sensitive land).

(c) However, Issuer A will become an overseas person as a result – as the overseas person issued the option will "have" 100% of a class of Issuer A's securities, despite not having a 25% or more ownership or control interest (the more appropriate trigger point in this respects).

(d) Perversely, Issuer A would cease to be an overseas person were the options to be exercised, as it would then only have ~9% overseas ownership.

58 For the reasons outlined above, we submit that s 7(2)(c)(i) of the Act should be amended – not just for listed issuers, but all body corporates – so as to be aligned with a 25% or more ownership or control interest.

Part C: How does the Act screen transactions in sensitive assets?

Assessing investors' character and capacity

(from page 51 of the Consultation Paper)

59 We agree with Treasury's assessment that the benefits of some of the current investor test criteria are not clear and do not seem to assess material risks. For that reason, we support the removal of the business experience and acumen, financial commitment and immigration eligibility criteria, as proposed by Treasury's Option 2 (at page 56 of the Consultation Paper).

60 The good character criterion can impose significant compliance costs, particularly where individuals with control (IWCs) include directors who hold or have held multiple roles with large organisations, and often entails addressing numerous irrelevant allegations. Accordingly, we support the simplifications proposed by Options 1 and 2.

61 We oppose the introduction of a bright-line test for assessing an investor's character and capacity, as proposed in Option 3 – except if supported by an overriding discretion for Ministers or the OIO to determine that the good character criterion is nevertheless met.

62 A screening regime requires a degree of flexibility in order to avoid illogical and unintended outcomes. A bright-line test applied inflexibly would create a real risk that overseas persons will be prevented from investing in New Zealand due to one, largely irrelevant factor.

63 If a bright-line test was adopted, we agree with Treasury that appropriate time limits for the chosen criteria would need to be considered carefully.

Additional potential changes (page 57 of the consultation paper)

NEW ZEALANDERS

64 We strongly support removing New Zealanders identified as relevant overseas persons (ROPs) or IWCs from the requirement to satisfy the investor test. This change would streamline the application process for a number of investors.

65 The need to obtain comment from New Zealand professional directors about the actions of unrelated companies where they also hold or have held a directorship, is time consuming and frustrating for our clients. It is also difficult to justify, given that the directors are not subject to the Act in their personal capacity and the allegations can concern entities wholly unrelated to the Applicant.

CORPORATE CHARACTER

66 We do not support the corporate character assessment proposal. It will be too subjective, will not add anything to the way character is assessed now and the factors proposed for consideration (tax arrangements, labour practices and environmental practices) are all regulated by other statutes.

STANDING CONSENT

67 We support a more formal standing approval process for the investor test but not as a separate consent structure, which would inevitably involve fees and time delays. A more efficient approach would be to formally exclude ROPs and IWCs who have been previously approved from consideration on subsequent applications unless there have been material changes.

Screening the impacts of investments (from page 60 of the Consultation Paper)

68 We support the introduction of a national interest test to operate alongside a simplified benefit to New Zealand test. This would address many of the concerns with current screening methods while still allowing for delegation to the OIO, driving timely decisions.

69 But we attach a number of provisos to our support. The issues with the counterfactual test would need to be addressed, there would need to be a clear timeframe for decisions (as set out at paragraph 102), and the right balance would need to be struck between protecting New Zealand from investments that threaten national security, and deterring legitimate and productive overseas investment.

70 The design of the test is crucial. We wish to comment, in particular, on the following points.

CLARITY OF CRITERIA

71 Any national interest test should have clear and discrete criteria for Ministers to consider. There are two examples given of existing national interest tests, the test from the Outer Space and High-altitude Activities Act 2017 (the ***OSHAA***) and the test under the Australian foreign investment legislation. We do not think either of these tests are appropriate to adopt in the New Zealand overseas investment context.

72 Both of the above tests are too broad in their formulation. While the OSHAA test contains some guidance, it ends with a 'catch-all' that provides the decision maker with an undesirable amount of discretion. The Australian test provides minimal legislative constraint for the decision-maker, with national interest being defined only in ancillary guidance by FIRB.

73 We think that a national interest test should consider national security, international relations and public safety. We support the inclusion of consideration of the extent to which risks can be mitigated by consent conditions or other legislation.

74 It is also important that the test is formulated in a way that focuses on the circumstances of the investor and not merely the type of asset. The Consultation Paper discusses certain assets that, by their nature, may require more careful scrutiny under the national interest test – e.g., interests in strategically important industries or critical infrastructure and activities such as media, transport, defence and military.

75 We would not support a view of national interest that effectively precludes overseas investment in certain types of assets. The national interest test should require Ministers to demonstrate why the national interest will be harmed with reference to both the asset in question and the identity and circumstances of the investor.

ONUS OF THE TEST

76 The onus should be on the decision-maker to identify a reason why the national interest would be harmed by a particular transaction, rather than requiring applicants to demonstrate that the transaction would benefit national interest. There are two reasons for this requirement.

77 First, the applicant will already have had to demonstrate that the investment results in benefits to New Zealand.

78 Second, the national interest should operate as a discrete test alongside the simplified benefit test to capture considerations that are not otherwise addressed in the benefit test (for example, national security concerns). It is unreasonable to require applicants to predict and address in advance the matters that might prompt Ministers to intervene on this ground, or to prove the

negative. This approach is similar to the way the test is framed under the Australian legislation, which is that the transaction proceeds unless it is contrary to the national interest.

NATIONAL INTEREST AND BENEFITS TEST SHOULD BE DISCRETE

79 We think the principal value of a national interest test is to permit Ministers to intervene in circumstances where the investment would result in a benefit to the public, under the benefit test, but there are overriding reasons to decline consent. Accordingly, the national interest test and simplified benefit test should operate discretely. Put another way, a national interest test and simplified benefit test that cover the same ground will introduce incoherence into the regime as the same considerations will be assessed under two separate tests.

SIMPLIFIED BENEFITS TEST

80 We are broadly in support of the simplified benefits test proposed at paragraph 202 of the Consultation Paper. We would like to see more specificity in the types of economic benefits that will be considered, for example:

80.1 the additional capital value realised by the seller as a result of the foreign buyer's willingness to pay more

80.2 the ability of New Zealanders to raise capital in international markets; and

80.3 greater liquidity for significant assets, which reduces barriers to entry and exit and therefore promotes investment.

81 Factors of the kind identified in paragraphs 80.1 and 80.3 above are particularly important in respect of well-run New Zealand assets. New Zealand vendors of such assets are disadvantaged by the current benefits test. In our experience, it is often more challenging to obtain consent for a well-run asset, as compared to a poorly-run asset, because of the lesser potential for improvement. Overseas buyers therefore have less scope to demonstrate they will bring the fresh benefits required to receive consent. Ultimately this creates a constraint on liquidity, which potentially deters investors (whether domestic or overseas) from investing in assets that have been well managed or that they intend to develop to a mature state.

82 Similar issues can also arise in respect of greenfield investment, as once a greenfield development has been completed there may be little incremental benefit that a subsequent overseas investor can demonstrate.

COUNTERFACTUAL

83 If any form of benefits test is to remain, we consider it is essential that the issues with the current counterfactual test are dealt with. We support Sub-Option A (discussed at page 75 of the Consultation Paper), which would result in:

83.1 a status quo counterfactual test, and

83.2 a 'no-detriment test' for transactions involving transferring land between two overseas persons, although this should also apply (so long as the other requirements are met) to:

(a) shareholding changes (as well as transfers of land), and

(b) transactions where the benefit to New Zealand test had previously been satisfied downstream of the current transaction, or where the investment in New Zealand pre-dated the benefit to New Zealand test.

84 This is the only option of the various sub-options proposed which would deal with the problems that arise under the current counterfactual test of artificially constructing what might happen with the investment. Further, we note that facilitating transfers between overseas owners under the 'no-detriment test' should provide investors with greater certainty around their ability to exit, which can in turn increase the attractiveness of investing in New Zealand.

85 Sub-options B and C (discussed at page 76 of the Consultation Paper) both still require a theoretical exercise in assessing what might occur. Adopting the vendor's continued ownership of the investment as the counterfactual is artificial as the vendor has determined to dispose of the investment.

Water extraction (from page 82 of the Consultation Paper)

86 We agree with the commentary in the Consultation Paper that the RMA has a clear role in regulating water extraction and that including this in the Act would risk conflicting decisions and investor uncertainty. For these reasons we do not consider change in this regard is necessary.

87 That point made, of the options proposed, we prefer Option 1 which is limited to water bottling or bulk water export. Option 2 is too broadly worded and could have an unnecessarily negative impact on transactions involving water extraction for net positive uses, such as golf courses or horticulture, which uses are strictly regulated by the RMA.

Tax (from page 85 of the Consultation Paper)

88 We do not support any changes to the way tax is assessed under the Act. We agree that breaches of tax law are relevant to good character, but these are adequately addressed already in the context of the investor test.

89 The OIO is not the appropriate body to decide whether the tax arrangements of a person, although legal, should bear on the character of that person. Such decisions should be left to tax agencies.

90 If an overseas person has to certify that they aren't involved in any tax avoidance, the OIO would be required to make an assessment as to whether the person's tax arrangements would violate tax laws where no tax agency has made the same assessment. This should not be the case.

Māori cultural values (from page 88 of the Consultation Paper)

91 We agree that the current regime does not consider Māori cultural values enough and support Treasury's Option 2 (on page 89 of the Consultation Paper). There is some ambiguity in the Consultation Paper around what the impact of this change will be for investors. We think it should be formulated to 'reward' those who intend to protect or enhance wāhi tūpuna but not to penalise those who are neutral, in that their actions would not harm wāhi tūpuna.

Special land (from page 91 of the Consultation Paper)

92 Any revised special land regime must recognise the practicalities of providing access and allow for the requirement to be waived. If the land is in forestry, for example, there would be significant health and safety considerations involved. There can also be significant costs attached to providing access to special land which would be unduly burdensome on the overseas investor.

93 We consider that each of Options 1, 2 and 4 would better address the practical realities of how the special land process operates. For the reasons described above, Option 3 should not be implemented as an absolute requirement.

Farmland advertising (from page 95 of the Consultation Paper)

94 We support Option 2 (discussed at page 96 of the Consultation Paper), which removes the farmland advertising obligations altogether.

95 They are an unwarranted imposition on vendors who, if they think they would likely get a better offer from a New Zealander, would have advertised regardless of the requirements of the Act.

Timeframes for decisions (from page 98 of the Consultation Paper)

96 We support prescribed periods for decision making, depending on the type of application submitted. These should factor in a period for Ministerial consideration.

97 But we consider the timeframes proposed in Option 2 (discussed at page 99 of the Consultation Paper) are too long and suggest deadlines (and extension periods) as follows:

97.1 30 working days for consent applications subject to a national interest or substantial harm test (if adopted) and for consent applications subject to the benefit to New Zealand test (or the modified benefit to New Zealand test), with a possible extension right of up to 20 working days

97.2 20 working days for consent applications subject to the investor and bright-line residential tests or special forestry tests, with a possible extension of 10 working days

97.3 15 working days for consent applications subject only to the investor test, with a possible extension of 10 working days, and

97.4 10 working days for consent decisions involving only a bright-line residential test.

98 We consider these shorter timeframes are appropriate because:

98.1 assuming other proposed reforms to the Act are adopted, the red tape in the application process should be significantly reduced (e.g. a more refined character assessment), and

98.2 the timing for applications of the types described at 1 above would be broadly consistent with the FIRB timing.

99 We agree that consent should be deemed to be granted if no decision is made within the required time period. This would ensure that the timeframes are effective. The Act would need to prescribe the basis on which consent would be granted, such as on published standard conditions of consent.

100 We also strongly agree that consideration be given to the OIO's resourcing.

SUB-OPTIONS: WHEN SHOULD TIMEFRAMES COMMENCE?

101 We support a solution that combines aspects of Sub-Options A and B, whereby the timeline would start immediately an application was received but would be paused if the OIO determined, within the first half of a prescribed period, that additional information was required. Any subsequent information requests would not affect the deadline.

102 Based on our proposal at paragraph 97, we suggest the following specific timeframes:

102.1 15 working days for consent applications subject to a national interest or substantial harm test (if adopted) and for consent applications subject to the benefit to New Zealand test (or the modified benefit to New Zealand test)

102.2 10 working days for consent applications subject to the investor and bright-line residential tests or special forestry tests

102.3 7 working days for consent applications subject only to the investor test, and

102.4 5 working days for consent decisions involving only a bright-line residential test.

103 We consider this to be appropriate because:

103.1 assuming a number of the other proposed reforms to the Act are adopted, the red tape in the application process should be significantly reduced (e.g. a more refined character assessment), and

103.2 the certainty delivered by prescribed periods for decision making would be at significant risk of being undermined if any information requests – even if minor in nature – paused the timeline.

104 Also for the reasons noted above, we are strongly opposed to Sub-Option C, which would pause the timeline any time additional information was required.

Other comments on the regime

DEFINITION OF NON-URBAN LAND

105 We have had difficulties with the interpretation of the "non-urban land" definition for land on the urban fringe as this land is nearly always zoned to allow for some form of residential or commercial development with the expectation that the urban boundary will be extended. The policy reasons for regulating land acquisition at the urban fringe is unclear.

106 We consider that the definition of non-urban land should be amended to better reflect the zoning of the land and should read:

"***non-urban land*** *means –*

(a) farm land; and
(b) any land other than land that is both:
(i) in or adjoining an urban area; and
(ii) either zoned under the relevant District Plan for or used for commercial, industrial, or residential purposes or for future commercial, industrial, or residential purposes"

CONSENT PATHWAYS

107 The current consent pathways do not work well in respect of certain types of transactions. We propose that pathways be created to address:

107.1 upstream transactions where the interests being acquired are not the purpose of the transaction. The New Zealand Takeovers Panel, for example, grants exemptions for genuine upstream acquisitions based on a 'purpose test' (where acquiring control of the voting rights in the New Zealand company would not reasonably be regarded as a significant purpose of the upstream acquisition) and a 'value test' (where the purpose test is prima facie satisfied if the New Zealand company represents less than 25% of the overall transaction value), and

107.2 transactions involving a relatively minor sensitive land interest, where the purchaser is willing to provide an enforceable undertaking to divest that interest within a prescribed period. This would be similar to the divestment undertakings that the Commerce

Commission may require under the Commerce Act 1986. Another potential solution would be to make it explicit that parties are permitted to structure a transaction to exclude the interest in sensitive land without being in breach of the (incredibly broad) avoidance provisions in the Act.

108 These pathways could likely be incorporated through the liberalisation of the individual exemption regime.

REGULATION 37 – EXEMPTIONS FOR CORPORATE DEALING

109 Although the corporate dealing exemption was expanded through the amendments to the Regulations in 2018, it contains two significant issues that we consider ought to be addressed.

110 The first issue is that the formulation of regulation 37 is such that it cannot be relied on to interpose a new holding company above an existing corporate structure. There is no policy reason to prevent parties from undertaking such action. The effect of adding a new top holding company is no different from incorporating a new holding company further down the chain of a corporate group. Interposition of a holding company above an existing corporate group is a common step for structuring an initial public offer, in conjunction with the listing.

111 The second issue is that regulations 37(b)(ii), (iii) and (iv) permit dilution of interests to New Zealand persons but not to overseas persons in circumstances where those overseas persons will not hold significant interests (either alone or in aggregate). Some illustrations below.

111.1 Company X is 100% owned by Overseas Person B. Company X has New Zealand assets valued in excess of NZ$100m or an interest in sensitive land.

111.2 Overseas Person B wishes to transfer the shares in Company X to Company A. This is permitted under regulation 37(1)(b)(ii) if:

(a) Company A is 100% owned by Overseas Person B, or

(b) Company A is 100% owned by Overseas Person B and one or more New Zealand investors.

111.3 However, if Company A is 90% owned by Overseas Person B and 10% owned by Overseas Person Y, regulation 37(1)(b)(ii) does not apply – Company A would need consent to acquire the shares in Company X.

111.4 If the transaction was instead structured as the issue of shares in Company X to Overseas Person Y, resulting in Overseas Person Y holding 10% of the shares in Company X, then (assuming no association issues) Overseas Person Y would not need consent under the Act to subscribe for such shares. It is a perverse outcome in such situations that simply by utilising a new company (Company A) to undertake a transaction, consent is required.

112 Similar examples can be formulated for limbs (iii) and (iv) of regulation 37(1)(b). We suggest that these exemptions should be amended to permit dilution to one or more overseas persons, provided that none of those overseas persons (together with its associates) obtains a 25% or more ownership or control interest in the relevant sensitive assets.

ADDITIONAL PART 2 EXEMPTION – LIMITED PARTNERSHIPS

113 Under the current framework, there is a failure to recognise the passive nature of investments where no control or degree of influence is held, or sought, by limited partners investing through a limited partnership. We propose that limited partnerships controlled, and majority owned, by New

Zealanders should not be screened by the Act. This could be achieved by the addition of a new class exemption, similar to our preferred option for the treatment of portfolio investors (see paragraph [41] above). That class exemption would apply to limited partnerships that are (i) controlled by New Zealanders (which would focus on the control and ownership of the general partner(s) of the limited partnership); and (ii) beneficially owned by New Zealanders (ownership for this purpose being more than 50% of the interests in the limited partnership being owned by or on behalf of New Zealanders).

114 Alternatively, the same outcome could be achieved by amending the definition of overseas person itself, by adding an additional limb that is specific to limited partnerships (and therefore distinct from the body corporate limb of the definition that currently applies, but is more suited to companies). That new limb of the definition would apply the current overseas person definition to the general partner(s) of the limited partnership (e.g. the body corporate test in section 7(2)(c) of the Act if the general partner was a company), and include a further provision that (notwithstanding if the general partner is not an overseas person) a limited partnership will be an overseas person if an overseas person or persons own 50% or more of the limited partnership interests.

115 The effect of either approach is to move the point at which a limited partnership is an overseas person from the current 25% beneficial ownership threshold to a more appropriate 50% threshold (given the passive nature of limited partners' involvement in the limited partnership), while retaining the same thresholds for the control of the limited partnership by focusing on the ownership and control of the general partner.

REGULATION 46 – EXEMPTION FOR UNDERWRITING

116 The exemption under regulation 37(1)(o) for an underwriting by an overseas persons of an issue of securities should be extended to cover an underwritten transfer (or sale) of securities. Sometimes initial public offers, in conjunction with a listing, are structured in this way - for example some of the mixed ownership model IPOs - and "block trades" of a significant stake in the listed issuer are also frequently underwritten.

117 Extension would help facilitate New Zealand capital market activity without giving rise to policy concerns because the extension is available only to underwriters whose ordinary course of business comprises bona fide underwriting and has a timeframe restriction of six months for holding any shortfall.

118 A similar exemption is provided for under the Takeovers Code class exemptions but unlike the exemption in the regulations the Takeovers Code exemption is not restricted to new securities underwriting.

EXEMPTIONS IN PARTS 4 AND 5 OF THE REGULATIONS

119 The exemptions contained in Parts 4 and 5 of the Regulations do not permit eligible investors to rely on the relevant exemption if they wish to structure the transaction using a New Zealand subsidiary (whether existing or newly incorporated). We do not consider there to be any good policy reasons for this prohibition.

120 While the position may be equivalent to the treatment of New Zealand investors in those other countries, reciprocity for the sake of reciprocity is not a rational basis on which to proceed. The reality of many corporate transactions is that a purchaser wishes to use a local subsidiary to make an acquisition. Provided that subsidiary is incorporated in New Zealand and is wholly owned by eligible investors (including New Zealanders for these purposes), we suggest that the exemptions in Parts 4 and 5 of the Regulations ought to apply.

REGULATION 57 – NETWORK UTILITY OPERATORS

121 Current regulation 57 of the Regulations exempts network utility operators from the consent requirements when acquiring residential (but not otherwise sensitive) land for the purpose of providing electricity conveyance.

122 We think this exemption should be expanded so that network utility operators do not require consent when acquiring any sensitive land. The same policy considerations that warranted the creation of the exemption in the first place warrant its extension to sensitive land more generally. Extending the exemption would recognise that acquisitions of sensitive land for the purpose of providing regulated utility services invariably benefit New Zealand

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