BUDDLE FINDLAY

# Navigating the minefield - offshore investing in New Zealand

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Australian and other offshore private equity firms investing in New Zealand will be familiar with the difficulties of navigating the country's notorious foreign investment laws, otherwise known as the OIO (Overseas Investment Office) regime. This article identifies some common challenges that arise in relation to the OIO regime and suggests some strategies to minimise complications.

## Trigger for consent

Under New Zealand law, an 'overseas person' must obtain consent under the Overseas Investment Act before acquiring an interest in 'sensitive land' or 'significant business assets' in the country.

An overseas private equity firm's acquisition of shares in a company that owns or controls an interest in sensitive land or significant business assets in New Zealand will require consent if it will result in the private equity firm having a 25 per cent or more ownership or, increases an existing 25 per cent or more ownership or interest.

If sensitive land is involved, consent is also required if the private equity firm's acquisition means that the company will become 25 per cent or more overseas owned or controlled (for example, if the private equity firm wants to acquire 5 per cent of a company that is already 23 per cent overseas owned or controlled, the private equity firm will need consent).

### Sensitive land

Land will be sensitive, regardless of its value, if it:

- Possesses a certain characteristic or feature (for example, if it is residential land, non-urban land, contains foreshore or seabed or lakebed, contains a reserve, or is a historic place) or adjoins land which possesses such a characteristic or feature
- Exceeds a specified area threshold (other than land including foreshore or seabed or that is residential land, which is always sensitive).

Any investment in a company owning non-urban land with an area exceeding five hectares (as typically seen in agricultural deals), or any residential land (for example, retirement villages) should raise a red flag but so too should less obvious examples such as the target company owning or leasing space in a heritage building (common in cities such as Wellington) or a factory/warehouse adjacent to a public reserve or a small creek or river.

### Significant business assets

The legislation also governs overseas persons' investments in New Zealand assets where the value of the assets of the target company (and its subsidiaries), or consideration paid, exceeds a specified threshold (generally, $NZ100m). When determining whether the threshold will be exceeded, investors should err on the side of caution and make allowances for variables in price, such as a working capital adjustment.

### Australian exemption

The legislation includes an exemption for investments by 'Australian non-government investors', which increases the monetary threshold at which consent is required for these investors to invest in significant business assets (up to $NZ530m at the date of this article). However, the exemption does not apply to investments in sensitive land – when sensitive land is involved, Australian investors are treated the same as all overseas persons.

This exemption is less helpful in practice than one might initially think. To rely on the exemption, the investing entity (ie the buyer/subscriber in the legal documentation) must not only be an enterprise located in Australia that is formed under Australian law, but it must also carry on 'substantive business operations in Australia'. So, a private equity fund would need to invest through an existing Australian incorporated portfolio company that had already made an investment or owned a business in Australia to rely on the exemption.

We generally see that, for offshore private equity funds, the benefits of investing in New Zealand through a newly established New

Zealand holding company outweigh the benefits of structuring the investment to fall within this 'Australian non-government investors' exemption. Hence this exemption is more commonly utilised by Australian trade investors rather than private equity firms.

## Criteria for consent

At a high level, to invest in significant business assets, an overseas person must be able to show the OIO that it and any other relevant overseas persons (ROPs) (for example, parent companies and co-investors) have business experience and acumen relevant to the investment; that the overseas person has demonstrated financial commitment to the investment; and that the ROPs are of good character.

If an ROP is not an individual, the criteria are assessed with reference to the individuals with control of the ROP (IWC).

Any of the executives of a private equity firm on a holding company board will be IWCs, however, not all individuals on an investment committee will necessarily be IWCs (because they do not control the investment in ordinary circumstances).

Where an overseas person is acquiring an interest in sensitive land, in addition to satisfying the criteria above, the investor will also need to meet one of several potentially applicable tests. The most well-known is the 'benefit to New Zealand' test. If the investment is in non-urban land over five hectares, the investor must demonstrate that the benefit to New Zealand will be, or is likely to be, substantial and identifiable (ie an even higher threshold).

As many offshore private equity firms will be aware, overseas investment has been a key focus for New Zealand's coalition government. To have any chance of successfully obtaining consent, an applicant must provide detailed and robust analysis of the benefits that will arise from the investment.

## Key considerations for offshore private equity firms

### Changes in fund investors may require OIO consent

A private equity manager making a seed investment for its fund in New Zealand, or an open-ended private equity fund investing in New Zealand, will need to keep a close eye on the ownership interests of its ultimate investors/limited partners to avoid inadvertently breaching the legislation.

The OIO will require full details of a private equity fund's ownership structure and ultimate investor list during the application process. Fund managers can take some comfort that the investor list is generally kept confidential by the OIO - however, a likely exception will be a 25 per cent or more investor in the fund. The OIO may consider any such investor to be an ROP, which means that the private equity fund manager will need to approach that investor for the necessary information about good character and business experience to provide to the OIO.

If the private equity fund's fundraising remains open at the time an application is submitted to the OIO (so that the ultimate ownership and control of the proposed investment is not entirely settled):

- Any new 25 per cent or more investor may require their own consent to invest in the fund
- Existing investors may need consent to increase their interest in the fund.

Therefore, the fund manager needs to be mindful of the exact ownership percentages of its larger investors.

Closing a fund and completing an equalisation adjustment may trigger the need for consent. For this reason, new funds may decide to wait until their fundraising is closed and their investor list settled before making any New Zealand investment that will require OIO consent. Alternatively, a fund may apply for an exemption for equalisation adjustments when making its initial application for OIO consent.

### Consent required for private equity fund increasing its ownership interest in NZ Portfolio Group

Any private equity investor that has structured its investment so that the vendors or management retains or takes an equity stake may need to obtain OIO consent for the private equity fund's ownership interest to increase over time.

A private equity fund deploying a buy-and-build strategy funded by debt and equity is likely to increase its ownership interest in the New Zealand investment, as participating management are typically unable to fund their pro rata share of a bolt-on acquisition. A private equity fund may also see its ownership interest creep upwards as a result of a working capital adjustment or successful warranty claim that is remedied through the private equity fund receiving additional shares. In either situation, the private equity fund's increase in ownership interest will require OIO consent if the portfolio company owns sensitive land or has gross assets worth more than $NZ100m, unless:

- An exemption applies, (for example, the 'shareholder creep' exemption)
- The initial consent is sufficiently broad where a future increase in the private equity fund's ownership interest in the investment is anticipated (for example, if the initial application seeks consent for a private equity investor to acquire up to 100 per cent of a

New Zealand investment over a specified time period).

Of course, any future bolt-on acquisition that itself involves sensitive land will require its own OIO application, to demonstrate the benefits to New Zealand that will result from the private equity fund's acquisition of that new land interest.

### Exiting an investment

Given the likelihood that a purchaser of a private equity firm's investment will be another overseas person, any overseas private equity firm investing in New Zealand should consider whether it can build up its portfolio company so that it does not include sensitive land. This would mean that, when the portfolio company is sold, it would only be necessary for the purchaser to consider whether the business asset threshold is crossed. If it is, the consent process is more straightforward than the process if sensitive land is involved.

This may not always be practical, but wherever a private equity firm can choose between its New Zealand portfolio company acquiring or leasing land that is sensitive or land that is not, then opting to steer clear of sensitive land not only spares the private equity firm pain and increased transaction costs at the time of its investment, but may also make for a much easier exit in future.

### Staggered investments and minority veto rights – watch this space

Given an investment in sensitive land or significant business assets through a company does not require OIO consent unless the investment will result in overseas persons holding a 25 per cent or more ownership or control interest in that company, it has to date been relatively common to see overseas investors acquiring up to 24.9 per cent of the shares, whether with the intention of maintaining a minority interest or with a view to later increasing its investment (subject to obtaining consent). It is also customary for any minority holder with less than a 25 per cent interest to want protective provisions built into the investment documentation, including a list of reserved matters that require super-majority approval before they can be implemented.

The OIO is increasingly scrutinising such stepped investment plans more closely and requiring foreign investors to offer a compelling commercial explanation for investing in two steps rather than seeking consent before making any investment. In particular, the OIO will assess any protective provisions and reserved matters to determine whether they confer 'negative control' on the overseas investor. If the OIO considers that an overseas investor has gained control of sensitive land or significant business assets even if that investor holds less than 25 per cent of the target portfolio company, the OIO is likely to take the view that its consent is required for the investment. Overseas investors will need to bear this in mind when negotiating such protective provisions.

## Conclusion

The fund structures and investment practices that private equity firms commonly adopt can create headaches when navigating New Zealand's OIO regime. Mistakes can be costly. We recommend that offshore private equity firms obtain professional advice at an early stage of any proposed investment in New Zealand to identify potential OIO challenges upfront and maximise the chances of successfully engaging with the OIO.

*This article was written by corporate partner Grant Dunn and senior solicitor Amy Cunniffe for the Australian Private Equity & Venture Capital Journal (June 2019).*


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