THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Supplementary Overseas Investment Act Issues

Date:	30 July 2004	**Treasury Priority:**	Medium
Security Level:	RESTRICTED	**Report No:**	T2004/1376

Action Sought

	Action Sought	**Deadline**
Minister of Finance	**Agree** to recommendations, and advise any changes required to the attached draft paper for POL	Tuesday 3 August
Minister of Land Information	Note recommendations on transitional issues	None
Associate Minister of Finance (Hon Trevor Mallard)	None	None
Associate Minister of Finance (Hon David Cunliffe)	None	None

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Rosemary Cook	Principal Advisor	471 5942 (wk)		✓
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Enclosure: **Yes**

30 July 2004 IM-5-3-1

Treasury Report: Supplementary Overseas Investment Act Issues

Executive Summary

Right of first refusal over foreshore and seabed

The time periods within which the right of first refusal should be exercised should match those used by the Crown in the Ngai Tahu Settlements Claims Act. The Minister of Conservation, as Minister responsible for the Crown's ownership functions under the Foreshore and Seabed Bill, should be responsible for administering the right of first refusal.

Aquaculture

The mechanics of including aquaculture under the regime are relatively straightforward. However officials do not support its inclusion. Consent holders are expected to face significant limitations under the terms of their marine farming consent, and further benefit from imposing overseas investment requirements is likely to be limited. ***[Withheld under sections 6(a) and 9(2)(h) of the Official Information Act]***

Drafting issues raised by PCO

The main issue raised by PCO relates to the ability to change thresholds by regulation. The previous Cabinet paper suggested that coverage and criteria be contained in the Act, rather than in regulation, to increase the transparency of the regime. If you wish to retain flexibility around thresholds, the threshold amounts (land area and business asset values) could be retained in regulation.

The other issue raised by PCO relates to the coverage of leases under the Overseas Investment Act. Currently relatively short term leases can be subject to the Act. We recommend that the Act only apply to leases of sensitive land where the term (including rights of renewal) exceeds ten years. However, further work is needed on this issue before it is reported to POL however.

Transitional issues

LINZ has commenced developing an implementation plan for the transition of the functions and staff from the Reserve Bank to LINZ, which is expected to be available by the end of September. LINZ proposes to offer employment to all staff of the Overseas Investment Commission, and to keep the staff together in a dedicated unit reporting to the General Manager, Property Regulatory Group.

Parks and reserves

We have asked Local Government New Zealand to liaise with all councils, and ask for information about parks or reserves that are used for recreation purposes, and that are over 10 hectares in size. We have also asked for information about any such parks or reserves smaller than that which the relevant council considers to be particularly sensitive, and for information about what that sensitivity is. On the basis of that information, we will work with DOC and DIA to develop a list of relevant parks and reserves that should be screened for overseas investment. This is expected to be available in the first quarter of 2005.

Maori Land

Your paper to Cabinet on the review of the Overseas Investment Act described four options for addressing the application of the act to Maori land. Option 4 (bringing Maori land within the Overseas Investment Act and amending Te Ture Whenua Maori accordingly) is our preferred option. We have met with the Maori Land Court unit of the Ministry of Justice. Broadly, they have advised that they see no insurmountable difficulties in pursuing this option. However, we are unable to meet with the Chief Registrar of the Court until next week. We will advise further following that meeting.

Fishing quota issues

There are some technical issues arising from the drafting of the overseas investment provisions in the Fisheries Act and their inter-relationship with the Overseas Investment Act. These relate to clarifying who the appropriate applicant is, and the enforcement process. We are working through these issues with the Ministry of Fisheries and will report back on these in time for the next POL report in mid September.

Recommended Action

We **recommend** that you:

Right of first refusal over foreshore and seabed

a. **agree** that the right of first refusal be one of the criteria to be taken into account in assessing applications under the Overseas Investment Act;

   Agree/disagree

b. **agree** that the Minister of Conservation, as Minister responsible for the Crown's ownership functions under the Foreshore and Seabed Bill, be responsible for implementing the Crown's right of first refusal over foreshore and seabed land under the Overseas Investment Act;

   Agree/disagree

c. **agree** that the Crown be required to notify its intention to purchase any foreshore and seabed land within one month of an application to sell the land being lodged under the Overseas Investment Act;

   Agree/disagree

d. **agree** that the vendor have nine months from the expiry of the one month period referred to in recommendation (c) to sell the land on terms and conditions no more favourable than those offered to the Crown;

   Agree/disagree

e. **agree** that any sale within the nine month period referred to in recommendation (d) on terms and conditions more favourable than those offered to the Crown, and any sale after that nine month period, will require the land to be re-offered to the Crown;

   Agree/disagree

f. **agree** that where a foreshore strip is taken by the Crown as a condition of consent under the Overseas Investment Act, this shall not be treated as a subdivision for the purposes of the Resource Management Act or any district plan;

Agree/disagree

Aquaculture

g. **agree** that the overseas investment regime not be extended to include aquaculture based on our international treaty commitments;

Agree/disagree

h. **agree** that a possible process for the inclusion of aquaculture in the Overseas Investment Act be included in your paper to POL;

Agree/disagree

i. **agree** that, if Cabinet decides to include aquaculture, officials be directed to consult with the aquaculture industry on the proposals;

Agree/disagree

Drafting issues raised by PCO

j. **agree** that the Act only apply to leases of sensitive land where the term exceeds ten years (including rights of renewal);

Agree/disagree

k. **note** that your paper to Cabinet on the review suggested that coverage and criteria be contained in the Act, rather than in regulation, to increase the transparency of the regime;

l. **agree** that the thresholds for coverage be retained in regulation;

Agree/disagree

Transitional issues

m. **note** that LINZ staff have met with Reserve Bank staff and have commenced developing an implementation plan for the transition of the functions and staff from the Bank to LINZ;

n. **note** that LINZ propose to offer employment to all staff of the Overseas Investment Commission, and to keep the staff together in a dedicated unit reporting to the General Manager, Property Regulatory Group;

Parks and reserves

o. **note** that we have asked Local Government New Zealand to liaise with all councils to identify parks or reserves over 10 hectares, or of particular sensitivity, in order to develop a list of recreational parks or reserves in respect of which land adjoining should be screened;

Maori Land

p. **note** that informal enquiries suggest there have been very few, if any, applications to the Maori Land Court for consent to sell Maori land to an overseas person;

q. **note** that officials from Treasury and Te Puni Kokiri expect to meet with the Chief Registrar of the Maori Land Court over the next week and will report further following that meeting;

Fishing quota issues

r. **note** that Treasury and the Ministry of Fisheries are working on proposals to align the Overseas Investment Act and Fisheries Act, particularly with regard to determining who the applicant for consent should be, and enforcement issues.

Rosemary Cook
Principal Advisor
for Secretary of the Treasury

Hon Dr Michael Cullen
Minister of Finance

Treasury Report: **Supplementary OIC Review Issues**

Purpose of Report

1. On 28 June 2004 Cabinet agreed to certain reforms of the Overseas Investment Act (CAB Min (04) 22/6 refers). Several outstanding issues were identified. These include:

   - Right of first refusal for foreshore and seabed
   - Aquaculture
   - Transitional issues
   - Recreation parks and reserves
   - Maori land
   - Fishing quota
   - A cost recovery framework for the regulator
   - Drafting instructions.

2. This paper addresses six of these issues, as well as some drafting issues raised by Parliamentary Counsel (PCO). We will report back on the Maori Land Court options following discussions with the Chief Registrar of that Court. A cost recovery framework will be developed by the end of the year. We have already forwarded to your office and to PCO drafting instructions in relation to coverage and criteria of the regime. We expect drafting instructions on the remaining issues to be complete by the end of August.

Right of first refusal over foreshore and seabed

3. You discussed with Cabinet a process for the Crown's right of first refusal over foreshore and seabed that was based on the right granted to Te Runanga o Ngai Tahu by the Crown under the Ngai Tahu Claims Settlement Act 1998. Your paper noted that there are potentially two issues outstanding – the time limits within which offers must be made and agreements entered into, and whether an arbitration or mediation process is needed to deal with potential disagreements about whether land has been offered on more favourable terms and conditions.

   Time limits

4. We recommend that the time periods used in the Ngai Tahu legislation should be used as a precedent. Unless there are extenuating circumstances, the Crown should not take for itself a longer time period than it has agreed to give Ngai Tahu under their right of first refusal. In order to match those timelines, the Crown would have one month from being notified of a proposed sale to decide whether it wanted to acquire the land. The vendor would then have nine months following that one month period, during which it could sell on terms and conditions no less favourable to those offered to the Crown.

5. In some complex cases the regulator and/or Ministers could take many months to decide whether, and with what conditions, to approve a sale under the Overseas Investment Act. That being so, the nine month period may not be long enough for the vendor to complete negotiations or to find a new buyer. For this reason, the Crown should have the power to extend that nine month period.

Terms and conditions more favourable

6. If conditions placed on the sale by Ministers or the overseas investment regulator are considered to be onerous, the prospective purchaser may wish to negotiate a lower price than originally agreed. Where the price is reduced to reasonably account for conditions of consent, the land should not be treated as having been sold on more favourable terms. At this stage we do not recommend legislation to address this, but note that the regulator may wish to issue guidelines to overseas investors explaining that the cost of compliance with conditions of consent may be taken into account in determining whether land has been offered on more favourable terms and conditions.

Administration of the right of first refusal

7. Cabinet has agreed that the Overseas Investment Act be administered by Land Information New Zealand. Under the Foreshore and Seabed Bill the vesting of foreshore and seabed, and any compensation payable to local authorities under clause 19 of that Bill, is to be managed by the Minister of Conservation. Further, ownership functions under the Bill are to be undertaken by the Minister of Conservation. On balance, therefore, we recommend that the Minister of Conservation be responsible for administering that part of the Overseas Investment Act that relates to the Crown's right of first refusal over foreshore and seabed land.

8. The right of first refusal in favour of the Crown should be incorporated into the legislation as one of the criteria to be taken into account in assessing applications. ***[Withheld under sections 6(a) and 9(2)(h) of the Official Information Act]***

Aquaculture

9. In CAB Min (04) 22/6 Cabinet directed officials from Treasury, TPK and the Ministry of Fisheries to develop details of how aquaculture can be covered in the regime.

10. The Cabinet paper proposed that aquaculture remain outside the regime. This reflected the significant limitations placed on consent holders under the consent. The aquaculture consent is a right to undertake a specified activity within a defined space and for a defined time. A change in the nature of the activity away from aquaculture would require both a new consent and a change in the status of the area under the regional coastal plan.

11. ***[Withheld under sections 6(a) and 9(2)(h) of the Official Information Act]***

12. There are three possible approaches to this issue. Briefly, these are:

    - Include aquaculture and ***[Withheld under section 6(a) of the Official Information Act]***
    - Include aquaculture, ***[Withheld under section 6(a) of the Official Information Act]***;
    - Not include aquaculture.

13. ***[Withheld under section 6(a) of the Official Information Act]***

14. ***[Withheld under section 6(a) of the Official Information Act]*** Direct investment includes the granting of licences and concessions and any conditions placed on these.

15. The third option is therefore supported by officials.

Possible mechanism for incorporating aquaculture into the Act

16. If Cabinet decided to incorporate aquaculture under the Overseas Investment Act the process for doing so would be relatively straightforward. However, consultation with the aquaculture industry on implementation would be necessary.

17. The Act could require overseas investors to obtain permission to hold or have an interest in a coastal marine farming permit from the Minister of Finance and Minister of Conservation, as Minister responsible regulation of activities in the coastal marine area.

18. This could be achieved by providing that an estate or interest in land includes the right to undertake coastal marine farming activities are defined in the proposed Aquaculture Reform Bill. For clarity and transparency, it should also be included under the coverage section of the Overseas Investment Act.

19. The criteria that Ministers would be required to have regard to could be the same criteria as for non-land assets (i.e. the investor test), or the same criteria as for fishing quota (i.e. the investor test and economic development criteria). However it may be difficult for applicants to show economic development benefits – especially if they propose to purchase an already operational marine farm.

20. The proposed monitoring and enforcement provisions in the revised Act will be sufficient to cover consents for marine farming. Appropriate transition provisions will need to be developed to deal with existing marine farms in overseas ownership. This will need careful attention, but we do not envisage it to be problematic.

Drafting issues

21. We have met with PCO to discuss drafting of the proposed coverage and criteria provisions. They have raised two technical issues that were not addressed in the Cabinet report. The draft POL paper seeks decisions on the first of these issues.

Location of coverage details in Act or regulations

22. Assets that are subject to the Act are at present set out in regulation. To improve transparency the Cabinet paper discussed that both coverage and criteria be contained in legislation rather than regulation.

23. If the government wishes to maintain some ability to change the coverage of the Act there are three alternatives. Overall we would recommend that the asset categories be moved to the legislation, however thresholds (land areas, and value of business assets) could be treated differently. The options are:

- the thresholds would be set out in regulation;
- the thresholds would be set out in the Act, but with a the power to change the thresholds by regulation;
- the thresholds would be set out in the Act, but with a power to modify both the asset categories and the thresholds by regulation.

24. We consider that the first option is preferable. It would increase the transparency of the regime, and address any concern about government's ability to significantly alter the impact of the regime by regulation – such as through changing the asset categories

that are subject to the regime. However it retains the present level of flexibility for governments to adjust thresholds should they wish.

25. While options 2 and 3 would be more transparent by having all aspects of coverage in the Act, and would provide greater flexibility to the government, the Regulations Review Committee considers powers to amend legislation by regulation should only be used rarely and with strict controls.

Leases

26. At present approval is required under the Act for leases of sensitive land (e.g. over five hectares, over 0.2 hectares and adjoining the foreshore) where either the term is three years or more (including rights of renewal) or the consideration is $10 million or more.

27. Given that the Act deals with sensitive New Zealand assets, it could be that coverage of leases is too comprehensive. As a comparison, under Te Ture Whenua Maori, approval of the Māori Land Court is only required for leases over Māori land that exceed 52 years (including any rights of renewal).

28. One option for addressing this is that the Act only apply to leases of sensitive land where the term (including rights of renewal) exceeds ten years. The reason is that we consider only leases that are more akin to ownership need be screened.

29. We will continue to explore this option and report back to you, including with information about the number of applications likely to be affected by such a change.

Transitional issues

30. Discussions have been held between the Reserve Bank and LINZ on the issue of transitional arrangements for the staff and functions of the Overseas Investment Commission. The Reserve Bank is preparing a report on separation of the information technology and document management systems used by the OIC. LINZ is currently working on an implementation plan for the transition, which is expected to be available by the end of September.

31. LINZ has confirmed that offers of employment will be made to all OIC staff. Some conditions will not be able to be replicated – for example, because of the organisational design changes there will no longer be a separate CEO for the group. However, offers will be made on terms and conditions as similar as possible to the existing terms and conditions of OIC staff.

32. LINZ has confirmed that the functions of the regulator will be performed by a dedicated business group within LINZ, reporting to the General Manager, Property Regulation Group.

Parks and reserves

33. Cabinet has directed officials, in consultation with relevant regional and territorial authorities, Local Government New Zealand, the Department of Internal Affairs (DIA) and the Department of Conservation (DOC), to develop options for identifying those recreation parks and reserves other than regional parks, in respect of which adjoining land is to be screened, as well as options for revising that list.

34. We have asked Local Government New Zealand to liaise with all councils, and ask for information about parks or reserves that are used for recreation purposes, and that are over 10 hectares in size. We have also asked for information about any such parks or reserves smaller than that that the relevant council considers to be particularly sensitive, and what that sensitivity is. On the basis of that information, we will work with DOC and DIA to develop a list of relevant parks and reserves for which overseas ownership of land adjoining should be screened. The list is likely to be finalised in the first quarter of 2005.

Maori Land

35. The sale of Maori freehold land is currently exempt from the provisions of the Overseas Investment Act if it has been confirmed by the Maori Land Court under section 152 of the Te Ture Whenua Maori Act 1993. In confirming a sale to an overseas person, the Maori Land Court is required, as far as possible, to act in conformity with the relevant provisions of the Overseas Investment Act and Regulations. Thus both processes are currently required to be undertaken, but with the Overseas Investment Act process carried out by the Maori Land Court.

36. However the focus of the two Acts is different. The focus of Te Ture Whenua Maori is on promoting the retention of Maori land. In the sale context, it is designed to consider the actions of the vendor(s) of Maori land, and ensure that proper processes have been followed with respect to sale – for example that there is sufficient consensus for the sale and that the price is fair. In contrast the Overseas Investment Act considers the proposed actions of potential purchaser(s).

37. Four options were described in your Cabinet paper. Our recommendation is that option 4 be adopted. That is, Ministers and the regulator under the Overseas Investment Act would have jurisdiction over Maori land in respect of the granting of Overseas Investment Act consent. The Maori Land Court would retain its jurisdiction over the sale process in all other respects.

38. As directed by Cabinet, officials from Te Puni Kokiri and Treasury have discussed these options with the Maori Land Court unit of the Ministry of Justice. The discussions did not give rise to any new issues or information that would lead us to recommend a different approach. Further, the Court advised that they are not aware of any application being made to sell Maori land to overseas persons. This suggests that the impact of these changes will not be large. We expect to meet with the Chief Registrar of the Court during the week beginning 2 August, and will report back following that meeting. The draft POL paper includes a square bracketed section on this issue – and may change following this meeting.

Fishing quota

39. There are some technical issues arising from the drafting of the overseas investment provisions in the Fisheries Act and their interrelationship with the Overseas Investment Act. These include:
    - Who is required to apply for consent
    - Alternative enforcement mechanisms in the two Acts.

40. Further consultation is required with PCO and the Ministry of Fisheries on these issues.

Who is required to apply for consent

41. We understand that the Fisheries Act process was intended to be similar to that in the Overseas Investment Act. This is not the case for sales of shares in a quota[1] owning company to overseas persons, as shown in the table below.

Situation	Applicant for: Fishing quota	Applicant for: Land/Business
1. An overseas person (OP) purchases 25% or more of a company owning sensitive assets.	The company the OP is buying into. Under s56 of the Fisheries Act, permission is required to own quota, or an interest in quota. Legal opinion is that owning shares in a company that owns quota is not equivalent having an interest in quota. Thus, the company the OP is buying into is required to seek consent to continue to own its quota.	The OP
2. OP1 sells its 25% share of a company (NZ Ltd) that owns sensitive assets to another OP2.	No consent required The company already has permission to hold quota as an overseas person (obtained under situation 1).	OP2

42. There are two concerns with this. First, a quota owning company is required to apply for consent to become an overseas person. In a joint venture, one partner could use the overseas investment provisions to prevent the sale of shares by another partner. This is an unintended consequence of the Act. Second, no consent is required if the overseas investor sells its interest to another overseas investor. This appears to allow circumvention of the "good character" test.

43. A change to require any overseas person buying into a quota owning company to obtain consent will make the process clearer for participants in the industry, but is not expected to change the nature of the decisions. Changes will ensure that all overseas shareholders of quota owning companies are screened and subject to the good character and economic development tests. However it is likely to mean that some transactions will require consent that currently do not. This could be controversial within the fishing industry.

Alternative enforcement mechanisms in each Act

44. At present there are two alternative enforcement mechanisms for breaches of the overseas ownership provisions. Enforcement provisions under the Fisheries Act deal with forfeiture or disposal of quota of overseas persons holding it without consent. Enforcement provisions under the Overseas Investment Act apply for breaches of conditions of consent. The relationship between these two enforcement provisions is not explicit.

45. We are discussing with the Ministry of Fisheries and PCO the best options for dealing with this. These discussions include who has responsibility for enforcement. At present enforcement under the Overseas Investment Act is undertaken by the OIC, and under

[1] Quota is used as shorthand to refer to provisional catch history, quota, annual catch entitlement or any interest in any such provisional catch history, quota, annual catch entitlement.

the Fisheries Act is by Commercial Fisheries Services Limited (owned and controlled by the Seafood Industry Council) under powers transferred from the Ministry of Fisheries.

Consultation

46. We have had some discussions on these issues with the Ministry of Fisheries, the Overseas Investment Commission, Te Puni Kokiri, Land Information New Zealand, the Ministry of Foreign Affairs and Trade, the Department of Internal Affairs, the foreshore and seabed unit of the Department of Prime Minister and Cabinet. We will consult comprehensively with them early next week before finalising a cabinet paper for you.