BUDDLEFINDLAY

Do parent companies bear the sins of their subsidiaries? The New Zealand perspective

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Although far from the heady pre-GFC days of 2007 and 2008, we are seeing increasing signs of life in Australasian private equity deal-making. By their nature, private equity investors sometimes tend to tolerate a slightly higher risk threshold than more conservative institutional investors. But a more bullish appetite for investment risk should not diminish the need for thorough due diligence on target companies, and in particular due diligence on a target's past and current compliance measures.

Recent developments in Europe should prompt local private equity investors to scrutinise the compliance culture of potential and existing portfolio companies both before and during their ownership. In early April 2014 the European Commission confirmed that a private equity investor can be jointly liable for the anti-competitive conduct of a portfolio company under its so-called "parental liability doctrine".

An investigation by European competition regulators found that the private equity investor's portfolio company had, both before and during its ownership, participated in a cartel involving market allocation and agreements to pre-determine ostensibly competitive tenders. The portfolio company was fined over €100m for its part in the cartel and the private equity investor was jointly and severally liable for €35m of those fines. The European Commission's decision followed from its decision in January 2014 to hold a German private equity fund liable for over €10m in fines levied against one of that fund's portfolio companies which had similarly participated in a cartel.

The question for local private equity investors following these developments is whether this "parental liability" approach might be adopted in New Zealand or Australia. New Zealand's courts largely respect the "corporate veil" and unlike their European counterparts, do not attempt to attribute liability further up the corporate chain to parent entities. For obvious reasons private equity funds rarely provide guarantees or letters of comfort in respect of their portfolio companies' financial obligations. But there are nonetheless certain circumstances, albeit narrow, in which a parent company may be called upon to make good or be held partly liable for the defaults of a subsidiary. For example, if a subsidiary has breached a contract, and it can be shown that the parent company induced that breach of contract by way of pressure or persuasion on the subsidiary to do so, the parent may be liable for such breach. However such cases are rare and typically require a degree of reckless action on the part of the parent company's directors.

For now it appears that New Zealand law, where the limited liability doctrine reigns supreme, is unlikely to follow the European example. The notion of parental liability as adopted by European regulators in these latest proceedings seems unlikely to gain traction in New Zealand any time soon. That said, private equity investors should not simply assume that all is right within their portfolio companies. Oversight of regulatory compliance is an essential part of prudent investment management. While parent entities of New Zealand companies are unlikely to be on the hook for large fines such as those seen in Europe, the level of fines imposed by New Zealand's courts in recent prosecutions highlights how anti-competitive conduct can have a costly impact on the (parent's) bottom line – something all investors have their eyes on.

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