Overseas Investment Act 2005

Brief Update On Latest Developments

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Overseas investors seeking consent under the Overseas Investment Act 2005 (the Act) need to be aware of the implications of the High Court decision of *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* (*Tiroa E*).[1] The way in which an application for consent has to be approached has changed considerably: it has added significant complexity, for both the Overseas Investment Office and the applicant, in satisfying the requirements of the Act.

In addition, recent changes to the Overseas Investment Regulations 2005 (the Regulations) have introduced some conditional exemptions that apply to some Australian investors acquiring significant business assets in New Zealand.

The Crafar Farm decisions

The "with and without" test

***Tiroa E* clarified the application of** the "benefit to New Zealand" criteria for overseas investments in sensitive land in section 16(1)(e)(ii) and (iii) of the Act. Benefit to New Zealand is determined by reference to a list of factors set out in section 17 of the Act and regulation 28 of the Regulations.

As a result of *Tiroa E*, the Overseas Investment Office and the decision-making Ministers must apply a "with and without" test when assessing whether an overseas investment will, or is likely to, benefit New Zealand. This test requires a comparison of what is likely to happen *with* the investment, and what is likely to happen *without* the investment ("the counterfactual"). The "with and without" test applies to both overseas investments in sensitive land and the overseas investments in fishing quota.[2]

Practically speaking, this means that a potential overseas purchaser of sensitive land or fishing quota will need to ask themselves what could reasonably be expected to occur if the transaction in question does not proceed. Purchasers will need to know as much as possible about other potential purchasers of the asset. Vendors will also need to understand each bidder's plans for the asset. This will involve consideration of the following questions:

- Who else may be interested in purchasing the particular asset? Were there any other parties interested in purchasing the asset? Details of the advertising process must be disclosed to the Overseas Investment Office to enable it to ascertain what level of interest was shown by other parties in purchasing the asset;
- If there is an alternate New Zealand purchaser, what would a reasonably funded alternate purchaser likely do with the asset?
- What are the vendor's intentions with the asset if the sale should fall through?
- What alternative uses can the asset be put to?

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The effect of *Tiroa E* is that the overseas purchaser's use of the land has to deliver a benefit over and above the benefit that would be delivered by an alternative New Zealand owner. The Court suggested that the status quo may serve as the counterfactual only if it is likely that in the hands of another owner or owners, the asset will remain in its present state.[3]

The Court was not persuaded that a "with and without" test would be unworkable. Unlike the Commerce Commission guidelines, which require benefits to be quantified as much as possible, the Overseas Investment Office is not required to analyse alternative scenarios or evaluate competing offers. It is a matter of enquiring, for each claimed economic benefit, whether it is likely to happen without the overseas investment and whether that will result in benefits to New Zealand. The weighing of benefits among themselves does not require calculation, but is a matter of Ministerial judgement.[4]

The Overseas Investment Office will expect applicants to address the "with and without" test in their application for consent and address the questions set out above. The Overseas Investment Office may contact the vendor directly to clarify or verify the applicant's claims.

It should also be noted that general responses are not sufficient. The "with and without" test must be applied to each of the relevant factors in section 17 and regulation 28 (discussed further below). The assessment process will require the applicant to provide the Overseas Investment Office with specific business plans, including such matters as projected expenditure, likely additional jobs and likely timeframes for completion. Acquisitions will need to be timed carefully so that there is sufficient business and planning detail to be able to address the "with and without" test.

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Applying the "with and without" test to the "benefit to New Zealand" factors

Economic factors in section 17(2)(a) of the Act

When considering each economic factor, applicants should explain what is likely to happen with the investment against a "counterfactual" of what would likely happen anyway. For example, if the "jobs factor" is relevant, applicants must explain whether the creation

of new job opportunities or the retention of existing jobs that would or might otherwise be lost (as relevant) will or is likely to result anyway. In that example, only the additional new or retained jobs that will, or are likely to, result from the overseas investment can be considered.

Non-economic factors in section 17(2)(b)–(f) of the Act

The Overseas Investment Office has found that using the status quo as the counterfactual may overstate the non-economic benefits claimed, having regard to the Court's comments about the legislative objective of the Act not being served if a benefit would accrue in any event. Therefore, applicants should use a "with and without" counterfactual for these factors.

Regulation 28 factors

The Overseas Investment Office has found that a counterfactual analysis may be appropriate for the following factors, depending on the particular circumstances:

- Regulation 28(a) – consequential benefits factor;
- Regulation 28(d) – further significant investment by the vendor;
- Regulation 28(f) – significant Government policy or strategy;
- Regulation 28(h) – strategically important infrastructure; and
- Regulation 28(i) – "economic interests" factor.

Therefore, if any of the above factors are relevant to the investment, applicants should include a counterfactual analysis for each factor.

Overseas Investment Office example

For an example of how the Overseas Investment Office applied the "benefit to New Zealand" criteria following *Tiroa E*, please see its recommendation to the Ministers with respect to Milk New Zealand Holding Limited's application to acquire the Crafar Farms: *www.linz.govt.nz/sites/default/files/docs/overseas-investment/Overseas* Investment Office-recommendation-crafar-farms-20120420.pdf. TPL

1 *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC

2 Refer sections 56 to 58B of the Fisheries Act 1996.

3 *Tiroa E* at [42].

4 *Tiroa E* at [39].

Overseas Investment (Australia) Amendment Regulations 2013

The Overseas Investment (Australia) Amendment Regulations 2013 (the 2013 regulations) came into force on 1 March 2013 and inserted a new Schedule 5 into the Regulations.

The 2013 regulations implement an obligation under the Protocol on Investment to the New Zealand-Australia Closer Economic Relations Trade Agreement. One intention of the Protocol is to treat certain Australian investors in New Zealand significant business assets as if they were New Zealand investors, subject to certain conditions.

The 2013 regulations only relate to significant business asset acquisitions. Therefore, if the transaction also involves sensitive land or fishing quota, the requirement for consent provisions will still apply.

Previous regime for Australian investors

Before the 2013 regulations came into force, Australian investors were subject to the same rules as all other overseas investors. Under the Act, any overseas investor who wishes to obtain, directly or indirectly, a 25% or more ownership or control interest in significant business assets (such as shares in companies that do not own or control sensitive land, or other business assets), is required to obtain consent where:

- the consideration paid; or
- value of the shares or assets, or
- the value of the target and its 25% or more subsidiaries

is NZ$100 million or more.

New exemption for Australian investors

Now the 2013 regulations are in force, Australian non-Government investors and Australian Government investors (as defined in the 2013 regulations and discussed below) may be exempt from the requirement for consent in relation to significant business asset transactions that fall under a specified threshold. If the investor is an Australian non-Government investor, the initial threshold is $477 million; and if the investor is an Australian Government investor, the initial threshold is $100 million.

The thresholds for both Australian non-Government investors and Australian Government investors may be adjusted to a new amount each year. The amounts of the new thresholds will be published by the Overseas Investment Office on its website and in the *Gazette*.

Who is an Australian non-Government investor?

Generally, an investor will qualify as an Australian non-Government investor if the investor is:

- an Australian individual; or
- located in Australia and carries on substantive business operations in Australia; or
- an entity or branch that is located in Australia and is more than 75% owned or controlled by Australian individuals or New Zealanders; and
- is not owned or controlled by the Australian Government or a foreign Government investor.

Who is an Australian Government investor?

Generally, an investor will qualify as an Australian Government investor if the investor is:

- either the Australian Government; or
- an entity or a branch located in Australia that is 25% or more owned or controlled by the Australian Government; and
- is not a foreign Government investor or 25% or more owned or controlled by a foreign Government investor.

What does "substantive business operations" mean?

"Substantive business operations" is not defined in the 2013 regulations or the Act. However, the Overseas Investment Office considers that in order to carry on "sub-

stantive business operations" in Australia, the investor must be carrying on real and substantial business operations in Australia. The mere incorporation of a company in Australia, the establishment of a representative office, or the engagement in activities that do not amount to carrying on a business in Australia (such as undertaking promotional activities) will not amount to "substantive business operations".

Applying the exemption – investor examples

The "substantive business operations" rule means that a subsidiary of a Japanese non Government company can take advantage of the exemption, provided that the subsidiary is located in Australia, carries on substantive business operations in Australia, and all other conditions of the exemption are met. However, if the Australian subsidiary of the Japanese company makes the investment through a New Zealand incorporated subsidiary, the exemption will not apply.

Associate rules

In general terms, investors do not qualify for the exemption if, as a result of the transaction, an associate of the Australian investor that is not itself an Australian investor will acquire a 25% or more ownership or control interest. Under section 8 of the Act, if a person (A) is controlled by B or is subject to B's direction, A will be an associate of B (and vice versa). This is an anti-avoidance provision designed to ensure that it is not possible for a non-Australian investor to take advantage of the exemption by appointing an Australian investor as its agent or trustee to acquire the assets.

Under the associate rules in the Act, overseas parent companies and their subsidiary companies will be associates of each other and therefore the parent company triggers the consent provisions of the Act. However, under the 2013 regulations an overseas non-Government parent does not automatically disqualify an Australian investor from the benefit of the 2013 regulations. For example, as discussed above, an Australian subsidiary of a Japanese company undertaking substantive business operations in Australia may still be able to take advantage of the exemption. TPL

ANNELIES MCCLURE

Annelies has been the manager of the Overseas Investment Office since 2005. The Office has a range of statutory functions, including the provision of recommendations to Ministers about overseas investment applications. Prior to this, Annelies held roles as chief executive officer and secretary, and manager, within the Overseas Investment Commission, which was disestablished in 2005. Before joining the state sector, Annelies practised in the field of general commercial law at Chapman Tripp's Wellington office.

CATHERINE HEWITT

Catherine is a senior solicitor at the Overseas Investment Office. Her role involves assessing foreign investment applications, advising Ministers and undertaking enforcement responsibilities under the Overseas Investment Act 2005. Before joining the Overseas Investment Office in 2011, Catherine was a senior solicitor at Chapman Tripp specialising in resource management and environmental law.

State of overseas investment not what you might think

TUREI MACKEY

Some myths are broken and our closeness with Australia is reconfirmed in a study released by KPMG in June titled *Foreign Direct Investment in New Zealand*.

The study reviewed Overseas Investment Office (OIO) approvals over the period July 2010 to December 2012 and conjured up some interesting statistics and interesting investors, when it comes to investment and land acquisition through the Overseas Investment Office.

During this period approximately $18 billion was invested through the OIO into New Zealand, with Australia still the dominant player at 46 per cent of the overall foreign capital. Australia, North America and Europe made up 70 per cent of source of all foreign investment in New Zealand.

Preston Russell Law partner Russell Mawhinney says the Trans-Tasman benefits will always make the Australians a prime investor in New Zealand.

"There are some obvious attractions for Aussie investors apart from the ease of getting here. These include no stamp duty in New Zealand, no capital gains tax although there can still be income tax implications if they buy for the intention of resale, and our streamlined conveyancing, banking and title registration systems in New Zealand."

Corporate finance KPMG partner Justin Ensor, who authored the report, says the dispelling of the Chinese myth, following the purchase of Crafar Farms by a Shanghai based company in 2012, has been the biggest talking point from the review along with the overall lack of investment from Asian trading partners.

The Asian region only made up 16 per cent of the total overseas investment applications approved by the OIO. Among the Asian nations, Japan was the largest source of overseas investment in New Zealand with 53 per cent, while China was second on 33 per cent. "While there has certainly been a lot of interest in terms of investment from Asia the statistics shows that perhaps hasn't happened just yet," he says. "That is on the basis when you look at where our investment comes from it is historically with whoever has been our traditional trading partners. So it is logical to assume as a nation like China becomes that traditional trading partner we will see the increase."

South Korea does not feature in the statistics but Mr Ensor says it could be partly due