THE BIG PICTURE: OVERSEAS INVESTMENT

New wave of reforms set the tone for the next decade

January 2020

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Introduction

A second wave of reform to New Zealand's overseas investment rules is set to usher in a new age for overseas investment, rounding out the most significant overhaul of the Overseas Investment Act in 15 years. While the government signalled this further reform in late 2018, a Cabinet paper released in the closing weeks of last year set out in detail what investors can expect from the regime over the next decade.

Key proposed changes include the implementation of a national interest test that will bring the Act into line with jurisdictions overseas and the simplification of the entire assessment process, including removing low risk transactions from the regime for which screening is unnecessary.

The Phase II reform does not revisit substantive issues addressed in Phase I. Instead, its aim is to strike a better balance between attracting productive overseas investment while also managing the risks associated with overseas investment. The Phase I reform of October 2018 implemented restrictions on overseas persons buying residential land and streamlined the consent pathways for forestry acquisitions.

On the whole, the changes will be welcomed by the overseas investor community. They address some of the most long-standing and fundamental concerns about the current regime, which have made it a global outlier in terms of complexity and consent timeframes. In particular, simplification of the screening regime, introduction of statutory timeframes for review and eliminating many low risk transactions should vastly improve the 'user experience' for overseas investors. Equally, removal of many fundamentally 'New Zealand' entities from the regime is a long overdue step.

On the other hand, application of a new national interest test and call in power will introduce substantial ministerial discretion to affected transactions. While this test will apply only to a confined set of transactions, it has the potential to reduce investor certainty in those transactions, at least until such time as the new regime is bedded in.

Our comments on the proposed reforms are highlighted in blue boxes throughout the report.

The key areas of reform are:

Bolstering the Act: enhancing the government's ability to manage investment in infrastructure and other important assets with a national interest test, enhanced enforcement tools and legislated farm land thresholds.

Cutting Red Tape: simplifying the application process and removing transactions from the regime that should not require screening.

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KEY REFORM 1: Bolstering the regime

Strengthening the government's ability to manage risks to security and other national interests.

Aims for this area of reform:

To create a **national interest test**, like that in the Australian regime, enabling the OIO to decline investments that are not in New Zealand's national interest (including security interests), complemented by a **call in power** enabling the OIO to do the same for strategically important investments that would not otherwise require consent.

To provide the OIO with sufficient **Enforcement Tools** to deter non-compliance with the regime

To set the bar for **Farm land** investments by enshrining the 2017 rural land directive into law and strengthening farm land advertising requirements

Creating more certainty around the requirement to offer **Special Land** to the Crown

National interest test

Under the proposed test, any investment ordinarily screened under the Act and found contrary to New Zealand's national interest (which incorporates consideration of our economic, security and other interests) could be declined. This is similar to the national interest test that underpins Australia's foreign investment screening regime. This test would automatically apply to investments that always warrant greater scrutiny.

The test would automatically apply to investments that constantly warrant greater scrutiny:

- **Investments where a foreign government or its associates would hold a 10% or greater interest**
- **Investments that present national security risks**
- **Investments in strategically important industries and high risk Critical National Infrastructure**

CRITICAL NATIONAL INFRASTRUCTURE

Categories to be specified in regulations:

- Significant **Ports and airports**
- **Electricity generation distribution** businesses
- Systemically-important **financial institutions and market infrastructure** (for example, payments systems).
- **Water infrastructure**
- **Media entities** that have an impact on New Zealand's media plurality
- Critical direct **suppliers** to the **New Zealand Defence Force, Government Communications Security Bureau** and the **New Zealand Security Intelligence Service**
- Entities with access to, or control over **dual use military technology**
- **Telecommunications infrastructure**

The suggested categories do not come as a surprise and are consistent with similar overseas rules. However, overseas experience suggests that calling out government investors, particularly with a low 10% threshold, can capture a large number of seemingly benign investments where pension funds, frequently established by government entities, are involved in a passive investment capacity.

Call in power

The national interest test would apply only to assets already screened under the Act. It would not enable the government to manage risks posed by investments in strategically important assets that are not screened by the Act (for example, assets worth less than NZ$100 million that do not include sensitive land).

The government proposes to introduce the Call in power to manage risks that may be posed by such transactions. It would allow the relevant minister to call in certain transactions for review, and place conditions on, block or unwind transactions that present significant risks of harm to New Zealand's national security or public order. It would apply to the same categories of strategically important assets as those automatically subject to the national interest test (excluding irrigation schemes), but with the addition of entities with access to or control of **sensitive data**.

When is notification required?

For transactions involving certain categories of high-risk assets (such as military technology), it would be compulsory to notify the regulator of the transaction. For other transactions covered by the call in power, such as those in certain critical national infrastructure, notification would be voluntary.

If voluntarily notified, the government will conduct a review. If no problems are found, the government forgoes the right to take action in respect of that transaction in the future. If an investor does not notify, and problems are later found, the government can require disposal of the asset.

ADMINISTRATION OF NATIONAL INTEREST TEST AND CALL IN POWER

The national interest test and call in power are intended to be reserve powers, exercised rarely and only when necessary to mitigate material risks that cannot be managed through other mechanisms. **The government must be able to demonstrate that the transaction is not in the national interest**.

A designated senior minister, who does not ordinarily make decisions on transactions covered by the Act, will be responsible for exercising both powers. There will also be a range of transparency and review mechanisms in place to provide investors with confidence that the powers will not be used often or to manage less than significant risks to New Zealand's national interests.

The call in power is consistent with similar regimes overseas and we would expect that it would be used sparingly. It will be important that detailed guidance is provided on the extent of the "high risk" categories so that investors can make an informed decision as to whether to voluntarily notify a transaction.

SENSITIVE DATA

- Valuable personal information, including
  - Genetic data
  - Biometric data
  - Data concerning health or a natural person's sex life and / or sexual orientation
  - Data about the financial position of a natural person or entity / juridical person
- Official information of the New Zealand Government that is particularly relevant to the maintenance of public order or national security

OVERVIEW OF PROPOSED NATIONAL SECURITY AND PUBLIC ORDER CALL IN POWER

Assets or entities within scope	Military and dual use technology	Critical direct suppliers to defence and security services	Sensitive data	Media	Critical national infrastructure
Notification mechanism	Compulsory	Compulsory	Voluntary	Voluntary	Voluntary
Trigger level (excluding the acquisition of listed equity securities that do not grant a disproportionate level of access or control)	Any interest	Any interest	Any interest	25% interest	Any interest
Trigger level for the acquisition of listed equity securities	10% interest	10% interest	10% interest	25% interest	10% interest

Enforcement tools

HEFTY PENALTIES AND STRONGER ENFORCEMENT POWERS

The government has proposed stronger enforcement powers to deter and better sanction serious breaches of the Act. These changes would put breaches of the Act on par with those of other regulatory regimes, such as New Zealand's competition law.

Over the past few years the OIO has massively increased its enforcement focus and capabilities. This includes a dedicated and well-resourced compliance team. This has sharpened investors' focus on compliance even without the new penalty regime, although there is logic in aligning this with other New Zealand regulatory regimes.

THE TOOLBOX:

ENFORCEABLE UNDERTAKINGS

Undertakings set by the OIO will be directly enforceable in court.

Breach of an undertaking will result in pecuniary penalties of up to NZ$300,000 for a corporate investor and NZ$50,000 for an individual (lower than the proposed maximum penalties for general breaches of the Act).

PECUNIARY PENALTIES

Pecuniary penalties for breaches will differ for individuals and corporate investors, and be raised from the current NZ$300,000 maximum to:

- NZ$500,000 for individuals; and
- NZ$10 million for corporate investors

INJUNCTIVE RELIEF

The OIO will be given an explicit power to seek injunctive relief. For example the ability to seek urgent orders from the High Court requiring an investor to take, or not take, certain steps.

These powers will align with those available to other regulators, such as the Commerce Commission.

In the context of a risk to national security or public order, ministers will also be able to seek an Order in Council for managed disposal of the investment at issue.

The Act will retain criminal sanctions punishable by up to 12 months imprisonment for breaches of the Act.

Farm land thresholds

MAINTAINING THE THRESHOLD FOR INVESTMENT IN RURAL LAND

In 2017, the Minister of Finance issued a rural land directive to the OIO that substantially raised the bar for overseas investments in rural land (all non-urban land over five hectares, excluding forestry land). The government now proposes to enshrine this in legislation to ensure that future governments are accountable to Parliament for any changes to this policy. Overseas persons seeking to invest in farm land will have to continue to deliver benefits with a substantial point of difference—such as new technology or partial New Zealand ownership.

STRICT ADVERTISING REQUIREMENTS

The Act currently requires that farm land be advertised for sale on the open market before consent can be given to an overseas person to acquire it. The government proposes to enhance these requirements.

VENDORS

- Updating the prescribed forms of advertising.
- Increasing the minimum advertising period.
- Specifying that the advertising **must occur before any agreement is entered into**.
- Requiring that the type of interest in the land offered to the overseas person is the same as that advertised on the open market.

THE OIO

Allowing the OIO to approve alternate forms of advertising that is appropriate for the type of asset being sold. For example traditional forms of advertising may not be appropriate for a sale of shares in a large company that holds some farm land.

PROSPECTIVE INVESTORS

Improving the process for exemptions from the advertising requirement, by clarifying that:

- the minister may impose conditions on exemptions to ensure they are not used to circumvent advertising requirements; and
- an exemption application may be submitted and decided before an overseas investor application for consent is lodged (and this will incur a fee).

The requirement to advertise land before an agreement is entered into could create substantial difficulties for corporate transactions that involve farm land. We will advocate for a robust exemption regime and clear guidance in order to avoid unintended consequences.

Special land

Due to the special nature of New Zealand waterways, the Act currently recognises the offer of foreshore, seabed, riverbed and lakebed (special land) to the Crown before being sold to an overseas buyer as a benefit that can be taken into account when granting consent. This is often a mere formality that can cause significant commercial delay.

The government proposes to remove ambiguity from this process by (for example) requiring the Crown to decide within a specified timeframe whether it waives the right to acquire special land, and placing a duty on the Crown to take ownership of any desired special land within 10 years.

The special land regime currently does not apply to the acquisition of securities (as opposed to direct interests in land). This makes the regime workable in corporate transactions and this exception should be retained.

KEY REFORM 2: Cutting red tape

Streamlining and simplifying the Act to ensure level of screening is proportionate to actual risk.

Aims for this area of reform:

Simplify the regime by:

- Ensuring the investor test focuses on material risks
- Simplifying the benefits test
- Imposing timeframes on decision making

Exclude less-sensitive transactions from the regime, including those which relate to:

- Short-to-medium term leases
- Low-risk sensitive adjoining land
- Fundamentally New Zealand entities (that are currently defined as overseas persons)
- Other low risk transactions

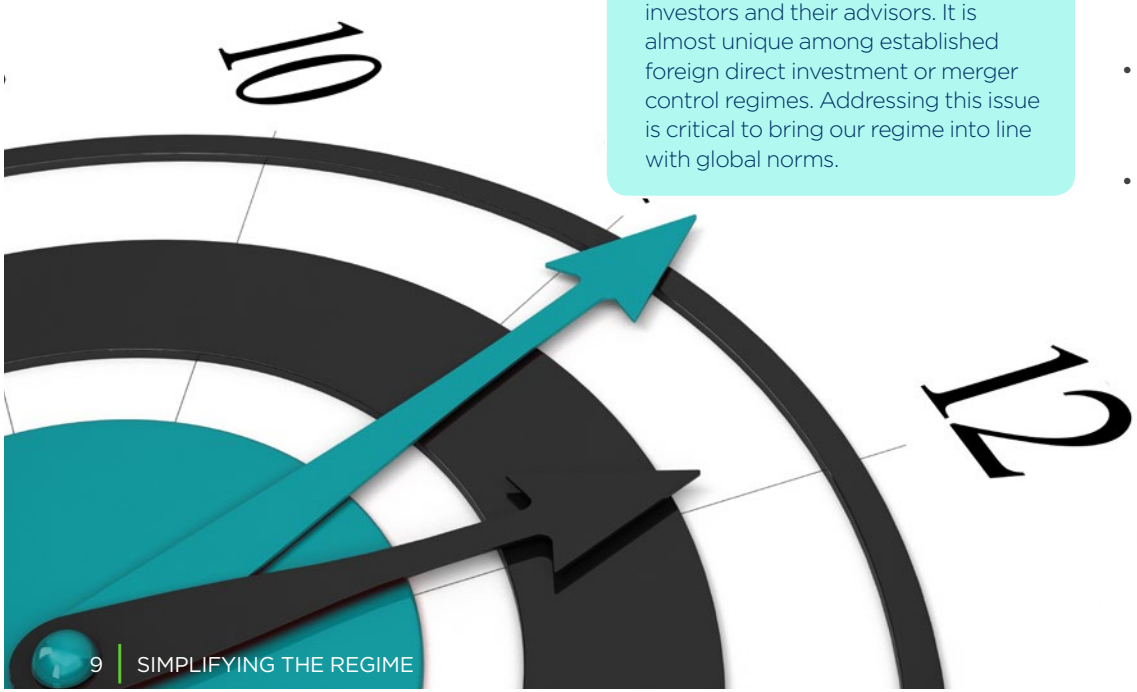
Simplifying the regime

IMPOSE TIMEFRAMES ON DECISION MAKING

The reforms will introduce tailored timeframes for decision making. Under the reforms the OIO and ministers will be required to arrive at decisions with more pace and publicly report on their compliance. However, decisions will not be void if timeframes are not met, and the Crown will not be liable for any loss suffered by applicants as a result of breaching a timeframe.

Statutory timeframes should shorten the time required to obtain OIO consent—one of the biggest obstacles to overseas investment in New Zealand. The OIO will still have a pre-acceptance period to review transactions before the timeframe commences and will be able to reject applications that do not provide adequate information. In addition, the OIO will be able in certain circumstances (for example, complex investments), to extend timeframes (under the Act or by agreement).

Lack of formal review timeframes in the OIO process is the subject of substantial criticism by overseas investors and their advisors. It is almost unique among established foreign direct investment or merger control regimes. Addressing this issue is critical to bring our regime into line with global norms.



SIMPLIFYING THE BENEFITS TEST

The benefits test will be amended to:

- Simplify the counterfactual so that benefits are assessed on a 'before and after' basis, removing the costly, time consuming process of assessing benefits against a hypothetical counterfactual.
- Require an investment's benefits to be proportionate to the sensitivity of the land and the interest being acquired (for example, the acquisition of an interest in a lease requiring less substantial benefits than of a freehold interest in sensitive land).
- Replace the 'substantial and identifiable' benefit threshold for non-urban land greater than five hectares.
- Replace the list of 21 specific benefit factors with a broadly defined economic factor, environmental factor and general public access factor (while maintaining the current historic heritage, advancement of significant government policies, New Zealanders' involvement, and other consequential benefits factors).
- Remove the ability to add factors to the benefits test by regulation.
- Clarify that the test is only to consider benefits and not detriments.
- Better provide for Māori cultural values by recognising the potential investment benefits of protecting or enhancing wāhi tūpuna, wāhi tapu areas and Māori reservations and providing, protecting or enhancing access across land for the purposes of stewardship of historic heritage or a natural resource.

The Cabinet paper also sets out an alternative approach that would allow ministers to consider likely or actual environmental harms when considering whether to grant consent to applications to acquire non-urban land greater than five hectares.

This is a long overdue reform to the current process, which is unwieldy and unnecessary.

Simplifying the regime

ENSURING THE INVESTOR TEST FOCUSES ON MATERIAL RISKS

The investor test currently applies to all individuals with control of the 'relevant overseas persons', regardless of their involvement with the transaction, whether they are New Zealand persons, or whether they have been previously examined under the regime. Together with offences and contraventions of the law, it also requires investors to disclose, and the OIO to consider, "any other matter that reflects adversely" on that investor. Accordingly, investors and the OIO spend a significant amount of time identifying and considering irrelevant matters and unsubstantiated allegations.

To address this, the Investor test will be simplified to focus only on material risks.

- It will no longer apply to New Zealanders.
- It will no longer apply to investors that have previously met the requirements of the test (provided their character has not changed).
- The open ended regime, which requires investors to address even spurious law suits or allegations disclosed through internet searches, will be abolished. Instead, character will be judged by reference to:
  - convicted offences limited to the last 10 years, unless the offence was punished by a five year or greater term of imprisonment,
  - civil contraventions punished by pecuniary penalties, or enforceable undertakings entered into, within the last 10 years, and
  - allegations (of the same level of offending or contravention) where formal proceedings have commenced.
- The 'business experience and acumen' and the financial commitment criterion will be abolished.

The investor test, not currently applied to corporate entities, will be expanded to consider offences and contraventions by corporate entities with substantive control over the investment, for example, a parent company of the investing company.

The current Investor test imposes compliance costs that are disproportionate to the risks that most investors pose, particularly in large, corporate transactions. These are welcome reforms to this process and we expect they will significantly reduce the timeframe and complexity for the OIO's consideration of applications. It will also allow investors to become 'pre-verified' which could be advantageous in a competitive bid scenario.

Removing screening requirements for less-sensitive transactions

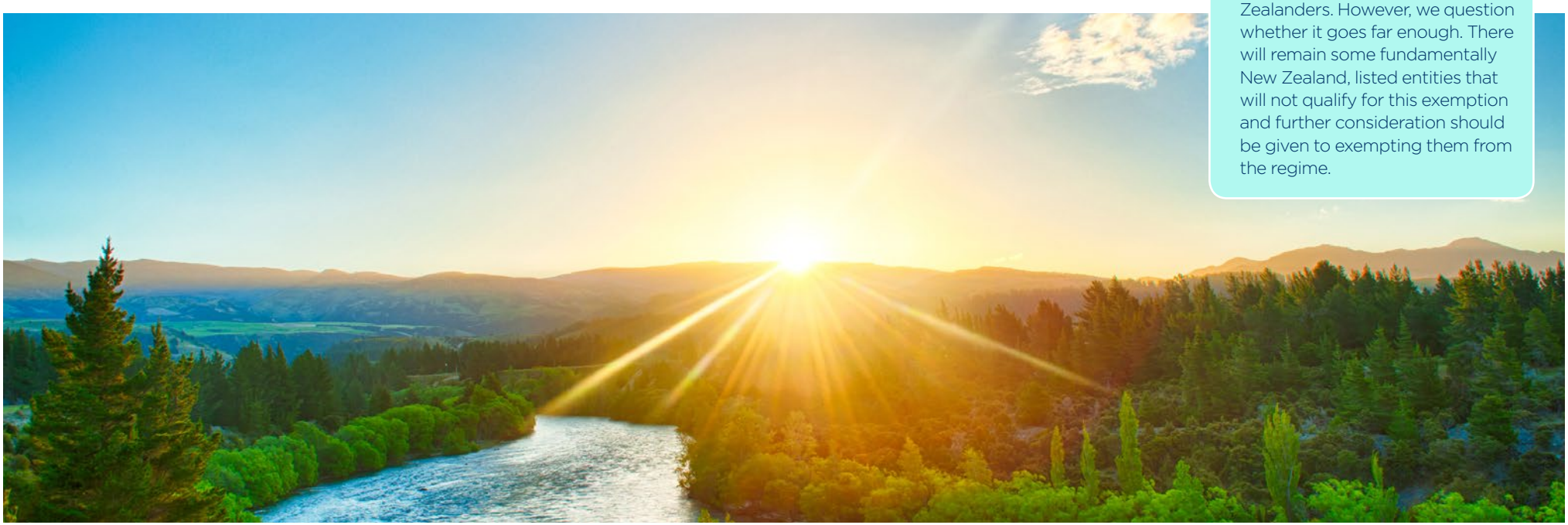
ENSURING SOME FUNDAMENTALLY NEW ZEALAND ENTITIES ARE NOT OVERSEAS PERSONS

In general, under the current regime, entities that are 25% or more owned or controlled by one or more overseas persons are considered overseas persons. This definition of overseas person will be amended so that:

- NZX listed companies will only be considered overseas persons if they are 50% or more owned by overseas persons, or the overseas persons holding 10% or more of the listed entities' shares cumulatively control more than 25%, and
- retirement schemes including KiwiSaver, in which New Zealanders own 75% or more, will no longer be considered overseas persons.

Bodies corporate not listed on the NZX and managed investment schemes will also be able to apply for an exemption if they do not meet the above bodies corporate ownership or control test for listed bodies corporate and no foreign government (together with their associates) holds 10% or more of the entity's securities. In granting these exemptions, ministers will consider the entities' record of compliance with foreign and New Zealand law and the degree of control or access that a foreign government may have.

We strongly support these changes as we see all too frequently, what are fundamentally New Zealand entities being dragged through time-consuming and expensive OIO consent processes unnecessarily. In the last year alone, we have been involved in multiple OIO consent processes for investments undertaken by entities that are majority beneficially owned by New Zealanders. However, we question whether it goes far enough. There will remain some fundamentally New Zealand, listed entities that will not qualify for this exemption and further consideration should be given to exempting them from the regime.



Removing screening requirements for less-sensitive transactions

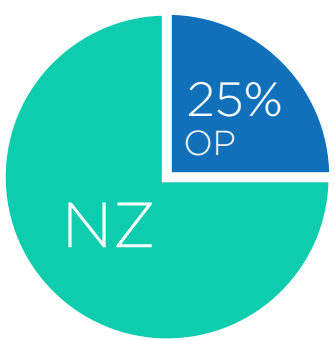
Proposed changes to the definition of overseas person for bodies corporate and managed investment schemes:

KEY

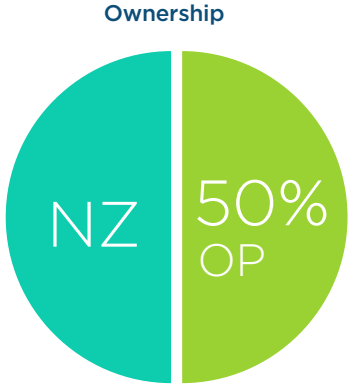
- NZ ownership
- Overseas persons (OP)
- Overseas persons with 10% or greater ownership/ funding (as relevant)
- Foreign government

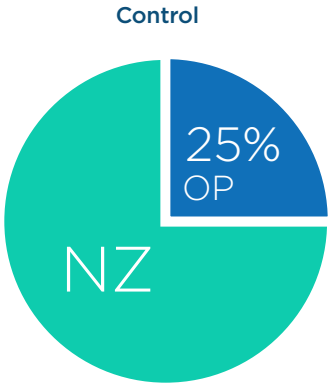
Status quo: All domestically incorporated bodies corporate and managed investment schemes

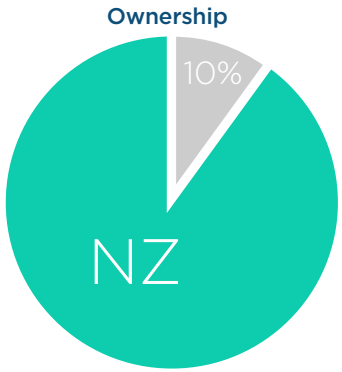
Proposed thresholds for domestically incorporated and **listed** bodies corporate being defined as an overseas person



Proposed thresholds for domestically incorporated **unlisted** bodies corporate and **managed investment schemes** applying for an exemption from the definition of overseas person*







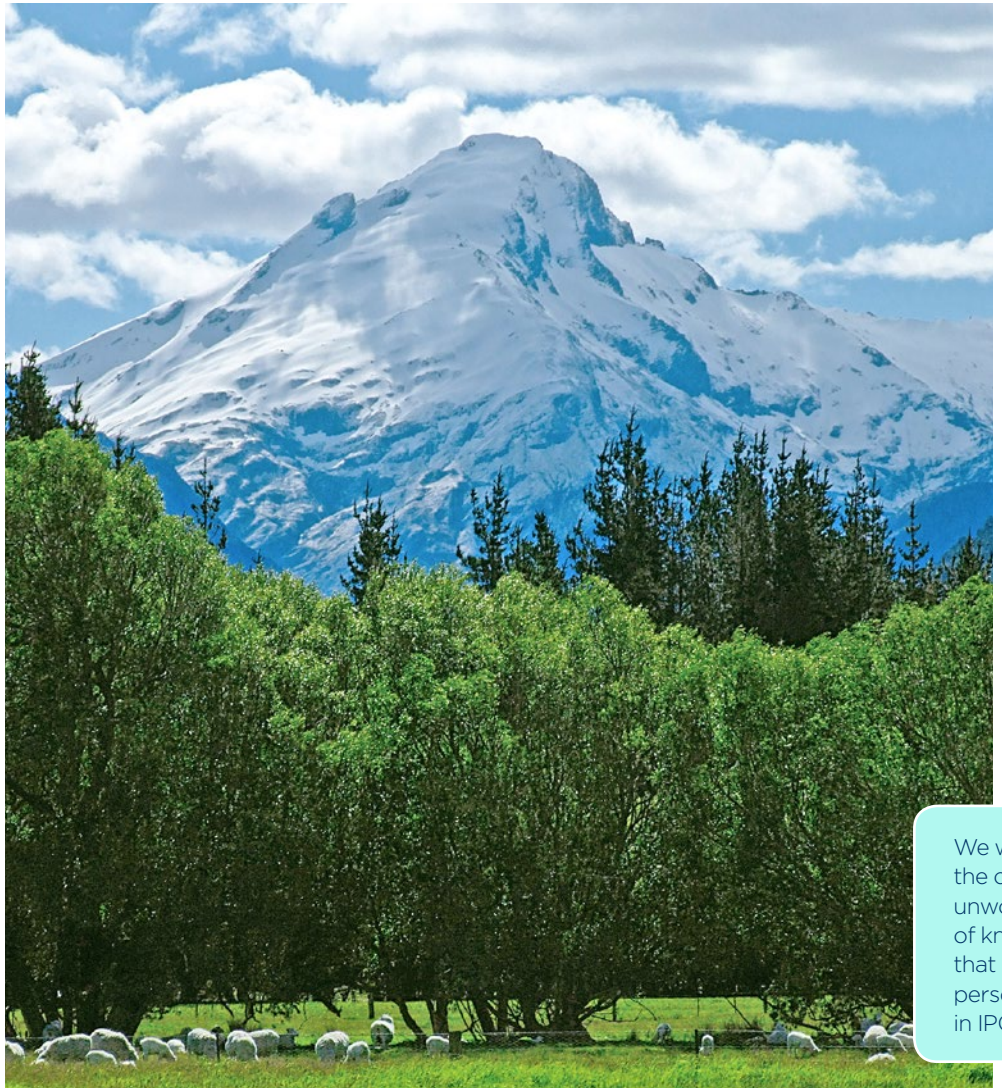
*With consideration given to conduct and degree of foreign government ownership (for example, whether a foreign government owner has disproportionately large access or control rights).

Removing screening requirements for less-sensitive transactions

REMOVING SMALLER TRANSACTIONS, WHERE CONTROL DOES NOT MATERIALLY CHANGE

The Act currently requires overseas persons with an interest of more than 25% in a New Zealand entity to obtain OIO consent whenever they increase that interest. There is an exemption from the requirement to get consent for increases of up to 5%, and increases of up to 10% provided that increase does not exceed certain 'control limits'. This exemption is unnecessarily and impractically restricted in that it only applies to the entity that holds the consent, only covers transactions for five years, and applies to investors increasing an existing 90% ownership interest despite no material change in control. The amendments will abolish these restrictions, so that investments resulting in small increases in ownership will not require consent.

This is a welcome amendment. We have been involved in numerous consent or exemption processes in recent years which have been required for minor changes in shareholding that do not fundamentally affect ownership or control.



ENSURING LOW RISK TRANSACTIONS ARE NOT SUBJECT TO SCREENING

Under the current regime, an investor who acquires securities that tip a New Zealand person into overseas ownership must obtain consent.

The amendments will create a consent trigger where, as a result of their investment, overseas persons holding 10% or more across all share classes cumulatively hold more than 25%. This will improve investors' ability to determine when consent is actually required (because there are existing reporting obligations where shareholders hold 5% or more of a class of shares in listed companies) without reducing the government's ability to manage overseas investment.

Additionally, the reforms will remove transactions involving interests that do not grant any control over the sensitive asset, such as transactions that support the issuance of financial products that support New Zealand's financial stability, from the scope of the Act.

We welcome these changes. In our experience, the current regime has been impractical and unworkable—investors often have no practical way of knowing if they are the 'tipping shareholder' that causes a company to become an overseas person. This can also cause substantial difficulties in IPOs of New Zealand entities.

Removing screening requirements for less-sensitive transactions

REMOVING SHORT-TO-MEDIUM TERM LEASES

The threshold for when leases (including rights of renewal) and other 'less-than-freehold' interests in sensitive land (other than residential land) will be changed from three years to 10 years or more. The reforms will also clarify that periodic leases are not captured by the Act.

This is a sensible change that we expect to significantly reduce the number of overseas investments requiring consent.

REMOVING LOW-RISK SENSITIVE ADJOINING LAND FROM THE REGIME

The current requirement that consent be obtained for acquisitions of land that adjoins sensitive land (but is not otherwise sensitive) will be amended so that consent is only required to obtain land that adjoins the foreshore, a lakebed, conservation land and regional parks, and some land significant to Māori.

This will remove the need for consent for land that is currently captured by the Act, but has no obvious sensitives and where there is no material risk to New Zealand's sensitive assets.

We have seen numerous transactions, which presented no material risks to New Zealand assets, being bogged down in lengthy and expensive OIO processes due to sensitive adjoining land. We expect these amendments will significantly reduce the number of unnecessary OIO applications required in New Zealand.

Bell Gully's overseas investment team

Bell Gully's overseas investment team has expertise across a broad range of sectors, including agriculture, commercial property, energy, forestry, retail, tourism and the wine industry.

Our experts provide a fully integrated service for international investors in New Zealand, and can advise at every stage of a proposed investment.

We act for a wide range of international clients seeking to invest in, or expand, their presence in New Zealand. We also regularly advise private clients, who wish to acquire real estate in New Zealand, on applications for New Zealand permanent residency.

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Acknowlegements

Our thanks to Bell Gully lawyers Gabrielle Carter and Charles Partridge for their assistance in preparing this report.

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