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Comments on the ‘Crafar Farms Counterfactual’

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Executive Summary

In a recent case heard in the High Court in New Zealand, Justice Miller set aside the Ministerial consent given under the Overseas Investment Act 2005 for the highly contentious sale of the Crafar farms to Chinese interests. He determined that an error of process had resulted in the Ministers' official advisers inappropriately using a counterfactual of the status quo rather than a forward-looking counterfactual of what would have occurred if the foreign investment had not been made. The proposed counterfactual would take into account what a New Zealand purchaser would have invested, so therefore the assessment used by the Ministers had overstated the benefits of sale to the overseas parties.

This paper proposes that, whilst Justice Miller was correct in determining that a forward-looking counterfactual is appropriate, that counterfactual is more properly what would occur in the event of the application for the currently-proposed foreign investment being declined. Such a counterfactual would require the consideration of wider effects upon the markets for transaction of the assets concerned to be taken into account when sales to higher-valuing foreigners are declined on the basis of the current range of economic and non-economic tests required under the Act. As the costs of intervening were not considered, then it is equally likely that the benefits of the sale to the overseas parties have in fact been substantially understated.

Based upon an analysis of the Overseas Investment Act published in 2010, the paper also contends that a second process error has routinely been occurring in the assessment of applications under the Overseas Investment Act whereby the financial benefits to the vendor from selling to a foreigner (almost always at a higher price than the highest-valuing New Zealander) have been excluded from the assessment. Justice Miller finds that the Overseas Investment Office has been correct in omitting them from consideration, on the basis of the tightly specified criteria specified in the Act and the Act's purpose which he interprets is to reinforce the privilege granted when foreigners are allowed to own and control New Zealand assets. However, if viewed from a forward-looking and economy-wide perspective, the current criteria are sufficiently broad enough to allow the

private gains to be included in consideration. Indeed, on the basis of Justice Miller’s finding that excluding them is correct, the risk now exists that decisions denying foreign ownership will result in a ‘curse’ of New Zealand owners becoming ‘locked in’ to the ownership of lower-valued assets, with significant negative consequences for future capital raising and thus the development and expansion of the country’s land-based exporting businesses.

Furthermore, an assessment process based upon a counterfactual of what would occur if the foreign investment application is declined and the inclusion of the private gains to New Zealand vendors as proposed in this paper is more consistent with the stated commitment of the government that oversaw the Act’s introduction to a liberal investment regime that was (and continues to be) necessary because of New Zealand’s reliance upon foreign capital if its economy is to be developed to its fullest potential.

1. Background

On January 27, 2012, Associate Minister of Finance Hon Dr Jonathan Coleman and Minister for Land Information Hon Maurice Williamson granted consent to Milk New Zealand Holdings Limited, a wholly-owned subsidiary of Shanghai Pengxin Group Co. Limited (Pengxin)¹, to acquire the land and other associated business assets of 16 farms formerly owned by the Crafar family but being liquidated by receivers on instructions from creditors. In doing so, the Ministers concurred with the recommendation of the Overseas Investment Office (OIO)² that all relevant criteria required under the Overseas Investment Act 2005 (‘the Act’) and the Overseas Investment Regulations 2005 (‘the Regulations’) had been assessed, and that on balance, the sale to a foreign party would be of “substantial and identifiable benefit to New Zealand”³. This benefit was deemed to have accrued in respect of ten specific criteria contained in section 17 of the Act, and three Regulations.

¹ <http://www.linz.govt.nz/sites/default/files/docs/overseas-investment/decision-summary-milk-nz-holding-limited-201110035.pdf>

² <http://www.linz.govt.nz/sites/default/files/docs/overseas-investment/oio-recommendation-crafar-farms-20120127.pdf>

³ See footnote 1, p 3

On February 3 2012, in the High Court in Wellington, Justice Miller heard the case brought by Tiroa E and Te Hape B Trusts and Baytown Investments (directed by Michael Fay and David Richwhite) ('the Plaintiffs') against the Chief Executive of Land Information, the Ministers of Finance and Land Information, Pengxin, and the Receivers ('the Defendants'). The Plaintiffs alleged that "the Ministers' decision was flawed because it attributed to the transaction benefits which any buyer, including a domestic buyer such as themselves, would bring, notably the \$14 million (approximately) needed to bring the farms into full production"⁴. Justice Miller's decision, released on 15 February 2012, set aside the Ministers' consent and instructed them to reconsider Pengxin's application⁵.

2. The Judgement

At the crux of the judgement is the interpretation by the OIO and Ministers under section 17 of the Act whether the overseas investment (that is, the purchase of the Crafar farms by Pengxin) "will, or is likely to, benefit New Zealand (or any part of it or group of New Zealanders)"⁶. As the transaction involves non-urban land exceeding five hectares, the benefit arising from the transaction must be "substantial and identifiable"⁷. This benefit must be assessed relative to a counterfactual. At question is whether the counterfactual used by the OIO and the Ministers was the correct one. It is then a matter of determining whether the assessment of benefits relative to the counterfactual resulted in the finding of a substantially and identifiably positive benefit to New Zealand as a consequence of the transaction proceeding.

Justice Miller determined that if the assessment is to correctly isolate the economic benefits attributable to the overseas investment, then the 'factual case' is what will occur

⁴ TIROA E AND TE HAPE B TRUSTS V CHIEF EXECUTIVE OF LAND INFORMATION HC WN CIV-2012-485-101 [15 February 2012] at 3. Subsequently referred to as the Judgement.

⁵ Judgement at [61].

⁶ Sections 14(1)(c) and (d); and 16(1)(e)(ii).

⁷ Section 16(1)(e)(iii).

if the investment is made. That is, it must be forward-looking. The counterfactual against which it is compared must also be similarly forward-looking⁸. The status quo may serve as that counterfactual only if the Ministers think it likely that in the hands of another owner, the farms would stay in their present state⁹. That would be the case if the farms were sold as a ‘going concern’. However, as the Crafar farms were in poor repair, “any solvent purchaser can be expected to bring their production up to its potential”¹⁰. The appropriate counterfactual was therefore held to be the purchase of the farms by any other solvent purchaser. Under this counterfactual test, many of the benefits relied upon in support of the Pengxin application would have occurred anyway, so they cannot “easily be described as a substantial consequence of the overseas investment”¹¹.

The judge held that, in advising that the Act does not require an overseas investor to do more than a New Zealand investor would do but required only the determination of whether the investment was likely to benefit New Zealand, the OIO had misled the Ministers¹². The error was “not a mere technicality”¹³. Rather, he concluded that “the economic benefits caused by the overseas investment were materially overstated in the OIO’s recommendation”¹⁴.

It is noted that in coming to this conclusion, Justice Miller observed that “investment capital introduced into New Zealand counts as an economic benefit in itself under s 17(2)(a)(v)”¹⁵, but that “the s 17 factors do not include economic benefits to the vendor”¹⁶. Although enjoined by the defence counsel to treat the very much higher price proposed to be paid by Pengxin as an added benefit, he instead affirmed that the OIO had made no mention of these benefits in its recommendation and he assessed this to be the correct procedure. Notably, he states “by excluding financial benefits to the vendor, s 17 ensures that an overseas investor cannot pass the benefit test merely by outbidding

⁸ Judgement at [37].

⁹ Judgement at [42]

¹⁰ Judgement at [57]

¹¹ Judgement at [38]

¹² Judgement at [42]

¹³ Judgement at [57]

¹⁴ Judgement at [57]

¹⁵ Judgement at [41]

¹⁶ Judgement at [20]

others”¹⁷. The justification for this stance is the presumption under the Act that New Zealand ownership of sensitive assets is desirable – a position advanced in several ways; “for example, by requiring that sensitive land first be offered for sale to non-overseas persons”. Nonetheless, in the same paragraph, he concedes that “from an economic perspective, the price paid to a domestic vendor benefits the New Zealand economy by releasing capital for investment”. This apparent contradiction will be discussed subsequently.

¹⁷ Ibid

3. **Analysis Based on Heatley and Howell (2010)**

In June 2010, in response to the New Zealand government review of its own Act, ISCR published a comprehensive analysis of the economic and political objectives that might be sought to be achieved under an Overseas Investment Act, and assessed the likelihood that these would be achieved by New Zealand's Act¹⁸ (henceforth H&H). This analysis noted, *inter alia*, two significant weaknesses in the New Zealand Act which have surfaced in Justice Miller's decision:

- an apparent contradiction between the Act's Purpose statement and the overall economic impact of an overseas investment; which has led to
 - the subjugation of relevant economic considerations to other factors, which results in process errors including:
 - the choice of an incorrect counterfactual for the assessment process; and
 - the omission of relevant costs and benefits to New Zealand (or any part of it or group of New Zealanders)
- in the assessment of applications concerning sensitive land.

It is quite likely that these weaknesses have emerged because the current Act is the result of the amalgamation of two historic Acts – the original Overseas Investment Act 1973 covering financial investment in firms and the Land Settlement and Promotion Act 1952 that conferred on the government substantial powers to control the ownership of farm land by both New Zealanders and foreigners – including the ability to prevent the aggregation of several farms under common ownership¹⁹. Until 1968, foreign ownership of farm land was precluded by the requirement that the owners reside on the farm and be actively carrying out farming activities. Amendments in 1968 introduced provisions to control acquisition of farm land by overseas corporations and persons who were not New Zealanders. Whilst the original Overseas Investment Act was predicated upon the opening up of New Zealand firms to foreign ownership in order to improve the nation's

¹⁸ Heatley, D. & Howell, B. (2010). Overseas Investment: Is New Zealand 'Open for Business'? Wellington, New Zealand: ISCR.

http://www.iscr.org.nz/f578,16550/16550_Overseas_Investment_Act_paper_v20_15Jun10_final_.pdf

¹⁹ Thereby precluding the development of 'corporate farming' such as engaged in by the Crafar family – which due to substantial economies of scale in (particularly dairy farm) infrastructure investment has become common since the lifting of these restrictions in the 1980s.

economic outcomes, the farm land controls were in large part a legacy of policies dating from the 1880s where closer settlement was seen as a way of expanding New Zealand farm production within an idealised social structure of family farm ownership²⁰.

3.1 Contradictory Intent and Act Purpose

An apparent contradiction is identified in H&H between the intention of the politicians who enacted the legislation in 2005, and the statement of the Act's purpose.

A reasonable assumption would be that an Overseas Investment Act should be focused primarily on the promotion of overseas investment that leads to long term economic benefits for the country. As such, it might be expected to grant to officials and Ministers the right to intervene in a transaction entered into willingly by New Zealanders and foreign parties only when that transaction would have a deleterious effect on the New Zealand economy²¹. That appears to be the intention of the Minister of Finance, in announcing the review in 2003, when he stated that the government “was committed to maintaining a liberal investment regime because New Zealand needed foreign capital if it was to return New Zealand to the top half of the OECD and to develop its economy to its fullest potential”.

However, the stated purpose of the Act is “to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets”²². This leads to a process for examining applications that prioritises characteristics relating to the identity of the purchaser and the nature of the asset over economic considerations²³.

The definition of what constitutes ‘sensitive New Zealand assets’ becomes the filter for determining if an application needs to be subjected to any economic assessment – however interpreted - in the first place. Almost all applications under the Act relate to

²⁰ Fairweather (1985), cited in H&H p 22

²¹ H&H pp 6-9.

²² H&H p21.

²³ H&H (p21) state that the thresholds for government intervention “focus strongly upon the nature of the assets subject to transactions between New Zealanders and foreign investors, and the definition of what constitutes a ‘foreign ownership interest’ in an asset rather than upon economic objectives. The statutory processes for assessing transactions of interest therefore subjugate economic consequences of the transaction to considerations of the asset in question and the identity of the foreign investors”.

sensitive land, which includes that currently used for farming purposes and any non-urban land in excess of five hectares. Whereas overseas purchasers of sensitive business assets excluding land are subjected to examination only with regard to their good character²⁴ (leaving open the possibility for a transaction with a potentially negative economic effect to proceed without any further assessment either economic or otherwise²⁵), the proposals made by those seeking to invest in any business that has any interest (however, small, and including leaseholds) in sensitive land are subjected to a series of tightly specified economic and non-economic assessments (as per s 17(2) and Regulation 28)²⁶.

The assessment criteria place considerable emphasis on a number of tightly-defined ‘spill-over benefits’ brought by the foreign investor as a consequence of the terms of the specific transaction in question, including for example, undertakings to enhance existing areas of indigenous vegetation and significant habitats of indigenous fauna²⁷ and providing, protecting and improving walking access over the relevant land²⁸. It is noted that New Zealand purchasers would not ordinarily be required to bring these types of benefits if they were to purchase the land. However, it is unclear within these restrictive criteria, which are the only ones that the Act allows to be taken into consideration, how unspecified but nonetheless material economic benefits such as a higher price paid by a foreigner than the highest-valuing New Zealander is prepared to pay, and the consequent effects upon the New Zealand economy from an intervention to prevent a transaction from being completed, should enter into the consideration.

The Act thus embodies an inherent tension between the pursuit of economic benefits arising from foreign investment and the privileges associated with ownership of substantial tracts of land in New Zealand. Justice Miller’s ruling appears to confirm that

²⁴ This test is based upon the same tests of good character that would be required for the appointment of a Director to a hypothetical New Zealand firm.

²⁵ For example, a transaction relating to intellectual property associated with the business, such as genetic information associated with farm animals or the license to control the use of a plant species developed in New Zealand.

²⁶ Judgement at [17]-[18].

²⁷ s 17 (2)(b)

²⁸ s 17 (2)(e)

the Act's stated purpose and the tightly specified economic and non-economic criteria must take precedence over an analysis that encompasses the wider economic outcomes of either approving or declining the application. This is the implication of his opinion that "the Act finds New Zealand ownership of sensitive assets desirable, and it advances this preference in several ways; for example by requiring that sensitive land first be offered for sale to non-overseas persons. By excluding financial benefits to the vendor, s 17 ensures that an overseas investor cannot pass the benefit test merely by outbidding others"²⁹.

3.1.1 Discussion

The implications of such a narrow focus for assessment are explicated in H&H. From an economic perspective, an overseas investment is desirable if it leads to an increase in the overall economic wellbeing of a country. The primary economic purpose of an Overseas Investment Act is to prevent the completion of transactions that will have a detrimental effect on the national economy. In this context, a transaction that economically benefits a New Zealander personally is nationally beneficial, and should be prevented only in the event that there are external costs to the New Zealand economy from the transaction proceeding that exceed the private benefits accrued by the New Zealand transactor(s). This principle applies regardless of whether the transaction relates to the purchase of a tangible asset such as land or an intangible asset such as shares in a firm.

If the highest-valuing foreigner is prepared to pay a higher price for the asset than the highest valuing New Zealander, then the difference between these prices enters the New Zealand economy as the gain from the trade. It is unequivocally an economic benefit to the country, albeit that it is accrued by the New Zealand vendor of the asset. A government granting itself the right to intervene in such a transaction has in effect appropriated from the New Zealand transactor the property rights normally associated with the freedom to exercise uninterrupted control of his assets – including the right to sell the asset to whomever he chooses. Equally, if the transaction is blocked, the New Zealand transactor forfeits the certain gain that would have accrued to him personally. If

²⁹ Judgement at [17].

the private loss exceeds the potential external gain (i.e. external loss avoided) to the New Zealand economy arising from the intervention, then the intervention has resulted in a net loss to the New Zealand economy. This loss can be interpreted as the price paid by the New Zealand economy overall for the privilege of ongoing New Zealand ownership of sensitive assets – albeit with the distributional consequence of the costs being borne privately by the vendor(s) forgoing expected profits exceeding the socialised gains to the rest of the country³⁰.

It is also noted that the Act does not grant New Zealanders an exclusive right to purchase the asset (at a potentially lower price) before it can be offered to potential foreign purchasers. Rather, the Act requires that before an application can be approved, evidence must be produced that New Zealanders were given an unhindered opportunity to participate in the sale process. The vendor cannot be bound to accept a competing local offer³¹. This is consistent with an open and transparent sale process intended to identify the highest-valuing potential owner, regardless of nationality, thereby furthering the economic objective of ensuring that the New Zealand vendor (and by extension, the New Zealand economy) receives the highest possible benefit from the sale of the asset. Specifically, it prevents a ‘closed’ sale to a foreigner (who may have offered less than the highest-valuing New Zealander) by ensuring potential New Zealand purchasers know that the asset is ‘on the market’ and are not denied the opportunity to make an offer in competition with the foreign interests³².

When Justice Miller invokes the Act’s insistence that “farm land first be offered for sale in New Zealand”³³ in support of the supremacy of the ‘privilege’ of overseas persons owning or controlling sensitive New Zealand assets and subsequently adjudges that “an overseas investor cannot pass the benefit test merely by outbidding others”³⁴, he appears to be indicating that some assets are so sensitive that their sale to foreigners can be contemplated only by ignoring the usual gains from trading assets. Yet the Act’s

³⁰ In the event of the sale

³¹ s 16(1)(f)

³² H&H p 25-6

³³ Judgement at [10]

³⁴ Judgement at [17]

definition of sensitive land is sufficiently broad that it will capture any transactions with overseas persons involving almost all of New Zealand's major exporting firms. This would appear to put major obstacles in the way of these firms financing future expansions in exporting activities³⁵. It also poses significant disincentives to the creation of new land-based businesses within New Zealand if the entrepreneurs establishing them know *ex ante* that the potential future sale of these businesses will be limited to predominantly New Zealand purchasers, rather than within a world market where a higher-valuing potential purchaser might exist.

H&H observe that if there is a class of assets whose ownership and control by New Zealanders is desirable for economic reasons, then these considerations would be surfaced in the assessment of the application against standard economic criteria regardless of the nature of the asset (indeed, the current Act is likely failing because transactions involving non-land assets are not subjected to any further tests beyond those concerning the good character of the applicant). In the event that there are non-economic reasons why ownership and control should remain in New Zealand hands, then it would appear inappropriate for them to be eligible for overseas investment in the first place. Rather, these interests are better catered for by the use of either separate legislation covering ownership of the relevant assets or the creation of special classes of shares that can only be traded amongst New Zealanders³⁶. Such actions would remove the uncertainty created by having to both wait until overseas interest was expressed in the purchase of various classes of sensitive assets and then proceeding through a long and costly OIO process before it is determined that non-economic criteria (including the opportunistic politically-motivated insertion of new criteria into the regulations, as occurred during the evaluation of one case study in H&H) ultimately determine the outcome of an application.

³⁵ This is not dissimilar to the problems faced by co-operatives, when expansion cannot be financed from within the firm's retained earnings and the (limited) other capital resources of the members, who are already substantially exposed by having most of their capital and future trading income tied up in the firm itself, as they cannot easily diversify into other industries.

³⁶ Such requirements can be specified in the constitution of a firm – for example, the Kiwi Share in the former Telecom and restrictions on the trade of shares to non-New Zealanders in the former Air New Zealand prior to its purchase and recapitalisation by the government in 2001.

3.2 Process Errors and Consequent Omissions

The subjugation of objective economic assessment to subjective checking against an exclusive list of assorted selected economic and non-economic criteria has likely contributed towards the occurrence of both ‘process errors’ and serious omissions of relevant costs and benefits in the assessment of proposed transactions.

3.2.1 The Counterfactual Error

H&H identify (as Miller J has adjudicated) a serious potential for ‘process error’ to occur with the inappropriate use by both the OIO and Ministers of the status quo as the appropriate counterfactual in assessing applications under the Act³⁷. It is appropriate that the investment case be compared to a forward-looking outcome including what would occur if the foreign investment did not proceed. However, contrary to Miller J, H&H propose that the correct counterfactual is not what would have occurred “if the investment is not made”³⁸ (i.e. no foreign investment had been proposed), but *what would occur in the event of the application for the currently-proposed foreign investment being declined*.

The distinction regarding the correct counterfactual is very important. A forward-looking counterfactual by its very nature must take a view of expected future outcomes, both in relation to the property concerned (e.g. purchase by a New Zealander who reinvests to the level proposed by the foreigner) and all other subsequent transactions that will be affected by the outcome of the current application (e.g. the market value for all properties of the class of the sensitive asset under current consideration).

The mere fact that an application has been made under the Act alters the information available in the market for investment in the class of asset to which that transacted belongs. It allows the gains to the New Zealand parties from the transaction proceeding to be quantified (at the very least by the vendor and the OIO)³⁹. If the transaction is prevented, then the gain that the New Zealand transactor (and by extension the New

³⁷ H&H pp 12-13; 33-4

³⁸ Judgement at [37]

³⁹ These are unquantifiable unless there is an ‘offer on the table’.

Zealand economy could have realised) from it proceeding will with certainty be forfeited. It is the ‘opportunity cost’ of intervening. Under most circumstances, if a transaction yielding a very large gain to a New Zealand transactor was to be overturned, it might be expected that evidence could be provided of an even larger disbenefit to New Zealand arising. If the evidence of disbenefits cited is small relative to a transaction that would otherwise be expected to yield a large private gain, then a signal is being sent that an individual New Zealander (or group of New Zealanders) is being asked to bear a very large personal cost in order to facilitate the wider national interest (the economic effects of which may be neither quantified nor certain). This will have the effect of altering the incentives faced by all transactors of all assets in the class in question in the future.

In the short run, turning down the application will have a significant effect upon the personal wealth of individual New Zealanders. In the long run, it will have a depressing effect upon the value of all New Zealand-owned assets in that class. The presumption is that the transaction before the OIO represents the best price achievable in the market at that time (in this case for the sale of dairy farm businesses, including the land associated), following an open sale process where any interested New Zealand purchaser has been free to participate. If the sale to the foreigner does not proceed, then the best that the New Zealand vendor can expect to achieve falls to (at best) the price offered by the highest bidding New Zealander. However, unless the property has been sold at an open auction, it is not known what that price will be. In practice, the highest-valuing New Zealander will now be in a position to offer a sum less than that at which he actually values the property, in order to maximise his own personal return from the transaction. Furthermore, any potential buyer of such a property, having had clarification of the likelihood of future transactions with higher-valuing foreign buyers being denied, will discount the price offered to reflect the vastly reduced number of potential owners with whom the asset can be traded in the future.

In respect of the Crafar sale, the receivers’ counsel informed the court that the umbrella organisation to which plaintiffs belong “came late to the sale process and has still to

commit itself to a formal offer, but he conceded that it has nominated a price, albeit one that the receivers claim to find unworthy of acknowledgement”⁴⁰.

The effect is thus to depress the market value for properties of the relevant type relative to what they would have been had the higher-valuing foreign buyer purchased. This has a flow-on effect to the values of all properties of that class. The total value of assets of that class in the market now falls, regardless of whether they are for sale or not. In the case of farm businesses, this affects the sums that can be borrowed by all such businesses for development, expansion or even maintaining the assets at their current productive level. The implications for an industry such as dairying which is already subject to capital market constraints arising from the co-operative structure of Fonterra could be material.

Applying the justifications used by Justice Miller to support the use of the counterfactual proposed at the hearing is instructive to the case of the counterfactual proposed here. He states “The Ministers could scarcely serve the legislated objective if when assessing a given economic benefit they were to ignore clear evidence that the benefit would accrue anyway, should the land remain in ...New Zealand ownership. ... If a given benefit will happen anyway, it cannot easily be described as a substantial consequence of the overseas investment”⁴¹. It equally can be argued that it scarcely serves the country’s economic interests if when assessing a given economic benefit they were to ignore clear evidence that a loss of wealth to the New Zealand economy were to accrue should they not approve a sale to a foreign applicant. If a large gain in New Zealand wealth would not occur if the foreign transaction is declined, then that act cannot easily be described as an insubstantial consequence of the exercise of the legislated powers of intervention in private transactions.

It is also noted in H&H that the fact that an offer has been made by the foreign purchaser enables quantification with certainty of the gains (or losses) to the private parties

⁴⁰ Judgement at [6].

⁴¹ Judgement at [38].

associated with the transaction whereas many of the other considerations in making the economic assessment are uncertain in either their quantum or likelihood of occurring. The certain gains from the trade accrue in full immediately the transaction takes place, rather than being discounted (in Net Present Value) terms as a consequence of occurring in the future. Thus, in applying an analysis using a forward-looking counterfactual test, certain gains or losses in the present should be given greater weight than the same gain achieved with certainty in the future in an assessment of the costs and benefits of a transaction. Furthermore, a certain gain should be given greater weight in the consideration than uncertain ones, holding time constant. This would appear to strengthen the case for placing greater weight on the costs and benefits arising with certainty from the proposed transaction than the costs and benefits arising from a hypothetical transaction that might (or might not) take place at some undetermined time in the future⁴².

3.2.2 The Relevant Costs and Benefits

Having established the appropriate counterfactual, the assessment of an application now turns on the relevant costs and benefits to include in the analysis. The preceding discussion highlights the incongruity of the second major process error identified in H&H – the failure to take into account the private gains to the New Zealand vendor of sensitive land in the assessment of an application under the Act.

H&H note that it has been the practice of the OIO to ignore private gains to vendors in their assessments. This appears to arise from the prescriptive manner of s 17, which identifies the factors which must be taken into account in making the decision. Justice Miller states that no other factors other than those contained in s 17(2) can be considered⁴³. Despite an economic test that will, or is likely to “benefit New Zealand (or any part of it or group of New Zealanders) as per s 16(1)(e)(ii) ordinarily taking into account the private gains to New Zealanders selling assets to foreigners (relative to the

⁴² H&H pp 11-12

⁴³ Judgement at [17].

next best New Zealand purchaser or any other case presumed to be the counterfactual), he states that “the s 17 factors do not include economic benefits to the vendor”.

If Justice Miller’s interpretation is upheld, then with regard to farm land at least, it would seem that the effect of the Act, played out through its purpose and restrictive s 17 criteria, is to correlate the privilege associated with foreigners owning and controlling sensitive assets with a corresponding curse (i.e. liability) for individual New Zealand investors owning sensitive assets. As it appears incongruous for a government to have an objective to penalise its own citizens for owning sensitive assets⁴⁴, the current interpretation is most likely the consequence of a series of process errors in the application of the Act.

Furthermore, upholding Justice Miller’s interpretation would also appear to expose the Act to strategic gaming in respect of future applications. If the gains from sale to the New Zealand vendor are not to be included, but great weight is given to the s 17 benefits that a foreign purchaser brings relative to a New Zealand one, then a prospective foreign purchaser can discount the price offered to the vendor to match that of the highest New Zealand tendered, but then offer to commit to a series of other ‘investments’ designed to appeal to s 17 assessment criteria, but are not the most valuable uses of the funds concerned to the New Zealand economy overall (e.g. ‘gold-plated’ upgrading plans in excess of what is economically efficient; ‘charitable’ donations to environmental causes). These inefficient investments come at the expense of the New Zealand vendor, who would most likely have reinvested the funds in productive activities within New Zealand. The risk thus exists for the Act to become a channel for a practice more consistent with the encouragement of bribery than the stewardship of national economic development.

H&H suggest that a second error has arisen within the OIO assessment process that has had the effect of incorrectly excluding the gains realised by vendors in sales of sensitive assets to foreigners. They contend that in a forward-looking factual and counterfactual

⁴⁴ Except perhaps in the case where the state itself wished to depress the private ownership incentives in order to lower the prices to the extent that there was no longer a market for them as a precursor to a ‘nationalisation by stealth’ via state purchase of the assets for which a missing market for ownership has emerged.

analysis, assessing whether the overseas investment will, or is likely to, result in “added market competition, greater efficiency or productivity or enhanced domestic services in New Zealand”⁴⁵ and “the introduction into New Zealand of additional investment for development purposes”⁴⁶ are sufficiently broad enough to allow consideration of the effects of increased liquidity in the New Zealand economy from the injection of the premium paid by the foreign buyer over the price that would have been paid by the highest-valuing New Zealander. Specifically, the New Zealand vendor(s) have greater wealth post sale, which will not sit idle, but will be applied to other productive activities in the New Zealand economy in addition to the ongoing productive activities associated with the property that has been sold⁴⁷. It might be argued that these gains could legitimately be considered in the factual case.

Not cited in H&H, but equally likely to be open to consideration as a means by which the higher price paid by a foreign investor is Regulation 28(g)(i), requiring consideration of “whether New Zealand’s economic interests will be adequately promoted by the overseas investment, including, for example, matters such as any or all of the following ... (iv) whether New Zealand’s key economic capacity is or will be improved”. As discussed above, if the counterfactual is taken to be the outcome if the application is denied, then the consequent effects on the market for land in the category considered are very likely negative. In the case under consideration, a substantial negative effect on the value of dairy farms in New Zealand is a probable consequence of a decision implying that foreign ownership of dairy farms is no longer desirable. On the face of it this would appear to meet the criterion of a non-trivial impact on New Zealand’s key economic capacity that would enter consideration in the assessment of the counterfactual.

⁴⁵ s 17(2)(a)(iv)

⁴⁶ s 17(2)(a)(v)

⁴⁷ H&H pp30-32

Conclusion

This paper has argued that whilst Justice Miller was correct in determining that a forward-looking counterfactual is appropriate in considering applications under the Overseas Investment Act, the counterfactual proposed – what would happen if the foreign investment did not occur – is not sufficient. Whilst it takes into account the investment a New Zealand purchaser would also make, it does not make adequate allowance for the opportunities lost to the New Zealand economy from declining the application. As intervening in a transaction freely negotiated between two willing parties will also have costs associated with it, then it is equally likely that the assessment made under current processes has resulted in the benefits of the sale to the overseas parties being substantially understated.

Rather, it is proposed that the relevant counterfactual is more properly what would occur in the event of the application for the currently-proposed foreign investment being declined. This alternative counterfactual is forward-looking, and invokes consideration of wider effects upon the markets for transaction of the assets concerned when sales to higher-valuing foreigners are declined on the basis of the current range of economic and non-economic tests required under the Act.

Based upon an analysis of the Overseas Investment Act published in 2010, the paper also contends that a second process error has routinely been occurring in the assessment of applications under the Overseas Investment Act whereby the financial benefits to the vendor from selling to a foreigner (almost always at a higher price than the highest-valuing New Zealander) have been excluded from the assessment. Justice Miller finds that the Overseas Investment Office has been correct in omitting them from consideration, on the basis of the tightly specified criteria specified in the Act and the Act's purpose which he interprets is to reinforce the privilege granted when foreigners are allowed to own and control New Zealand assets.

However, if viewed from a forward-looking and economy-wide perspective, the current criteria are sufficiently broad enough to allow the private gains to be included in

consideration. Indeed, on the basis of Justice Miller’s finding that excluding them is correct, the risk now exists that decisions denying foreign ownership will result in a ‘curse’ of New Zealand owners becoming ‘locked in’ to the ownership of lower-valued assets, with significant negative consequences for future capital raising and thus the development and expansion of the country’s land-based exporting businesses.

An assessment process based upon a counterfactual of what would occur if the foreign investment application is declined and the inclusion of the private gains to New Zealand vendors as proposed in this paper is more consistent with the stated commitment of the government that oversaw the Act’s introduction to a liberal investment regime that was (and continues to be) necessary because of New Zealand’s reliance upon foreign capital if its economy is to be developed to its fullest potential.