

Treasury Report: Overseas investment review: progress update

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| Date: | 27 August 2009 | Report No: | T2009/2012 |
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Action Sought

| | Action Sought | Deadline |
|--|--|-------------------|
| Minister of Finance (Hon Bill English) | Indicate any preferences you have on the design of the sensitive land hurdle, the business screening threshold, exemptions and the national interest reserve power. | 7 September 2009. |
| Associate Minister of Finance (Hon Simon Power) | Note the contents of this report. | None. |

Contact for Telephone Discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|----------------------|-------------------------------|----------------------|----------------------|--------------------|
| [withheld – privacy] | Analyst, International | [withheld – privacy] | [withheld – privacy] | ✓ |
| Nic Blakeley | Acting Manager, International | [withheld – privacy] | [withheld – privacy] | |

Minister of Finance's Office Actions (if required)

Forward a copy of this report to the Minister for Land Information.

Enclosure: No

Treasury Report: Overseas investment review: progress update

Purpose of Report

1. This report outlines details of the national interest reserve power and updates you on progress on three areas of work on the overseas investment review, prior to your discussions with colleagues about the review.

Analysis

National interest reserve power

2. You have asked for a summary of how we see the national interest test working. This is outlined in Annex 1. You have some policy choices about the scope of this reserve power, in particular whether it would be a national interest or national security based test. We would recommend that the test focuses on national security because:
 - it represents a higher hurdle for the use of the reserve power but would still allow economic interests to be considered, in so far as they threaten national security; and
 - it would be more in line with approaches in other jurisdictions and OECD guidance.
3. We consider that this reserve power would be an improvement on the current strategic assets test. The reserve power would only be used in rare circumstances, whereas the strategic assets test is a factor for consideration in every sensitive land investment. The requirement to show credible evidence and that the concerns about the investment cannot be addressed under other legislation would also help avoid creating uncertainty over when and how it will be used.

Other work areas

4. At our last meeting with you we undertook to do some additional work in three areas – the sensitive land hurdle, the business screening threshold, and providing exemptions for certain investors. We thought it would be useful to provide you with our preliminary conclusions in these areas before you meet with your colleagues.

Sensitive land hurdle

Preliminary conclusion: Either a simplified benefit test or a targeted benefit test would be workable and would still be an improvement on the current test. We would recommend the targeted benefit test.

5. The review originally recommended removing almost all Ministerial discretion that could be used to require investors to provide additional benefits in a number of areas, apart from walking access. In our last meeting with you we noted that more discretion could be added by either simplifying the existing benefit test or by providing discretion over a wider number of environmental/social areas.
 - **A simplified benefit test** would require Ministers to judge whether the investment would provide benefit against 16 economic, social, and environmental criteria. An assessment of overall benefit would still be made, but the requirement to show 'substantial and identifiable' benefits in the case of non-urban land would be removed.

- **A targeted benefit test** with 11 criteria would not consider economic factors, but would allow Ministers to assess whether there would be adequate provision for walking access, wildlife protection, heritage protection and indigenous vegetation.
6. Both tests would also require: the investor to meet the investor test (good character, business acumen and financial commitment); the offer special land to the Crown; and farmland to be advertised on the open market. More details on the proposed tests are outlined in Annex 2. We would recommend the targeted benefit test on the grounds that:
- it would more significantly reduce the amount of work required to prepare and assess applications as fewer factors are considered; and
 - it would provide more certainty for investors as Ministers no longer assess benefit by deciding the relative importance and relevance of each factor, but instead assess each factor independently to determine if they have been adequately addressed.

Business asset screening threshold

Preliminary conclusion: Screening only where the investment is worth more than \$100 million (by removing reference to the value of the assets of the company) is likely to create avoidance risks. We would therefore recommend increasing the threshold (to say \$150 million) or doing nothing.

7. We are investigating whether screening could be removed for firms with assets greater than \$100 million. The result of this change would be to only screen investments where the consideration paid is greater than \$100 million. The Overseas Investment Office advises that removing screening based on the assets of the company could create avoidance opportunities for investors who could structure their transactions to avoid actually paying \$100 million. At this stage we would not recommend a change to screening based on total assets for the following reasons:
- The total assets clause is useful for global transactions where the consideration paid for the New Zealand assets is often unknown.
 - Both Australia and Canada screen based on asset value.
 - This change would be locked-in for our FTA partners and could not be reversed in future, making it difficult to address any unforeseen evasion issues.
8. Increasing the screening threshold to \$150 million would have a positive signalling effect to overseas investors, particularly in light of Australia's recent unilateral increase. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements].* An increase of this size would reduce business applications by around 10% based on historical data.
9. *[Withheld - disclose prematurely decisions to change or continue policies relating to the entering into of overseas trade agreements.]*

Increased use of exemptions

Preliminary conclusion: Introduce exemptions for companies which have a long history of operating and investing in New Zealand.

10. We are considering whether exemptions could be created for firms that have had a long history of operating and investing in New Zealand (for example Contact Energy, Fletcher Building, Nobile Wines and Holcim). An exemption for such firms could be

justified on the grounds that their longstanding links with New Zealand and numerous investment approvals means that they are aware of New Zealanders' values and that their future investments are likely to benefit New Zealand.

11. Such an exemption would only remove a handful of firms from screening, but it would be of value as those firms have had to make a number of applications for consent under the Act.

Recommended Action

We recommend that you:

- a **indicate** any preference you have between the simplified benefit test and the targeted benefit test for assessing investments in sensitive land:

simplified benefit test- OR - targeted benefit test

- b **indicate** whether you prefer either of the following options for the business screening threshold: (circle one)

- i) increasing the business threshold to \$150 million; *or*
- ii) retaining the current threshold; *or*
- iii) further investigation into removing screening based on total assets.

- c **indicate** whether you are prepared to consider providing exemptions from screening for firms that have had a long history of operating and investing in New Zealand; and

Yes/no.

- d **indicate** whether you are prepared to base the national interest reserve power on either: (circle one)

- i) threats to national security and public order; *or*
- ii) threats to national security and public order and vital economic interests.

Nic Blakeley
**Acting Manager - International
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

Annex 1: Details of the national interest reserve power

A description of the national interest reserve power is outlined below. The text in square brackets represents policy choices that could increase or decrease the scope of the reserve power:

The national interest reserve power will allow the Minister of Finance to decline an investment in significant business assets or sensitive land [greater than 100 hectares in size] where:

- the investment will harm the national interest by threatening national security, public order, [and vital economic interests];
- the Minister has credible evidence to show that the national interest is threatened;
- the concerns cannot be addressed through other legislation;

In addition:

- The burden of proof will lie with the Minister to show that the investment will not be in the national interest.
- The Minister must have regard to whether refusal of consent will lead to New Zealand breaching any of its international obligations [or damage New Zealand's international reputation].
- The Minister must follow due process, in accordance with parameters to be outlined in regulations.
- The Minister must table any decision made using this criterion, and the evidence used to make the decision, in Parliament, within one month of the decision.

The aim of the due process requirement is to provide investors with some certainty over how the process will be applied. We have identified two preliminary options as outlined below. Further work is required to identify the preferred option.

| Notification approach | Exceptions approach |
|--|---|
| The OIO notifies the Minister of all applications with a summary of the investor and the investment. | The OIO assumes business as usual, unless the Minister asks to review a specific application under the national interest reserve power. |
| The Minister has 5 working days to inform the Office that he wishes to consider an application using the national interest test. | The Minister receives advice from MFAT and Treasury and decides within 20 days whether to decline the application. |
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Other country approaches

A number of countries have some form of national security/national interest test which may be used to decline an investment. Some examples are outlined in the table below.

| International Approaches | |
|--------------------------|--|
| Australia | <ul style="list-style-type: none"> The Foreign Acquisitions and Takeovers Act (FATA) requires investors to seek consent to invest in certain sensitive sectors including media, telecoms, transport (rail, airports, ports etc), and defence. The FATA also gives the Treasurer the ability to decline investments if they are not in the national interest across a number of areas, including acquisition of shares, urban land, and control of Australian businesses. |
| United States | <ul style="list-style-type: none"> President can suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. company that he determines threatens to impair the national security of the United States. All foreign investments that may affect national security can be screened and "credible evidence" is required to show that national security would be harmed by the investment. He must also consider that existing legislation does not provide adequate safeguards to protect national security. |
| United Kingdom | <ul style="list-style-type: none"> The UK does not prohibit any type of private sector investment. There are regulations on the use of business names and certain business sectors may require licences or authorisation (such as finance, defence and oil exploration). |
| Germany | <ul style="list-style-type: none"> Allows an investment to be prohibited if it constitutes a genuine and sufficiently serious threat to public order or security. This is defined as "a genuine and sufficiently serious threat to a fundamental interest of society". Acquisitions of 25 % or more of the voting shares of enterprises producing certain military goods, cryptographic equipment for intergovernmental communication, certain earth observation systems. Done by Ministry responsible for legislation initiating an enquiry into a specific investment (not screening all applications). Evidence supporting the decision must be provided to the investor, and decisions can be challenged in the courts. |
| Denmark | <ul style="list-style-type: none"> Denmark places particular safeguards around sensitive sectors including hydrocarbons, defence, aircraft and ships. The safeguards are contained in specific legislation, for example the law requiring the Minister of Justice to approve investments of 40% or more of the equity or 20% or more of the voting rights in a defence company doing business in Denmark. Approval will be granted unless there are foreign policy considerations or security issues weighing against approval. |
| Canada | <ul style="list-style-type: none"> Canada has recently introduced a national interest test that allows the relevant Minister to review an investment on national security grounds. |
| OECD | <ul style="list-style-type: none"> The OECD code of liberalisation of capital markets allows members to take steps to restrict investment for: <ul style="list-style-type: none"> i) the maintenance of public order or the protection of public health, morals and safety; ii) the protection of its essential security interests; and iii) the fulfilment of its obligations relating to international peace and security. |

Annex 2: Details of the proposed sensitive land tests

The following are two indicative options for a simplified overall benefit test and a targeted benefit test for sensitive land. In the first option Ministers need to be satisfied that, across all factors, the investment will be of benefit to New Zealand. In the second option Ministers must be satisfied that, where there are sensitive features on the land, the investor has provided an adequate level of protection for these features. These options are unlikely to significantly change the current hurdle for sensitive land applications; rather they are aimed at constructing a simpler test with fewer compliance costs for investors.

1. Simplified overall benefit test

The criteria for an overseas investment in sensitive land are all of the following:

[investor test]

That the investor –

1. has business experience and acumen relevant to the overseas investment
2. has financial commitment to the overseas investment
3. is of good character
4. is not an individual of the kind referred to in section 7(1) of the Immigration Act 1987

[farm land advertising]

If the relevant land is or includes farm land –

5. either that farm land or the securities to which the overseas investment relates have been offered for acquisition on the open market to persons who are not overseas persons in accordance with regulations

[special land offer back]

If the relevant land is or includes foreshore, seabed, or a bed of [a river]¹ or a lake –

6. that foreshore, seabed, [riverbed], or lakebed has been offered to the Crown in accordance with regulations

[benefit test]

7. that the overseas investment will, or is likely to, benefit New Zealand, as determined by Ministers after having regard to all of the following factors which are relevant –
 - i. whether the overseas investment will, or is likely to, result in economic benefits to New Zealand including but not limited to: the introduction of new technology or skills, and increasing efficiency or productivity ***[economic benefits]***
 - ii. whether there are or will be adequate mechanisms in place for maintaining or enhancing walking access ***[walking access]***
 - iii. whether there are or will be adequate mechanisms in place for protecting or enhancing historic heritage within the relevant land ***[historic heritage]***
 - iv. whether there are or will be adequate mechanisms in place for protecting or enhancing areas of significant indigenous vegetation ***[vegetation]***

¹ The special land process could be simplified by removing riverbeds from scope.

- v. whether there are or will be adequate mechanisms in place for protecting or enhancing significant habitats of indigenous fauna and significant habitats of trout, salmon, wildlife protected under section 3 of the Wildlife Act 1953, and game as defined in section 2(1) of that Act **[wildlife]**
- vi. whether refusing the application for consent will, or is likely to adversely affect New Zealand's image overseas as an investment destination or its trade or international relations **[New Zealand's reputation]**
- vii. whether the overseas investment will, or is likely to, result in further investment in New Zealand, will enhance the ongoing viability of other overseas investments in New Zealand, or is by an overseas investor who has previously undertaken investments of benefit to New Zealand **[enhanced investment]**
- viii. whether the overseas investment will, or is likely to, result in other consequential benefits to New Zealand **[other]**

In determining whether an overseas investment will, or is likely to, benefit New Zealand the Minister(s) may, in doing so –

- a) determine the relative importance to be given to each relevant factor
- b) consider that the maintenance of the status quo can contribute to benefit.

[reserve power]

8. unless the Minister of Finance declines consent where:

- i. the investment will harm the national interest by threatening national security, public order, [and vital economic interests];
- ii. the Minister has credible evidence to support the decision; and
- iii. the concerns cannot be addressed through other legislation.

2. Targeted benefit test

The criteria for an overseas investment in sensitive land are all of the following:

[investor test]

1. business experience and acumen relevant to the overseas investment
2. financial commitment to the overseas investment
3. that the investor is of good character
4. that the investor is not an individual of the kind referred to in section 7(1) of the Immigration Act 1987

[farm land advertising]

If the relevant land is or includes farm land –

5. either that farm land or the securities to which the overseas investment relates have been offered for acquisition on the open market to persons who are not overseas persons in accordance with regulations

[special land offer back]

If the relevant land is or includes foreshore, seabed, or a bed [or a river]² or a lake –

6. that foreshore, seabed, [riverbed], or lakebed has been offered to the Crown in accordance with regulations

[additional criteria]

That, where appropriate and practicable:

7. there are or will be adequate mechanisms in place for maintaining or enhancing walking access ***[walking access]***
8. there are or will be adequate mechanisms in place for protecting or enhancing historic heritage within the relevant land ***[historic heritage]***
9. there are or will be adequate mechanisms in place for protecting or enhancing areas of significant indigenous vegetation ***[vegetation]***
10. there are or will be adequate mechanisms in place for protecting or enhancing significant habitats of indigenous fauna and significant habitats of trout, salmon, wildlife protected under section 3 of the Wildlife Act 1953, and game as defined in section 2(1) of that Act ***[wildlife]***

[reserve power]

9. unless the Minister of Finance declines consent where:
 - iv. the investment will harm the national interest by threatening national security, public order, [and vital economic interests];
 - v. the Minister has credible evidence to support the decision; and
 - vi. the concerns cannot be addressed through other legislation.

² The special land process could be simplified by removing riverbeds from scope.