

## **Direction to Callaghan Innovation—Administration of a Short-Term Loan Scheme to Support R&D-Performing Businesses in Response to the COVID-19 Crisis**

Under section 112 of the Crown Entities Act 2004, I direct Callaghan Innovation to put in place and administer a loan scheme to support businesses performing research and development (R&D) impacted by the COVID-19 pandemic.

Under section 103 of the Crown Entities Act 2004, I direct Callaghan Innovation to give effect to Government policy in the administration of that scheme as specified in this direction.

In this direction I clarify the policy objective and note the funding to be used to achieve that objective. I set criteria for Callaghan Innovation to adhere to in assessing proposals for the R&D loan scheme. I also provide direction on the terms that should be included in the loan contract, the processes that Callaghan Innovation should follow in administering the scheme, and the information that should be collected.

This notice uses the following format:

- Policy objective
- Funding to be allocated by Callaghan Innovation
- Criteria to be applied in assessing applications
- Loan terms
- Administrative processes
- Collection and provision of information

### **Policy Objective**

The objective of this scheme is to encourage R&D-performing businesses impacted by the COVID-19 pandemic to maintain R&D activity in the year from 1 July 2020 to 30 June 2021. It is intended to supplement or replace private sources of funds that are temporarily reduced or unavailable because of the impact of COVID-19. It is not intended to be a permanent or long-term replacement for those other sources of funds.

### **Funding to be Allocated by Callaghan Innovation**

Callaghan Innovation will use funds from the Short Term Research & Development Loan Scheme category of the “Research, Science and Innovation: Callaghan Innovation - Operations” Multi Category Appropriation for the loans.

### **Criteria to be Applied in Assessing Applications**

Callaghan Innovation must make funding decisions in accordance with the:

- Public Finance Act 1989;
- Criteria specific to the initiative, which relate to:
  - Business Eligibility;
  - COVID-19 Impact; and
  - Eligible R&D Activity.

### **Business Eligibility**

Only businesses are eligible to receive funding via this scheme. To be eligible for a loan under this scheme a business must satisfy the following criteria:

- The business must, as at 1 April 2020, be one of the following entities:
  - a Company registered under the Companies Act 1993; or
  - a Limited Partnership registered under the Limited Partnerships Act 2008; or
  - a Māori incorporation or a trust established under Te Ture Whenua Māori Act 1993, a trust established on behalf of Māori claimants to receive and manage assets as part of the settlement of a claim under the Treaty of Waitangi, a Māori statutory body, or a business that is controlled by one or more of these types of Māori entities.
- A business may not be:
  - an entity listed in schedule 1 of the State Owned Enterprises Act 1986 or listed in schedule 4A of the Public Finance Act 1989 or an entity established under or governed by the Education Act 1989, Crown Research Institutes Act 1992, Local Government Act 2002, Local Government (Auckland Council) Act 2009, the New Zealand Public Health and Disability Act 2000, or the Crown Entities Act 2004; or
  - an entity that is 50 per cent or more owned by one or more of those types of entities.

- Callaghan Innovation must be satisfied that providing a loan to the business would not bring the reputation of Callaghan Innovation, the Government, or the R&D loan scheme into disrepute.
- Businesses must meet financial due diligence requirements sufficient to justify awarding the loan.

Businesses that have shown that they qualify for another form of government R&D support, including the R&D Tax Incentive (RDTI), R&D Growth Grants, and R&D Project Grants, should normally be deemed to have satisfied these criteria. Other businesses should be assessed more thoroughly against these criteria.

### **COVID-19 Impact**

To qualify for the loan, a business must be able to provide evidence that its ability to fund its R&D activity is impacted by COVID-19.

In the application an authorised representative of the business must attest that:

- The business was financially solvent prior to the impact of COVID-19; and
- relative to its position prior to the impact of COVID-19, the business has experienced or reasonably expects to experience a 30 percent or greater drop in the availability of private sources of funding that would have been used to fund eligible R&D activities over the year from 1 July 2020 to 30 June 2021.

Evidence that the business qualified for the COVID-19 Wage Subsidy should normally be considered as sufficient evidence that the business has experienced the requisite drop in private sources of funding if its circumstances have not changed significantly since that date.

The business must retain evidence to support its attestation that it satisfies the conditions above, and be in a position to provide this information on request.

### **Eligible R&D Activity**

The intention is that the loan is used to support R&D activity that the business would have performed during the year from 1 July 2020 to 30 June 2021 without the existence of the scheme, but for the negative impact of COVID-19 on the availability of private sources of funding.

Research and Development are defined as follows:

- Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
- Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services before the start of commercial production or use.

R&D activity is distinguished from other activity by the presence or absence of an appreciable element of innovation. If the activity departs from routine and breaks new ground it is normally R&D activity; if it follows an established pattern it is normally not R&D activity.

#### *Clarifying Principle*

If necessary, when seeking to distinguish R&D activity from other activity, the further advice provided by the OECD Frascati Manual definition should be applied. R&D activity is distinguished from other types of activity by the presence of the following five criteria. The activity needs to:

- be novel;
- be creative;
- have uncertainty about the final outcome;
- be performed systematically; and
- lead to results that will be reproducible and have the potential for transfer (to increase the existing stock of knowledge).

#### *Exclusions*

The following types of activity are not Eligible R&D Activity for the purposes of the R&D loan scheme:

- Engineering follow-through in an early phase of commercial production.
- Activities related to the construction, relocation, rearrangement or start-up of facilities or equipment, other than facilities or equipment solely used for the businesses R&D (which may be included). Pre-production activities that occur before production but after scientific or technological uncertainty has been resolved are excluded.

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Excluded activities include: demonstrations of commercial viability, tooling-up for commercial production, planning the production process, developing control systems, undertaking start-up procedures, and commissioning new equipment.

- Routine, on-going efforts to refine, enrich, or otherwise improve on the qualities of an existing product or process, or to make cosmetic or stylistic changes to it. Where a competent professional knows that it is possible to successfully develop a product or adapt a process or recipe, and testing is only required to confirm or optimise the results, the activities are not eligible.
- Routine design of tools, jigs, moulds, and dies, or seasonal or other periodic design changes to existing products. However, expensed design activities involved in developing a new product or process are eligible.
- Activities involved in ensuring that existing products or processes comply with statutory requirements or standards, and quality control, routine testing or troubleshooting during commercial production. However, testing in search of significant product or process improvements is eligible. Tests to commission equipment, calibrate, fine-tune, or optimise processes or production systems are not eligible.
- Adapting an existing product or process to a particular customer's need or site. Activities to adapt an existing product or process to a customer's need or site using standard engineering approaches for problem solving are not eligible.
- Supporting, de-bugging, or making minor improvements to existing computer software. Activities using known methods to de-bug, support, or make minor improvements to existing software using methods that a competent professional familiar with that type of software knows could achieve the minor improvement are not eligible.
- Market research or surveys, market testing, market development or sales promotion, management studies, efficiency surveys, or the routine collection of information. This exclusion targets activities conducted to investigate consumers' preferences and/or potential interest in a product or service, or activities designed to encourage the consumption of products or services.
- Any costs involved in protecting, licensing, selling, or defending intellectual property or of acquiring or using external intangible assets (eg, patent licences). This exclusion is concerned with the commercial, legal, and administrative activity associated with taking steps to protect your own intellectual property and granting rights to another party to use or access your intellectual property, and covers patents, trademarks, designs, and plant breeders' rights. Patent searches that are undertaken to discover the existing state of knowledge may be eligible.
- Interest expenses or lease payments of any kind, and any overheads that are not closely linked to R&D activities. Exclusions include interest and other financing costs and any overheads that are not closely linked to R&D activities.
- Prospecting or exploring for minerals, petroleum, natural gas, or geothermal energy.
- Research in the social sciences, arts, and humanities.

No more than 10 percent of the loan funds can be spent on R&D undertaken outside of New Zealand.

### *R&D Activity Eligible for Other Forms of Government Support*

R&D activity that has been deemed to qualify for another form of government R&D support (including the RDTI, R&D Growth Grants, and R&D Project Grants) should normally be deemed to be Eligible R&D Activity for the purposes of the loan scheme. Other R&D activity should be assessed more thoroughly against these criteria.

### *Minimum R&D expenditure*

To be eligible to receive the loan, a business must:

- Plan to spend at least \$50,000 on Eligible R&D Activity during the year from 1 July to 30 June 2021; or
- plan to spend less than \$50,000 on Eligible R&D Activity during the year from 1 July to 30 June 2021 and for all of that Eligible R&D Activity to be performed by an organisation that is an Approved Research Provider under the RDTI scheme.

## **Loan Terms**

### **Loan Entitlement**

A business's maximum loan entitlement under the scheme is equal to the lower of:

- The business's Projected Eligible R&D Expenditure minus Other Forms of Government R&D Funding; or

- \$400,000.

The business's Projected Eligible R&D Expenditure is the business's projected expenditure on Eligible R&D Activity (as defined above) over the year from 1 July 2020 to 30 June 2021.

Other Forms of Government R&D Funding comprises any funding received from New Zealand Government sources that is intended to subsidise the cost of activities included in the business's Eligible R&D Activity.

For purposes of calculating Other Forms of Government R&D Funding, it is to be assumed that all businesses that are eligible for the loan are entitled to receive (at a minimum) support covering 15 percent of their R&D expenditure through the RDTI. This means that the maximum loan entitlement for any business will be 85 percent of its Projected Eligible R&D Expenditure.

#### **Use of Loan Funds**

The loan funds may only be used to pay for Eligible R&D Activity that the business planned to perform during the year from 1 July 2020 to 30 June 2021.

Callaghan Innovation should develop processes and/or include terms in the contract to ensure the business does not use the funds except to pay for Eligible R&D Activity.

Callaghan Innovation may grant permission to extend the period in which a business may spend the loan funds by up to six months (ie, until 31 December 2021) if:

- At the date on which the business applied for the loan, the business had planned to perform the R&D activity during the year from 1 July 2020 to 30 June 2021.
- The business was prevented from spending the loan funds on that R&D activity during the year from 1 July 2020 to 30 June 2021 due to circumstances beyond its control.
- The business provides Callaghan Innovation prior to 30 June 2021 with information to support granting the extension.
- Callaghan Innovation provides the business prior to 30 June 2021 with formal written confirmation of that extension.

If any loan funds have not been applied to fund Eligible R&D Activity by 30 June 2021, or such later date as agreed by Callaghan Innovation (as described above), Callaghan Innovation must require the business to immediately repay on the next working day those funds that have not been applied.

#### **Interest Rate**

An interest rate of 3 percent per annum will be applied to the loan. However, the loan will be interest free if repaid in full within the first year.

#### **Repayment and Recovery of R&D Loans**

Businesses are expected to repay the loan by regular instalments. Where the loan funds have been applied to fund Eligible R&D Activity, the obligation to make repayments begins three years after the date the loan is issued but a business may choose to start making repayments before this date. The loan must be repaid in full within ten years.

#### **Priority of Debt on Liquidation**

Debt issued under the scheme will be unsecured, non-preferential, and subordinate to all other forms of debt except equity.

#### **Default**

A default rate of interest may be charged from the point in time that a default event occurs. The default rate is to be set at Inland Revenue's use-of-money interest rate on underpayments of tax, plus three percentage points.

Default shall be defined through the loan contracts to include terms commonly used in loan agreements.

#### **Interaction with R&D Project Grants and R&D Growth Grants**

Funding received via the R&D Loan scheme can be used as co-funding for the purposes of meeting the co-funding requirements of R&D Project Grants and R&D Growth Grants, as set out in the Ministerial Directions for those schemes ([New Zealand Gazette, 21 April 2020, Notice No. 2020-go1694](#) and [New Zealand Gazette, 3 October 2018, Notice No. 2018-go4864](#)).

#### **Administrative Processes**

Callaghan Innovation will:

- Market the scheme and provide easy to access public information explaining its features.
- Seek out applicants from inside and outside the group of businesses it currently works with, where appropriate.
- Develop and implement processes for assessing businesses to ensure that planned and reported research and

development expenditure that is funded by loans is legitimate.

- Ensure that applicants and recipients of grants have access to complementary advice and services where appropriate.
- Gather data on business during and following the loan period, and on the operation of the R&D loan scheme to support programme uptake, monitoring and evaluation.
- Monitor the activities of the funded businesses during and following the loan period and implement repayment (including default provisions) mechanisms for loans.
- Require businesses to verify eligible R&D expenditure to which the loan proceeds have been used.
- Share information on the R&D Loan scheme with government departments and agencies, Callaghan Innovation's agents, and debt recovery or other organisations as required.

#### **Receipt of Applications**

Callaghan Innovation will open the R&D loan scheme to applications as soon as possible after this Ministerial Direction comes into effect and remain open until 31 March 2021, unless otherwise agreed with the Minister of Research, Science and Innovation.

#### **Audit of Loan Activity**

Loan recipients are expected to provide accurate application information and to spend the loan monies only on eligible R&D activities. To provide a level of assurance, Callaghan Innovation may audit loan recipients at its discretion, in accordance with the terms of the loan contract. Callaghan Innovation may vary the level of auditing or review it undertakes according to the level of risk posed by an applicant in its assessment, or following reporting at 12 months, or anytime during or following the loan period.

Callaghan Innovation will require loan recipients to hold information that supports the declarations they made in their applications so that the relevant documentation can be produced if that recipient is audited.

#### **Collection and Provision of Information**

Callaghan Innovation will collect business-level information to support monitoring and evaluation of the scheme, analysis of business performance, and other related research. Callaghan Innovation will obtain consent from loan applicants to share this information:

- With MBIE, for the purposes of monitoring and evaluation of the scheme and policy development more generally; and
- with Statistics New Zealand, for the purpose of making it available to researchers on a de-identified basis through the Longitudinal Business Database.

Callaghan Innovation will provide the Minister of Research, Science and Innovation and MBIE with regular reports on business uptake of the scheme and the expenditure of funds under the appropriation. Callaghan Innovation will notify the Minister of Research, Science and Innovation and MBIE:

- When 75 percent of the funds appropriated for the loan scheme have been committed; and
- as soon as possible when it has reason to believe that the funds appropriated for the scheme are likely to be fully committed before all eligible applications have been paid out.

Dated this 27th day of August 2020.

HON MEGAN WOODS, Minister of Research, Science and Innovation.