

Memorandum



To: Annelies McClure
Manager, Overseas Investment Office

From: Pedro Morgan
Senior Solicitor

Date: 12 August 2015

File Ref: H2-100-ZHJ / 201020096

Subject: **Motukawaiti Island – Final Report**

For Your: **Action**

Overseas Investment Office
Radio New Zealand House
155 The Terrace
PO Box 5501
Wellington 6145
New Zealand
+64 4 460 0110
www.linz.govt.nz

Contents

INTRODUCTION	1
OUR INVESTIGATION	2
ISSUES WITH LINZ'S DELEGATIONS	3
RESUMPTION OF THE INVESTIGATION	4
THE PURCHASE OF MOTUKAWAITI ISLAND, AND OTHER EVENTS	4
THE PURCHASE OF THE ISLAND.....	4
THE PAYMENT OF A "FINDER'S FEE"	7
OTHER CONNECTIONS BETWEEN ST MORRIS AND MR ZHANG/MR ZHOU	9
MR HAN'S EXPLANATION OF THE TRANSACTION.....	10
MR ZHANG'S EXPLANATION OF THE TRANSACTION	12
APPROACH TO ENFORCEMENT	13
ENFORCEMENT OPTIONS	14
POSSIBLE OFFENCES AGAINST SECTIONS 42 AND 43.....	14
OFFENCE AGAINST S42 – PURCHASE BY ST MORRIS	14
OFFENCE AGAINST S42 - MORTGAGE INTEREST ACQUIRED BY MR ZHANG.....	18
OFFENCE AGAINST S43 - DEFEATING, EVADING, OR CIRCUMVENTING THE OPERATION OF THE ACT.....	19
A CIVIL PENALTY IS UNAVAILABLE.....	20
RECOMMENDATIONS	20

Introduction

1. We have now completed our investigation into the purchase of Motukawaiti Island (**the Island**), also known as Step Island, by St Morris NZ Limited (**St Morris**), and the grant of a mortgage to Jun Zhang (**Mr Zhang**). The Island is in the Cavalli Islands group in Northland and is sensitive land.

2. Our investigation has considered whether:
 - (a) St Morris required consent to acquire the Island; and
 - (b) Mr Zhang required consent to take a mortgage over the Island; and
 - (c) Whether there was an attempt to defeat, evade or circumvent the operation of the Overseas Investment Act 2005 (**Act**).
3. There are two key issues:
 - (a) First, whether St Morris or its sole shareholder and director Wenning Han (**Mr Han**) were associates of Mr Zhang or any other overseas person. Under the Act, associates of overseas persons need consent to acquire interests in sensitive land. Neither Mr Han nor St Morris is an overseas person, and so consent will only be required if one of them is an associate of an overseas person.
 - (b) Second, whether Mr Zhang's mortgage needed consent or was exempted from the requirement for consent under regulation 33(1)(h) of the Overseas Investment Regulations 2005 (**Regulations**).
4. All Crown prosecutions should be conducted in accordance with the Solicitor General's Prosecution Guidelines (**Guidelines**). Under the Guidelines, prosecutions ought to be initiated or continued only where the prosecutor is satisfied that the Test for Prosecution is met. The Test for Prosecution is met if:
 - (a) The evidence which can be presented in Court is sufficient to provide a reasonable prospect of conviction – the Evidential Test; and
 - (b) Prosecution is required in the public interest – the Public Interest Test.
5. Each aspect of the test must be separately considered and satisfied before a decision to prosecute can be taken. The Evidential Test must be satisfied before the Public Interest Test is considered. The prosecutor must analyse and evaluate all of the evidence and information in a thorough and critical manner.
6. My view is that we do not have a reasonable prospect of conviction. There is insufficient credible evidence which we could put before a court, and upon which a judge or jury could reasonably be expected to be satisfied beyond reasonable doubt that St Morris or Mr Han was an associate of an overseas person and needed consent and that Mr Zhang's mortgage was not exempted from the requirement for consent.
7. As we are not satisfied that there is sufficient evidence to provide a reasonable prospect of conviction, my view is that the Evidential Test' is not met. It is therefore not necessary to consider the Public Interest Test. Accordingly, my recommendation is that we take no enforcement action.
8. In this report, I set out:
 - (a) a summary of our investigation;
 - (b) a summary of the facts;
 - (c) the approach I have taken to considering enforcement options generally;
 - (d) why I consider that we have insufficient evidence to prosecute, and why other enforcement mechanisms are inappropriate; and
 - (e) my recommendation that we take no action.

Our investigation

9. Our investigation began in November 2010 after receiving a complaint from an investor who had made an unsuccessful bid to acquire the Island.

10. Our investigation has involved four distinct activities:
 - (a) initial notices issued under section 41¹ of the Act between December 2010 and June 2013 (**initial notices**);
 - (b) reissued notices under section 41 of the Act between July 2013 and December 2013 (**reissued notices**);
 - (c) further notices under section 41 of the Act between March 2014 and July 2014; and
 - (d) interviews, including with Mr Han and Mr Zhang².

Issues with LINZ's delegations

11. On 31 January 2013, the District Court³ found that one of Land Information New Zealand's (**LINZ**) internal delegations did not comply with the State Sector Act 1988 (**SSA**). The SSA only permits a power to be sub-delegated *once*, while the delegation in question involved a *second* sub-delegation. Upon investigation, LINZ discovered that the same issue existed with other delegations, including some Overseas Investment Office (**OIO**) delegations.⁴
12. The delegation to the Manager of the OIO (**Manager OIO**) *complied* with the SSA. That delegation was from the Chief Executive of LINZ (**Chief Executive**) to a Deputy Chief Executive (delegation) and from the Deputy Chief Executive to the Manager OIO (sub-delegation).
13. However, the delegation to the Team Manager of the OIO (**Team Manager OIO**) *did not comply* with the SSA. The delegation was from the Chief Executive to a Deputy Chief Executive (delegation), from the Deputy Chief Executive to the Manager OIO (sub-delegation), and from the Manager OIO to the Team Manager OIO (second sub-delegation).
14. In this case, we had gathered evidence using the power contained in section 41 of the Act. This power allows the regulator to compel a person to provide documents or information. In practice, this power is not exercised by the regulator (the Chief Executive) and is instead exercised by others under delegation.
15. The initial notices fall into three classes:
 - (a) Initial notices issued by the Manager OIO (valid delegation);
 - (b) Initial notices issued by the Team Manager OIO (invalid delegation); and
 - (c) Initial notices issued by the Manager OIO, relying on information in responses to notices issued by the Team Manager (valid delegation, but tainted by the Team Manager's invalid delegation).
16. There was a high risk that the evidence gathered as a result of the second and third classes of initial notices above would have been likely to have been excluded by the Court (that is, the evidence may have been inadmissible). Neither the Manager OIO nor the Team Manager OIO was aware of the issues with the delegations at the time the notices were issued.
17. We stopped issuing notices when the delegation issue was brought to our attention.

¹ Section 41 provides that if the regulator has reason to suspect that a person has committed an offence under the Act, the regulator may, by notice in writing, require any person (A) to provide the regulator with any document or information that in the regulator's opinion may furnish evidence in relation to that offence.

² Attendance at an interview conducted by the OIO is voluntary. We do not have the power to compel an individual to be interviewed.

³ *Body Corporate Number 212138 v Minister for Land Information* DC Auckland, CIV-2012-004-2027, 31 January 2013. These proceedings did not relate to the OIO.

⁴ These delegations are prepared centrally for all of LINZ. The delegations were not prepared by the OIO.

18. We made a decision not to terminate the investigation but to *reissue* the initial notices in order to 're-gather' the evidence. It took seven months (July 2013–February 2014) to reissue the notices and re-gather the evidence.⁵

Resumption of the investigation

19. After this evidence was re-gathered, our investigation resumed and a number of additional notices were issued, the last being in July 2014.
20. We also interviewed a number of individuals (including both Mr Han and Mr Zhang), the last interview being on 29 August 2014.
21. All material lines of enquiry have now been exhausted.

The purchase of Motukawaiti Island, and other events

22. Two competing 'stories' emerge from the evidence gathered.
- (a) Our investigation proceeded on the suspicion that Mr Han and St Morris bought the Island on behalf of Mr Zhang, with the intention that Mr Zhang would ultimately become the owner.
 - (b) Mr Han and Mr Zhang would have us believe that Mr Han and St Morris bought the Island for their own purposes, financed with a loan from Mr Zhang.
23. During the investigation, we uncovered credible evidence of [REDACTED] on Mr Han's part, to the detriment of Mr Zhang. This [REDACTED] involves the inflation of the purchase price for the Island for the purpose of paying a finder's fee to Mr Han. While this could be a feature of either of the two 'stories' described above, my view is that it is more consistent with the 'story' that Mr Han and St Morris bought the Island for their own purposes, financed with a loan from Mr Zhang.
24. What follows at paragraphs 25 to 70 is a narrative which applies equally to the two stories. That is followed at paragraphs 71 to 92 and 93 to 103 by accounts drawn from statements made by Mr Han and Mr Zhang respectively.

The purchase of the Island

QSG searches for a hotel investment in New Zealand

25. Qingdao Sanli Group Company, Limited (**QSG**) is a company based in Qingdao, China which specialises in the manufacture of water supply and pumping equipment, and also owns a hotel (The Sanli Morris Hotel) in Qingdao. The chairman and owner of QSG is Mingliang Zhang (Mr Zhang's father).
26. On 26 February 2010, Zhaoqun Zhou (**Mr Zhou**) contacted Haiming Jiang (**Mr Jiang**), who ran a New Zealand real estate website, to enquire about buying a property on behalf of a client⁶ for a total investment of approximately NZD \$10m. Mr Zhou's client was looking to invest in a property in New Zealand to use for employee holidays for 6-8 months of the year. The client was interested in a property close to tourist scenic areas, so that the accommodation could be opened to the public for the rest of the time. The client required accommodation with 30-40 rooms, and was interested in either renovating existing buildings or vacant land.
27. Mr Zhou also enquired about assistance for two families to emigrate from China to New Zealand.

⁵ Not all of the initial notices were reissued. Some of the initial notices (those issued by the Manager, but not in reliance on information gathered from responses to notices issued by the Team Manager) did not need to be reissued as the evidence would have been admissible. A small number of the initial notices yielded no useful evidence and were not reissued.

⁶ We have assumed that this client is QSG, and I believe that it probably is, but we cannot prove it. Mr Jiang says that Mr Zhou was calling on behalf of QSG, but it is unclear whether Mr Zhou made this claim or if Mr Jiang is merely assuming it to be so. Mr Zhou's initial email did not identify QSG as his client.

28. At the time, Mr Zhou was working as the general manager of Qingdao Chengxin Travel Service Co., Ltd, but in April 2010 he became the assistant general manager at QSG's hotel in Qingdao.
29. Mr Jiang introduced Mr Zhou to Mr Han, then working as a real estate agent, in April 2010. Mr Han was born in China and is a Chinese citizen, but has been residing in New Zealand since approximately 2001.
30. Mr Han showed Mr Zhou and Mr Zhang a number of properties in New Zealand, including the Hilton Hotel in Taupo.
31. While QSG chose not to invest in the Hilton Hotel, Sanley NZ Limited, a company owned by Mr Zhang, Mr Zhou and their wives, bought 22 units in the Westin Hotel at Lighter Quay, Auckland (**the Apartments**). The shareholders in the company were Mr Zhou and his wife Mingli Zhang (**Ms Zhang**), and Mr Zhang and his wife Guofeng Qu (**Ms Qu**). Although Mr Zhang denies any knowledge of this, the apartments were sold through several sets of hands contemporaneously, including to a company associated with Mr Han's ex-girlfriend Hang Yin (**Ms Yin**). The company in question made a significant profit as a result of the ultimate on-sale to Sanley NZ Limited. Mr Han denied any involvement in the transaction, but acknowledged that Ms Yin may have been involved.

St Morris agrees to buy the Island

32. On 1 July 2010, Mr Han entered into two interdependent sale and purchase agreements (**original agreements**). Mr Han agreed to purchase:
 - (a) the Island for \$10m (plus GST, if any); and
 - (b) a 72' motor launch (**MV Missionhills**), a marina berth and two car parks for \$2m (plus GST, if any).
33. On 2 July 2010, Mr Han incorporated St Morris, of which he was the sole director and shareholder. Note the similarities between the name of St Morris, and the hotel operated by QSG, the Sanli Morris Hotel.
34. On 8 July 2010, St Morris entered into two interdependent sale and purchase agreements (**replacement agreements**). St Morris agreed to purchase:
 - (a) the Island for \$12m (plus GST, if any); and
 - (b) MV Missionhills, a marina berth and two car parks for \$2m (plus GST, if any).
35. The only material differences between the original agreements and the replacement agreements were the identity of the purchaser (Mr Han/St Morris), the purchase price for the Island (\$10m/\$12m), and the purchase of the Island becoming subject to an existing tenancy. The tenancy was to be transferred to another company owned by Mr Han.
36. The vendor of the Island was Motukawaiti Island Trustee Company Limited, and the vendor of MV Missionhills, the marina berth and car parks was Northland Corporate Trustees Limited. The vendors were the trustees of trusts associate with Ray Arnesen (**Mr Arnesen**) and Helen Arnesen. The original agreements and the replacement agreements were executed by Mr Arnesen.

Financial arrangements

37. The \$500k deposit for the purchase of the Island was paid on 13 July 2010. The deposit for the purchase came from Mr Han's own funds and from family in China. See paragraph 87 for Mr Han's account of how the deposit was paid.
- (a) \$220k of the deposit was paid with funds drawn from a bank account in the name of Ms Yin's father.⁷ Ms Yin is Mr Han's ex-girlfriend. The funds came from the proceeds of the sale of the Apartments (see paragraph 31 for more information about the sale of the apartments).
 - (b) \$280k of the deposit was paid with funds drawn from a bank account in the name of Mr Zhou.
38. Also on 13 July 2010, St Morris entered into a term loan agreement with Mr Zhang.
- (a) The loan agreement provided for a term of 12 months, with repayment in one lump sum on the term expiry date along with interest at 5%. The first \$11.5m of the loan was to be secured by a registered first and only mortgage over the Island, with the remaining \$2.5m of the loan unsecured.⁸
 - (b) The loan was advanced for the specific purpose of assisting St Morris to settle its purchase of the Island. St Morris would be deemed to be in default of the loan agreement if it applied any part of the loan for any other purpose.
 - (c) If St Morris was unable to fully repay the principal sum together with interest and all other moneys outstanding on the term expiry date:
 - (i) St Morris was entitled to transfer the Island to Mr Zhang; and
 - (ii) Mr Zhang was entitled to request St Morris to transfer the Island to him.
 - (d) Such a transfer would constitute the Borrower's full and final discharge of its liabilities under the loan owed to the Lender.
39. From about 23 July 2010, Mr Zhou became involved in correspondence with Mr Han and Mr Han's/St Morris's lawyer, Haiyan Yang (**Ms Yang**). On 28 July 2010, Mr Zhou identified himself as the person in charge of the overseas business development department of QSG, and said he was helping QSG decide whether to lend money to St Morris. Note that this statement was made 15 days *after* the loan agreement between St Morris and Mr Zhang was executed. In response to a direct question from Ms Yang regarding whether the Act applied, Mr Zhou stated that neither Mr Han nor St Morris was acting as a 'middleman' or an agent for QSG.
40. In mid August 2010 (probably 16 and 17 August), a small group visited the Island for the purpose (according to Ms Yang) of assessing the feasibility of certain development plans. It is unclear who travelled in the group, though Mr Han, Mr Zhang, and Mr Zhou were all in New Zealand at the time. According to Mr Han's lawyer, St Morris's 'potential lender' (presumably Mr Zhang) was in the group.
41. In August 2010 Mr Han became the sole shareholder and director of a new company called Sanli Group Limited. The company was to take an assignment of a lease of all land and buildings on the Island. Again, note the similarity between the company's name, and QSG's name.

⁷ We have no evidence that Ms Yin's father played in part in the transaction. Ms Yin's father had not visited New Zealand since late 2008, making it less likely that he had played an active part in the transaction. Ms Yin had control of her father's bank account, and authorised the transaction in question.

⁸ The security being for less than the amount of the loan may simply have been an error. Originally, the loan and security amounts had been the same. However, a handwritten alternation to the amount of the loan was not matched with an amendment to the amount of the security.

Settlement of the purchase of the Island.

42. The purchases of the Island and the business (under the replacement agreements) were settled, and the lease of the Island was assigned to Sanli Group Limited, on 27 August 2010. A mortgage in favour of Mr Zhang was registered on 9 September 2010.

Visits to the Island

43. Mr Han and Mr Zhang both acknowledged that Mr Zhang and Mr Zhou made private visits to the Island on a number of occasions. Mr Zhang and Mr Zhou's families accompanied them on at least some of the trips.
44. Mr Han said that he refused Mr Zhang's offer to pay for the visit. Mr Zhang said that he thought Mr Han was operating a hotel business from the Island.
45. Mr Zhang said that Mr Han was present during some visits, but not on other visits.
46. The total number of visits is unclear, but was at least several.

Repayment of the term loan to Mr Zhang

47. On 2 August 2011, Mr Zhang and St Morris agreed to extend the period of the loan for a further 12 months. The agreement includes the same special conditions as the earlier agreement.
48. On 22 August 2012, Mr Zhang and St Morris again agreed to extend the period of the loan, this time for a further six months. Mr Zhang and St Morris also agreed to add an additional clause to the agreement:

If St Morris NZ Limited successfully sells the Step Island at a price above \$14,000,000, the Lender should get 15% share of the portion of the sale price exceeding \$14,000,000.

49. The third loan agreement required St Morris to repay the principal sum and interest by 26 February 2013.

Acquisition of the Island by Mr Zhang

50. St Morris did not repay the principal sum and interest to Mr Zhang on 26 February 2013 as required.
51. On 7 March 2013, Mr Zhang issued:
- (a) a statutory demand to St Morris, demanding payment of \$16.136m (being the principal sum plus interest); and
 - (b) a notice under section 119 of the Property Law Act 2007.
52. On 14 May 2013, Mr Zhang applied to have St Morris put into liquidation.
53. On 7 August 2013, Mr Zhang became the registered proprietor of the Island.

The payment of a "finder's fee"

54. In early 2010, Mr Arnesen was in financial difficulty. [REDACTED] say that Mr Arnesen told them that he wanted to sell the Island and they say that they knew Mr Han, who had suggested that he may be aware of a potential buyer.
55. We believe that Mr Arnesen arranged to pay three fees for the successful sale of the Island, and that Mr Han may have been an intended recipient of the largest of these fees.
- (a) The first two payments were to [REDACTED], and to [REDACTED]'s company [REDACTED]. The payments were NZD \$125k plus GST each, for "attendances re sale of Company assets to St Morris NZ Limited".

- (b) The third payment was a finder's fee, which was to have been \$1.6m plus GST. The finder's fee was claimed by [REDACTED], whose sole director and shareholder was [REDACTED]. We do not know whether or not this fee was actually paid.
56. The \$1.6m "finder's fee" may have had its genesis in an increase in the agreed purchase price for the Island.
- (a) The original agreements (1 July 2010) provided for the Island to be sold for \$10m plus GST.
- (b) The replacement agreements (8 July 2010) provided for the Island to be sold for \$12m plus GST.
- (c) On 9 July 2010, the day after the replacement agreements were executed, Mr Arnesen signed a document "confirming" that upon settlement of the sale of the Island, he would pay NZD \$1.65m plus GST (if the agreement for sale and purchase of the Island became unconditional by 16 July 2010) or NZD \$1.6m plus GST if the agreement became unconditional later. The document is not addressed to anyone in particular. The document purports to be an irrevocable instruction to Mr Arnesen's solicitor to make payment from the sale proceeds.
57. Initially, Motukawaiti Island Trustee Company Limited instructed its solicitors, Burton & Co, to undertake to pay this sum from the proceeds of sale. Burton & Co's undertaking was subject to a condition precedent that due diligence be completed within a certain time. The condition was not satisfied and the undertaking lapsed.
58. Upon settlement, [REDACTED] invoiced Motukawaiti Island Trustee Company Limited, the registered proprietor and vendor of the Island, for the finder's fee. The vendor declined to pay on the basis that the agreement to pay was with Mr Arnesen personally and not with the trust.
59. A document provided by a witness (**Witness A**) in response to a section 41 notice has additional information about the finder's fee. The document relates to a meeting held to discuss the finder's fee.
- (a) *"Appears Chinese principal does not know about this."*
- Witness A has told us that the Chinese principal referred to was the Chinese family introduced by Mr Han who Mr Arnesen met at the Island prior to entry into the sale and purchase agreement. We therefore suspect, but cannot prove, that the Chinese principal is either Mr Zhang or his father. Another witness (**Witness B**) has described the party that visited the Island as "the chairman and Chinese family." However, Mr Han and Mr Zhang have both said that Mingliang Zhang (QSG's chairman) had never visited the Island.
- (b) *"[REDACTED] says Chinese want some money."*
- Witness A says that they believe that "Chinese" was a reference to Mr Han. This is consistent with an earlier file note which talks of the purchaser taking proceedings against the vendor for payment of \$1.6 million + GST. "[REDACTED]" appears to be [REDACTED], whose company [REDACTED] was the recipient of one of the two \$125k finder's fees.
- (c) *"Chinese suggested they might bankrupt Ray."*
- We presume this is for non-payment of the finder's fee.

60. Court action to recover the \$1.6m finder's fee might have raised issues in respect of the sale and purchase transaction, including possible deception about the existence of the finder's fee. Witness A said:

If the Chinese family (including one known as the "Chairman") who had, according to Ray Arnesen, inspected the Island with Kevin (Wenning) Han prior to execution of the sale and purchase agreement were really the principal and had not been made aware of the "finder's fee" arrangement, they would have been concerned as the "finder's fee" had the effect of increasing the purchase price.

61. We understand that the \$1.6m may not have been paid, at least not in a lump sum as was possibly intended. A property in Fiji owned by Mr Arnesen was transferred to [REDACTED], possibly in part payment of the finder's fee. We are not aware of any other payment against the \$1.6m finder's fee.
62. Witness B has indicated that the "Chinese" was a reference to Mr Han, and the "Chairman's son-in-law". Witness B does not seem to know the identity of the "Chairman's son-in-law", but his description leads us to suspect that it may be a reference to Mr Zhou (despite Mr Zhou not, as far as we are aware, being the Chairman's son-in-law). Witness B was clear that Mr Zhang was not involved in the finder's fee transaction. Witness B also referred to the property in Fiji.
63. We have interviewed both Mr Han and Mr Zhang in respect of the suspected breach of the Act. Each was asked about the \$1.6m finder's fee. Each interview was conducted with the assistance of an interpreter.
- (a) Mr Han denied all knowledge of the finder's fee, and claims that the replacement agreements were to correct (for the vendor) a GST issue created by the original agreements. Mr Han said that the original agreements did not include the 'hotel business' and that the vendor would have been required to pay GST.
- In fact, the GST issue was resolved by the assignment of a lease of the Island to a company owned by Mr Han (making the sale of the Island the supply of a going concern, and therefore zero rated for GST). Against this background, we do not consider the payment of an additional \$2m to have been necessary to avoid the payment of GST. As a result, I do not accept Mr Han's explanation of the increase in the purchase price.
- (b) Mr Zhang denied all knowledge of the finder's fee and the original agreements. In stark contrast to the remainder of the interview, Mr Zhang became quite animated when we asked about these matters, and my impression was that the existence of the finder's fee and the original agreements came as a surprise to him.
64. Mr Zhou declined to be interviewed.

Other connections between St Morris and Mr Zhang/Mr Zhou

65. In November 2010:
- (a) Ms Qu applied for a Long-Term Business Visa for herself, Mr Zhang, and their child.
- (b) Mr Zhou applied for a Long-Term Business Visa for himself and Ms Zhang.
66. The proposed business for their Long-Term Business Visa applications was to establish a travel agency targeting high class travellers, the main service being a 10 day luxurious tour package of New Zealand by coach and yacht, which included sightseeing and activities. Advertising materials subsequently published by the travel agency business include references to the Island.
67. Work visas were granted to Mr Zhou and Ms Zhang in March 2011, and to Mr Zhang and Ms Qu in April 2011.
68. On 12 May 2011, Missionhills Group Limited was incorporated. The director was Ms Qu, and the two 50% shareholders were Ms Qu and Mr Zhou.
69. On 1 July 2011, St Morris sold MV Missionhills to Missionhills Group Limited.

70. Residence class visas were granted to Mr Zhang and Ms Qu in May 2012, and to Mr Zhou and Ms Zhang in June 2012.

Mr Han's explanation of the transaction

71. Mr Han's explanation was primarily given in a face-to face interview. On his solicitor's advice, Mr Han refused to allow the interview to be recorded.⁹ Small parts of the account which follows have also been taken from an affidavit Mr Han filed in proceedings brought against him by Mr Jiang (see paragraphs 26 above and 73 below for information about Mr Jiang).
72. Mr Han presented as an engaged and confident witness, he readily answered the questions posed to him, and often provided detail without being prompted to do so. Mr Han's answers were consistent with our knowledge of the transaction.
73. Mr Han was introduced to Mr Zhang by Mr Jiang, the operator of the "tradehouse.co.nz" website, which advertised New Zealand property opportunities to Chinese investors. Mr Jiang was a friend of Mr Han's family.
74. Mr Han had advertised an opportunity at the Hilton Hotel in Taupo on the tradehouse.co.nz website. He had previously been approached by one of the owners of the Hilton Taupo who was interested in selling units to Asian investors.
75. Mr Zhou had seen the advertisement on the website and approached Mr Jiang. A group (including Mr Zhang and Mr Zhou) were travelling from China and wanted to visit the hotel during their trip.
76. Mr Jiang picked Mr Zhang up from the airport, introduced Mr Zhang to Mr Han, and then left. Mr Han travelled to Taupo with Mr Zhang and his group and they stayed at the Hilton for one night, after which Mr Zhang's group travelled to the South Island without Mr Han.
77. Neither Mr Zhang nor his group invested in the Hilton Taupo.
78. At about the same time, Mr Han was introduced to Ray Arnesen, either by someone from the Hilton, or by [REDACTED] (who Mr Han described as '[REDACTED]'). Mr Han could not recall whether he was introduced to Mr Arnesen before or after he was introduced to Mr Zhang.
79. Mr Arnesen had a hotel in Paihia, and wanted to expand the hotel onto a neighbouring property and brand it as a Hilton. Mr Han's recollection is that Mr Arnesen provided him with plans for the hotel expansion as Mr Han knew about hotels. Mr Han knew that there were three Hilton hotels being planned: Paihia, Wellington, and Christchurch. He didn't consider that Wellington 'was on the agenda' but visited the other two locations.
80. While Mr Arnesen's main conversation with Mr Han was about the Paihia hotel, Mr Arnesen also told Mr Han that he had an island for sale. Mr Han did not discuss Mr Zhang with Mr Arnesen, instead he was thinking about other possible investors who were specialists in building or investing in hotels (and Mr Han says that Mr Zhang was not one of those).
81. Mr Arnesen provided Mr Han with a written valuation of the Island, which had not been formally put on the market. At the time, Mr Arnesen was living on the Island with his family.
82. Mr Han was interested in buying the Island himself. His intention was to "buy low" and "sell high". Development of the Island would involve multiple buildings of varying styles. Mr Han's inspiration was the 'Eagle's Nest' property in Russell.

⁹ Mr Han's solicitor said that he always advised his clients to refuse to allow interviews to be recorded.

83. Mr Han had two plans.
- (a) Mr Han's preferred option was to continue to own the Island while other investors built hotels on it. Mr Han would invite experienced investors to form a partnership with him. Mr Han had investors from Chong Qing and Xian in mind. He had been introduced to them through family connections.
 - (b) Alternatively, Mr Han would buy and on-sell to a developer at a profit. This would involve an investment of up to 18 months.
84. There was time pressure on Mr Han to conclude an agreement to buy the Island as Mr Arnesen said that there was another investor interested. Mr Han knew that Mr Arnesen would accept \$14m for the Island, the boat, and the marina berth. Mr Han didn't bargain with Mr Arnesen as he knew there was another buyer.
85. Mr Han incorporated St Morris to acquire the Island, boat and marina berth. Mr Han chose the name because it sounded good both in English and when transliterated into Chinese.
86. St Morris entered into two sale and purchase agreements with trusts associated with Mr Arnesen: one for the Island, one for the boat and marina berth. Mr Han did not visit the Island before signing the sale and purchase agreements.
87. The deposit for the purchase came from Mr Han's own funds and from family in China.
- (a) \$220k of the deposit was paid with funds drawn from a bank account in the name of Ms Yin's father (see paragraph 37(a) above for more information). Mr Han says that he asked Ms Yin for money, believing that she held joint funds arising from earlier residential property investments.
 - (b) \$280k of the deposit was paid with funds drawn from a bank account in the name of Mr Zhou. Mr Han borrowed these funds from his family in China, and paid them to Mr Zhou in renminbi in China. Mr Zhou then paid New Zealand dollars on behalf of St Morris in New Zealand.
88. Mr Han then visited China in July 2010 to get funding to complete the purchase.
- (a) Mr Han's first targets were people who wanted to invest in hotels (not Mr Zhang). Mr Han ascertained the investors' interest before leaving for China. However, the existing approved plans for developing the Island were not of sufficient scale for the investors to invest. The ability to build a larger hotel needed to be guaranteed before they could invest.
 - (b) "Plan B" was to borrow money to buy the Island, get the necessary consents, and then go back to the investors. [REDACTED]. Borrowing overseas also allowed him to borrow at lower interest rates.
 - (c) Mr Zhang was the first lender to respond. Mr Han didn't tell Mr Zhang about the boat and the marina berth, he simply asked for \$14m loan against security of a \$23m island. Mr Zhang asked what was being paid for the Island but Mr Han refused to say claiming it was a "business secret".
 - (d) Mr Zhang agreed to lend to Mr Han for 12 months, at 5% interest, and subject to a condition allowing the Island to be transferred to Mr Han in full and final settlement of all obligations under the loan agreement. Mr Han says that the condition was a requirement of Mr Zhang.
89. Mr Han's intention was to pay the interest on the loan by selling the boat, and repay the loan principal by seeking investors or selling the Island. Mr Han would ask to extend the loan if necessary.

90. Shortly after settling the purchase of the Island, Mr Han agreed to sell the boat to a company owned by Mr Zhang's wife, Guofeng Qu, and Mr Zhou. The proceeds of the sale of the boat were used to repay family in China who had lent money to pay the deposit for the Island, and invest in crude oil. The funds were not transferred to China via the banking system. Instead, Mr Han paid New Zealand dollars to Ms Qu in New Zealand, and Ms Qu paid renminbi¹⁰ to Mr Han in China. While we have been able to verify the payments to Ms Qu, we have been unable to verify the payment of renminbi in China.
91. At the conclusion of the loan period, Mr Han paid the interest with funds from family in China, and asked Mr Zhang to extend for a further two years. Mr Zhang only agreed to a one year extension.
92. At the conclusion of the second loan period, Mr Han was unable to pay the interest or repay the principal. He told Mr Zhang that he had someone who was interested in buying the Island. He asked Mr Zhang for a further extension and offered Mr Zhang a share of the profit from selling the Island. Mr Zhang agreed to a six month extension only and agreed to the profit share.

Mr Zhang's explanation of the transaction

93. Mr Zhang's explanation was primarily given in a face to face interview, with further information taken from a written statement dated 31 May 2013, and a letter sent by his solicitor dated 5 April 2013.
94. Mr Zhang was interviewed in Mandarin through an interpreter. Mr Zhang was not especially forthcoming. He answered the questions he was asked but had to be pressed for further detail. The language barrier may have contributed to this. As with Mr Han's account, Mr Zhang's account was consistent with our knowledge of the transaction. Mr Zhang expressly declined to answer questions about how the funds lent to St Morris were transferred to New Zealand, though I do not consider that matter to be relevant to the outcome of this investigation.¹¹
95. Mr Zhang remained impassive for almost the entire interview. He became animated only when we showed him the sale and purchase agreements entered into between St Morris and the vendor of the Island. He appeared to be surprised by the existence of the original agreements providing for the Island to be sold at a lower price.
96. Mr Zhang said that he was introduced to Mr Han at the Rainbow Hotel in Auckland in April 2010. He was introduced by a friend whose name he could not remember. Other evidence shows that Mr Zhang had travelled to New Zealand with Mr Zhou.
97. Mr Zhang said that he was living in China at the time, and owned a company involved in fire and rescue engineering.
98. Mr Zhang said that Mr Zhou acted as a tour guide for him.
99. Mr Zhang first learned of the Island when Mr Han showed him some information while in China in July 2010. Mr Han brought information about the Island and said that he had discovered a very good project. Mr Han said the return on investment was not bad and that he wanted to borrow some money to buy the Island. Mr Han said he could mortgage the Island and would pay interest.
100. Mr Han showed Mr Zhang a "valuation report" which showed that the Island was worth \$23m. Mr Zhang was shown a translation of the valuation and also had the valuation translated himself.
101. Mr Zhang agreed to consider lending money. After visiting the Island in August 2010, Mr Zhang believed that everything was okay and agreed to lend the money.

¹⁰ The renminbi is the official currency of the People's Republic of China.

¹¹ The funds were transferred in 21 transactions from a Chinese bank to a New Zealand foreign exchange agent. The total transferred was approximately \$16.7m.

102. Mr Zhang did not investigate St Morris' income, as Mr Zhang felt (from information from third parties) that Mr Han was "quite rich". Mr Zhang intended to rely on a mortgage to ensure that St Morris repaid the loan. As a result of the mortgage, Mr Zhang considered that the loan to St Morris was a safe investment. Mr Zhang took legal advice in China but did not take legal advice in New Zealand.
103. The loan agreement contained conditions allowing St Morris to give the Island, or Mr Zhang to take the Island, in full and final settlement and any of any liabilities under the loan agreement. Mr Zhang said that these conditions were added at his request and he considered that they were required for him to be able to enforce his security.

Approach to enforcement

104. Strictly speaking, the Guidelines only apply to decisions to prosecute. In my view however, they provide a useful framework for considering whether or not to take other enforcement steps, such as seeking a civil penalty.
105. A prosecution ought to be initiated or continued only where the Test for Prosecution is met. The Test for Prosecution is met if:
- (a) The evidence which can be adduced in Court is sufficient to provide a reasonable prospect of conviction – the Evidential Test; and
 - (b) Prosecution is required in the public interest – the Public Interest Test.
106. Each aspect of the test must be separately considered and satisfied before a decision to prosecute can be taken. The Evidential Test must be satisfied before the Public Interest Test is considered.
107. If there is insufficient evidence or if it is not in the public interest to prosecute, a decision of "no prosecution" will be taken. A decision of "no prosecution" does not preclude any further consideration of a case, if new and additional evidence becomes available, or a review of the original decision is required, though such a step will be rare.

The Evidential Test

108. Clause 5.3 of the Prosecution Guidelines provides that a reasonable prospect of conviction exists if, in relation to an identifiable person (whether natural or legal), there is credible evidence which the prosecution can adduce before a court and upon which evidence an impartial jury (or Judge), properly directed in accordance with the law, could reasonably be expected to be satisfied beyond reasonable doubt that the individual who is prosecuted has committed a criminal offence.
109. The Prosecution Guidelines provide that it is necessary that each element of the definition of 'reasonable prospect of conviction' be fully examined when considering the evidential test in each particular case. Clause 5.4 lists the six elements of the definition and comments on each.
110. Among other things, regard must be had for the credibility of witnesses, the admissibility of evidence, and any anticipated defences.

The Public Interest Test

111. Clause 5.5 of the Prosecution Guidelines provides that once a prosecutor is satisfied that there is sufficient evidence to provide a reasonable prospect of conviction, the next consideration is whether the public interest requires a prosecution. It is not the rule that all offences for which there are sufficient evidence must be prosecuted. Prosecutors must exercise their discretion as to whether a prosecution is required in the public interest.

Enforcement options

Possible offences against sections 42 and 43

112. I have considered whether there have been breaches of sections 42 (purchase without consent) or section 43 (defeating, evading, circumventing) of the Act.
113. My view is that there is no *reasonable prospect of conviction* in respect of suspected offending against section 42 and section 43. While there is evidence of offending, my view is that a court could not reasonably be expected to be satisfied beyond reasonable doubt that offences had been committed. I make this judgement having regard for the evidence available, the likely defences to be raised by the possible defendants, and my assessment of the creditability of the witnesses that they are likely to call.
114. I have considered whether we apply to the High Court for an order requiring the payment of a civil penalty under section 48 of the Act, and my view is that we cannot. The remedy under section 48 is statute barred.

Offence against s42 – Purchase by St Morris

115. Section 42 provides that a person who is required to apply for consent to an overseas investment transaction commits an offence if that person gives effect to the overseas investment without the consent required by the Act. Section 42 is a strict liability offence.
116. Overseas persons (section 7) and associates of overseas persons (section 8) require consent before giving effect to an overseas investment transaction (sections 11 and 22).
117. There is no question that the Island is sensitive land, that the transaction was given effect, and that consent had not been granted. What is in doubt is whether St Morris was required to apply for consent.
118. In my view, we cannot prove beyond reasonable doubt that St Morris was required to apply for consent. As St Morris was not an overseas person, we must instead prove that it was an *associate* of an overseas person (such as Mr Zhang). My view is that a court could not reasonably be expected to be satisfied beyond reasonable doubt that St Morris was an associate of an overseas person. I make this judgement having regard for the evidence available, the likely defences to be raised by the possible defendants, and my assessment of the creditability of the witnesses that they are likely to call.
119. My view is therefore that the Evidential Test, and thus the Test for Prosecution, in the Prosecution Guidelines is not satisfied.

What is an associate of an overseas person?

120. Section 8 provides that a person (A) is an associate of another (B) in relation to an overseas investment if:
- (a) A is controlled by B or is subject to B's direction;
 - (b) A is B's agent, trustee, or representative, or acts in any way on behalf of B, or is subject to B's direction, control, or influence, in relation to the overseas investment or the other matter;
 - (c) A acts jointly or in concert with B in relation to the overseas investment or the other matter;
 - (d) A participates in the overseas investment or the other matter as a consequence of any arrangement or understanding with B; or
 - (e) A would come within any of paragraphs (a) to (d) if the reference to B in any of those paragraphs were instead a reference to another associate of B.
121. It does not matter whether the control, direction power, influence, arrangement, or other relationship between A and B is direct or indirect, general or specific, or legally enforceable or not.

122. There has been relatively little judicial guidance on the definition of 'associate'. In *UBNZ v Stiassney*, the only case I am aware of that directly addresses the definition of 'associate', Harrison J said:¹² **(emphasis added)**

[15] The OIA proceeds on the unequivocal premise that it is a privilege for overseas persons to own or control sensitive New Zealand assets. Its purpose is, first, to require overseas investments in those assets before being made to meet specified criteria for consent and, second, to impose conditions on those investments. The Act defines "overseas persons" as either an individual who is neither a New Zealand citizen nor ordinarily resident here, or a body incorporated outside New Zealand, or a 25% or more shareholder in a local company. **It defines the "associate" of an overseas person expansively, for the apparent purpose of preventing such a person from circumventing its provisions by operating through the medium of a third party such as an agent, nominee or co-venturer.**

123. In this case, the two limbs of the definition of associate that are most likely to apply are:

- (a) A acts jointly or in concert with B in relation to the overseas investment or the other matter; and
- (b) A participates in the overseas investment or the other matter as a consequence of any arrangement or understanding with B.

Is St Morris an associate of an overseas person?

124. In my view, we cannot prove beyond reasonable doubt that St Morris is an associate of Mr Zhang. While there is considerable evidence that Mr Han and St Morris *are* associates, there is also evidence to the contrary. On balance, my view is that a court could not reasonably be expected to be satisfied beyond reasonable doubt that offences had been committed. I make this judgement having regard for the evidence available, the likely defences to be raised by the possible defendants, and my assessment of the creditability of the witnesses that they are likely to call.

125. We need to infer from the evidence that a scheme was put in place to ensure that Mr Zhang would ultimately own the island without the need to obtain consent. The inference from the evidence would have to be so credible that a court would be satisfied beyond reasonable doubt that an offence had been committed.

- (a) Mr Zhou's interest in hotel investments

Mr Zhou had enquired about hotel investments in New Zealand, probably on behalf of QSG, a company controlled by Mr Zhang's father. This enquiry was ultimately handled by Mr Han. The fact that Mr Zhang shortly then lent Mr Han's company, St Morris, money to acquire a resort island easily leads to a suspicion that St Morris was an associate of either Mr Zhang or QSG.

- (b) Mr Han's companies were similar to QSG's name

Two of Mr Han's companies, St Morris and Sanli Group Limited were similar to the names of QSG (Qingdao Sanli Group Company, Limited) and QSG's Qingdao hotel (The Sanli Morris Hotel).

- (c) The purchase was funded by Mr Zhang

St Morris did not have the resources to acquire the Island without assistance. Ultimately, the entire purchase price came from third parties (Mr Han's family, Mr Han's ex-girlfriend, but mostly from Mr Zhang). Mr Han had none of his own funds in the Island.

¹² *UBNZ Assets Holdings Ltd v Stiassney* HC Auckland CIV-2010-404-3263, 14 June 2010 at [15]

Even the money used to repay Mr Han's family in China ultimately came from Mr Zhang. Mr Han used the proceeds of the sale of MV Missionhills (bought with funds borrowed from Mr Zhang) to repay his family.

The loan agreement was generous to St Morris, though probably not to the point of being commercially unrealistic. The interest rate was low by New Zealand standards, and Mr Zhang had no recourse to St Morris or Mr Han's other assets on default (St Morris could simply transfer the Island to Mr Zhang in full settlement of all amounts owing¹³). The loan was in New Zealand dollars meaning that Mr Zhang took on a considerable foreign exchange risk.

(d) Sale of MV Missionhills

St Morris sold MV Missionhills to Missionhills Group Limited, a company owned by Ms Qu (Mr Zhang's wife) and Mr Zhou, on 1 July 2011, less than a year after St Morris acquired her. Mr Han says that after acquiring the Island he was short of funds and wished to sell MV Missionhills. Mr Han says that selling the boat had always been one way that he could have paid the first year's interest.

Given the parties to the transaction, it is conceivable that the sale of MV Missionhills was planned prior to the acquisition of the Island, and therefore might evidence an arrangement or understanding between Mr Han and Mr Zhang. If Mr Han had paid the interest to Mr Zhang using the proceeds of the sale of MV Missionhills, then Mr Zhang and Ms Qu would have obtained the boat without expending any money other than the original loan to Mr Han to purchase it.

(e) Visits to the Island

Since St Morris bought the Island, Mr Zhang has visited a number of times for 'pleasure'. Mr Zhang's visits are unusual given that he is only a lender to St Morris, and is not an owner of the Island. Mr Han says that he declined Mr Zhang's offer of payment to use the Island.

(f) Mr Zhang now owns the Island

Significantly, Mr Zhang now owns the Island. If Mr Han and Mr Zhang always intended that Mr Zhang ultimately own the Island, then their intention has been given effect.

126. Against that, we must consider evidence that casts doubt on the associate relationship.

(a) Mr Zhou's interest in hotel investments

The Island did not meet the criteria Mr Zhou had set for a hotel investment. Mr Zhou said QSG was interested in 30-40 rooms and was prepared to invest approximately \$10m. The Island had several rooms at most, and required more than \$10m to buy. Increasing the accommodation to 30-40 rooms would have required a significant investment and would have been very difficult to get resource consent for.

(b) The loan agreements

Mr Zhang says that he considered the loan to be a safe investment, being secured by a mortgage over an asset he believed to be worth \$23m. The interest rate was considered to be a market rate by Chinese standards. The ability for St Morris to give or Mr Zhang to take the Island in full settlement of amounts owing was seen by Mr Zhang as the means by which he could enforce his security.¹⁴

¹³ Non-recourse lending is common in parts of the United States, but in my experience is very uncommon in New Zealand.

¹⁴ Mr Zhang's insistence on the inclusion of those clauses might simply evidence an ignorance of New Zealand law, as the clauses were not actually required in order to enforce his security.

The third term loan agreement (the second extension) included a new clause: If the Island was sold by St Morris, then Mr Zhang would be entitled to 15% of the purchase price above \$14m. It follows that St Morris would be entitled to the remaining 85% of the purchase price above \$14m. Mr Han says that this clause was required by Mr Zhang at a time when St Morris was seeking an extension to the loan despite being unable to pay the interest it owed.

In my view this is less consistent with St Morris being an associate of Mr Zhang, and more consistent with Mr Zhang wanting a higher return on his loan. I consider that Mr Zhang would have expected a much higher percentage if St Morris was selling an island which he was expecting to ultimately acquire himself.

(c) Sale of MV Missionhills

The proceeds of the sale were used to repay Mr Han's family in China, and to make unrelated investments. The fact that the sale proceeds were not repaid to Mr Zhang weakens the arguments that the sale of MV Missionhills was part of an arrangement or understanding between Mr Han and Mr Zhang.

(d) Mr Zhang's actions to enforce the loan

Mr Zhang's enforcement actions to recover the loan from St Morris are consistent with a lender-borrower relationship. Rather than simply taking the property under the terms of the loan agreement, Mr Zhang first pursued other enforcement options, including issuing a statutory demand and applying to the High Court for an order putting St Morris into liquidation.

The Island is now being marketed for sale by Mr Zhang. A statement on one website reads:

We acquired this island as a result of a mortgagee deal. The purchase price and finance costs to date add up to \$16 million NZD. Due to the fact that we have commitment [sic] elsewhere, the price is negotiable.

(e) Visits to the Island

Mr Han and Mr Zhang's accounts diminish the significance of Mr Zhang's visits to the Island. Mr Han says that Mr Zhang offered to pay for his visits, an offer refused by Mr Han. Mr Zhang says that he thought Mr Han was operating a hotel business from the Island. If these accounts are correct, then the visits are significantly less relevant than they might initially seem. We have no evidence which contradicts these accounts.

(f) The original agreements and the finder's fee

Mr Han says that he did not tell Mr Zhang about either the purchase price for the Island or the original agreements and the increase in purchase price. It appears that Mr Zhang learned of the true purchase price and the original agreements from us in the course of being interviewed. It is reasonable to infer that Mr Han did not tell Mr Zhang as Mr Zhang may not have lent to St Morris had he known about the purchase price and the earlier agreements.

The evidence is consistent with Mr Han being a party to the finder's fee transaction. In light of the increased purchase price under the replacement agreements, any finder's fee was essentially being paid by the borrowing from Mr Zhang.

In my view, the evidence of Mr Han being a party to the finder's fee transaction casts doubt on the existence of an associate relationship.

(g) Mr Han and Mr Zhang's explanation of the transactions

Mr Han says that he had plans for the development of the Island. These plans did not involve Mr Zhang at all initially, and eventually involved Mr Zhang as a lender only. Against this, Mr Han was unable to provide documents to corroborate his stated development plans.

Mr Han was adamant that Mr Zhang was merely a lender to St Morris. I consider that he would be a credible witness (see paragraph 72 above).

Mr Zhang was equally adamant that he was merely a lender to St Morris. While Mr Zhang was less forthcoming than Mr Han, he still presented as a credible witness despite language difficulties (see paragraph 94 above).

127. In summary, my view is that the evidence of the finder's fee transaction, Mr Zhang's actions to enforce the loan, and the content of Mr Han's account in particular cast reasonable doubt on the existence of an associate relationship. Accordingly, I consider that there is no reasonable prospect of a conviction and that the Evidential Test in the Prosecution Guidelines is not satisfied.

Offence against s42 - Mortgage interest acquired by Mr Zhang

128. Section 42 provides that a person who is required to apply for consent to an overseas investment transaction commits an offence if that person gives effect to the overseas investment without the consent required by the Act. Section 42 is a strict liability offence.
129. Overseas persons (section 7) and associates of overseas persons (section 8) require consent before giving effect to an overseas investment transaction (sections 11 and 22).
130. There is no question that the Island is sensitive land, that the transaction was given effect, and that consent had not been granted. What is in doubt is whether Mr Zhang was required to apply for consent.
131. To succeed, we must prove beyond reasonable doubt that Mr Zhang:
- (a) Was required to apply for consent;
 - (b) Gave effect to a transaction; and
 - (c) Did not have consent.
132. We can easily prove the second and third elements of the offence, the matters are not in dispute.
133. However, I am not satisfied that we can prove beyond reasonable doubt that Mr Zhang was required to apply for consent. I expect that Mr Zhang would argue that the mortgage was exempt under regulation 33(1)(h) and my view is that we cannot show otherwise.

Exemption for security arrangements

134. Regulation 33(1)(h) provides that the requirement for consent does not apply to the acquisition of interests in land under certain security arrangements. If a defendant puts the exemption in issue in a prosecution, we must prove beyond reasonable doubt that the exemption does not apply.¹⁵
135. For the exemption to apply, the security arrangement must:
- (a) in substance secure payment or performance of an obligation (regardless of the form of the transaction or the identity of the person who has title to the securities or rights or interests); and
 - (b) be entered into by the parties in good faith and in the ordinary course of business; and
 - (c) require that the securities or rights or interests be retransferred to the original transferor or extinguished on the payment or performance of the obligation.

¹⁵ Prior to 1 July 2013, the burden was on the defendant to prove on the balance of probabilities that the exemption applied. The burden was reversed with the repeal of section 67(8) of the Summary Proceedings Act 1957.

136. In my experience, the most significant element of the exemption is the requirement that the security arrangement be entered into in good faith. My view is that 'in good faith' requires that the lender's purpose for a transaction be consistent with the purpose of the Act. In other words, the transaction cannot be for the purpose of gaining ownership or control of sensitive New Zealand assets without first obtaining consent under the Act.¹⁶
137. A transaction will be "in the ordinary course of business" if an objective observer would view it as having taken place in the ordinary course of business. The expression is not capable of further definition, and instead is simply a question of fact to be determined in each case.

Did the exemption apply?

138. In my view, we cannot prove beyond reasonable doubt that the mortgage granted to Mr Zhang was not exempt under regulation 33(1)(h).
139. It is clear that the mortgage secured the repayment of the loan from Mr Zhang, and section 97 of the Property Law Act 2007 provides that the mortgage must be discharged (extinguished) upon repayment of the loan, if required by the mortgagor.
140. This leaves only the requirements for the security arrangement to be in good faith and in the ordinary course of business.

(a) Good faith

While Mr Zhang did ultimately become the registered proprietor of the Island, we cannot prove that this was his purpose for lending the money. In fact, there is evidence to support the proposition that Mr Zhang was nothing more than a lender to St Morris, including the fact that enforcement action was taken when St Morris defaulted on repayment of the loan. We have no evidence of day-to-day involvement with Island, other than Mr Zhang's occasional recreational visits.

This evidence is sufficient, in my view, to cast reasonable doubt on the proposition that Mr Zhang's intention was to obtain ownership of the Island.

(b) Ordinary course of business

In my view, an objective observer would view the loan as having been made in the ordinary course of business. While the loan terms were unusual (at least by a New Zealand standard), interest was paid initially, and after St Morris defaulted, both insolvency and Property Law Act enforcement action was taken.

Offence against s43 - Defeating, evading, or circumventing the operation of the Act

141. Section 43 provides that a person commits an offence if they knowingly or recklessly enter into a transaction, execute an instrument, or take any other step, for the purpose of, or having the effect of, in any way, directly or indirectly, defeating, evading, or circumventing the operation of the Act.
142. To succeed, we must show that the actions of St Morris, Mr Han, and Mr Zhang were for the purpose of or had the effect of defeating, evading, or circumventing the operation of the Act. We must also show that they knew or were reckless as to the purpose or effect of their actions.
143. In substance, we must prove beyond reasonable doubt that it was Mr Han or Mr Zhang's intention that Mr Zhang ultimately own the Island. My view is that we cannot do that.
144. While Mr Zhang ultimately became the owner of the Island, my view is that the transaction will only have defeated, evaded, or circumvented the operation of the Act if Mr Zhang had always intended to become the owner of the Island.

¹⁶ This is the approach taken by Ronald Young J in *The Pharmaceutical Society of New Zealand v Peter Alexander Barron* [2003] 3 NZLR 69. This case related to an almost identical exemption to the "one pharmacist, one pharmacy" rule in the Pharmacy Act 1970 (since repealed).

145. For the reasons set out above in respect of whether Mr Han or St Morris was an associate of an overseas person, my view is that we cannot prove that beyond reasonable doubt. Accordingly, I consider that there is no reasonable prospect of a conviction and that the Evidential Test in the Prosecution Guidelines is not satisfied.

A civil penalty is unavailable

146. While the evidence is insufficient to secure a conviction, the Act also provides for the imposition of civil penalties. One difference between the criminal and civil penalty regimes is that the standard of proof for civil penalties is lower: *on the balance of probabilities* instead of *beyond reasonable doubt*.

147. While we have insufficient evidence to prove offending beyond reasonable doubt, I consider that the evidence may support the imposition of a civil penalty.

148. However, in this case, I consider that the civil penalty remedy is statute barred.

(a) For acts or omissions prior to 1 January 2011, the limitation period is two years: section 4(5) of the Limitation Act 1950.

(b) As the agreement to acquire the Island was entered into in July 2010, the limitation period expired in July 2012. I note that as at July 2012, we would have had insufficient evidence to justify seeking a civil penalty.

149. Note that for acts or omissions on or after 1 January 2011, the limitation period is six years, or longer in the case of late notice: section 11 of the Limitation Act 2010.

Recommendations

150. I recommend that you agree that:

- (a) while there is evidence that the Mr Han and St Morris were associates of Mr Zhang, the evidence to the contrary introduces sufficient doubt that there is no reasonable prospect of securing a conviction; and
- (b) while there is evidence that the mortgage obtained by Mr Zhang was not in good faith, the evidence to the contrary introduces sufficient doubt that there is no reasonable prospect of securing a conviction; and
- (c) the Test for Prosecution is not met; and
- (d) we should close our investigation.

[SIGNED]

Annelies McClure
Manager, Overseas Investment Office

Agree: ☒

Disagree: ☐

Date: [30-Oct-2015]