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MAUI CAPITAL

5 June 2019

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By email

OVERSEAS INVESMENT ACT REFORM

Introduction

1. Maui Capital Limited ("**Maui Capital**") is pleased to have the opportunity to make a submission on Phase Two of the reform of the Overseas Investment Act 2005 ("**Act**") and the matters raised in the Treasury's consultation document "Reform of the Overseas Investment Act 2005" ("**Consultation Document**").

2. Maui Capital is a 100% New Zealand owned and operated fund manager. It has sole management responsibility for its two funds Maui Indigo Capital Fund and Maui Capital Aqua Fund (together referred to as the "**Maui Capital Funds**").

3. Each Maui Capital Fund is comprised of a (majority) New Zealand owned and controlled retail fund and a (minority) institutional fund consisting of a limited partnership, where the general partner is a New Zealander. The limited partners are Australian minority passive investors and are prevented from having any management or investments decisions under the Limited Partnerships Act 2008 ("**LPA**").

4. While Maui Capital Funds are effectively 100% New Zealand controlled, with a majority New Zealand investors, because the limited partner is Australian, Maui Capital Funds are overseas persons for the purposes of section 7 of the Act.

5. Maui Capital supports the objective of the reform, being to achieve the right balance between supporting high quality investment and ensuring governments have flexibility to manage any risks arising from overseas investment.

6. The focus of this submission is on the proposed reforms in the Consultation Document that aim to better identify the types of investors that require approval under the Act. Maui Capital agrees that the definition of overseas person does not always work well for entities that are effectively New Zealand owned or controlled and, in this respect, does not achieve the right balance between protecting sensitive assets and supporting investment.

7. The Consultation Document includes options for exempting companies that are effectively New Zealand owned or controlled and portfolio investors from the requirement to obtain consent under the Act. We submit that there are compelling reasons (consistent with the policy set out in the Consultation Document) for extending these options to limited partnerships registered under the LPA.

8. Under the status quo, some limited partnerships that are New Zealand controlled and otherwise pose very low risk are being constrained in their ability to develop private capital markets in New Zealand, contrary to the intent of the LPA and the Government's broader policy approach to overseas investment.

9. Maui Capital submits that the Act should be amended to allow for individual exemptions for New Zealand controlled limited partnerships if certain criteria are met (similar to Option 4 for portfolio investors and Option 4 for bodies corporate). The criteria could build on existing restrictions in the LPA as discussed further in this submission.

10. In this submission, we summarise the relevant features of limited partnerships and provide some further background to Maui Capital before responding to the Consultation Paper with a focus on limited partnerships.

11. Maui Capital would be happy to engage further with the Treasury on the matters raised in this submission, the Consultation Document and the Phase Two review more generally. Our contact details for this submission are:

John Sandford
Chief Operating Officer

DDI: [23]

[23]

Limited Partnerships

12. The LPA was introduced in 2008 with the intention of facilitating the development of New Zealand's private equity markets in order to improve New Zealand's competitiveness and achieve its economic development goals. The absence of an internationally recognised limited partnership arrangement was considered an impediment to New Zealand attracting venture and private equity capital investment.

13. The LPA provides for a partnership structure where limited partners, who provide the capital contribution to the partnership, have limited liability provided they are not involved in the management of the partnership. The general partner is responsible for the debt and liabilities and the management of the partnership.

14. Schedule 1 of the LPA sets out the "safe harbour" activities that do not constitute taking part in the management of limited partnership. The LPA also contains rigorous registration and reporting requirements.

15. Under Schedule 1:

(a) In relation to investment decisions:

(i) limited partners have a narrow power to approve or veto investment decisions involving more than half of the value of the limited partners assets. This is a passive power, providing a last resort protection mechanism for capital investors (for most funds it is most unlikely that any one transaction would meet this threshold).

(ii) the limited partner can also take part as a member of an Advisory Committee, but consistent with the broader prohibitions in the LPA, an

Advisory Committee has no ability to actively influence any investment decisions.

16. Schedule 1 also sets out limited approval powers in relation to a change of senior employees or contractors engaged by a general partner. A limited partner can also take part in certain decisions concerning the general nature of the business, continuation of the business, reviewing of accounts and conflicts of interests.

17. Limited partnership agreements can only contain provisions in relation to capacity, rights, powers and privileges if these are restrictive.

18. In Maui Capital's submission, these restrictions provide the relevant starting point for determining whether a limited partnership is effectively New Zealand controlled. To the extent that further conditions or criteria are considered necessary for the purposes of the Act, specific criteria should be developed that are applicable to the unique features of limited partnerships (in the same way criteria have been developed for bodies corporate and portfolio investors). This is discussed further below.

19. Maui Capital notes that Treasury has previously given consideration to updating OIO guidance so that New Zealand controlled limited partnerships could be added to the Schedule 4 list. We understand that the Treasury recommended this change when it reported to Ministers at the end of 2015 and that proposal received Ministerial support.[1]

Background to Maui Capital

20. Maui Indigo LP was the first limited partnership registered under the LPA, reflecting Maui Capital's long-standing commitment to develop private capital markets for growth in New Zealand businesses.[2]

21. The general partners of each Maui Capital Fund is a New Zealander and their limited partners are Australian. The general partners of each Maui Capital Fund have delegated exclusive management control to Maui Capital.

22. A key reason for bringing in established Australian investors (as passive investors under the limited partnership structure) alongside a majority New Zealand fund was to improve the credibility of the fund and thereby better attract private capital to invest in New Zealand companies. More specifically:

    (a) At the time Maui Capital was formed, there was no institutional option for raising private equity funds over a certain scale and size. This limitation was negatively impacting on growth in New Zealand businesses.

    (b) The Australian investors not only provided a source of funds for New Zealand businesses: their credentials and experiences as specialist investors encouraged New Zealand retail investors to invest in private equity markets on the scale required. In effect involvement of the Australian investor was a conduit (and necessary first step) in the development of private equity markets in New Zealand.

1 We understand that this process stalled when other reforms were prioritised. We also understand that changes to the 2018 Act mean that it may no longer be possible for New Zealand controlled entities to be added to the Schedule 4 list.

2 In a speech by the then Commerce Minister, Lianne Dialzel, to celebrate the enactment of the Limited Partnership Act, Maui Indigo LP was specifically mentioned as the first New Zealand Limited partnership that had raised in the vicinity of $250 million.

23. The investors in the Maui Capital Funds' limited partners are themselves passive fund managers, and allocate capital via the New Zealand general partner to a person such as Maui Capital to manage the funds for them. It is not their intent or desire to engage in investment selection or company management. As noted above, the 100% New Zealand controlled funds are dominant in the structure with the limited partnership required to always invest and divest with the New Zealand retail fund (limited partnership 40% to the New Zealand retail fund's 60%)

24. Maui Capital has worked hard to bring in established Australian investors in order to better attract venture capital for investment in New Zealand businesses. It created the limited partnership and majority / minority structure where these investors could take on an entirely passive role. However, Maui Capital's overseas person status under the Act does not assist it in retaining these investors and attracting capital.

Consultation document: The definition of overseas persons

Problem

25. Maui Capital agrees with Treasury's problem definition: that the application of the definition of overseas person to some New Zealand controlled or owned entities does not work well (paragraphs 98 to 101 of the consultation document).

26. Maui Capital also notes that the following problems identified in the Consultation Document in relation to portfolio investors and bodies corporate apply to limited partnerships, including that:

(a) the Act captures entities that some would fundamentally consider New Zealand companies and that this imposes significant costs on affected entities and the broader New Zealand economy (paragraph 104);

(b) there is a question whether screening should apply to transactions in which overseas persons do not obtain majority ownership or meaningful control of sensitive New Zealand assets (paragraph 122); and

(c) that imposing consent requirements on portfolio investors may disincentivise investment in New Zealand and can be particularly problematic given portfolio investors important role in meeting New Zealand's funding requirements and the unique expertise they offer to domestic partners (paragraphs 123).

27. That is, the Act captures some New Zealand controlled limited partnerships comprised of low risk passive investors that have no effective control, imposing disproportionate compliance costs and resulting in a negative impact on investment in New Zealand. As with portfolio investors, these issues are particularly problematic given limited partnerships role in facilitating investment in private capital investment in New Zealand companies.

28. The impact of the overseas person status is having ongoing effects for Maui Capital in a number of critical ways as summarised below:

(a) <u>Reputational damage:</u> The overseas person status is a particular issue for Maui Capital where it is understandably perceived by other companies and investors as a New Zealand investor. Once its overseas person status is understood, there is a negative reputational impact, where such negative reputational perceptions impact on future investment opportunities.

(b) Disadvantage compared to overseas controlled investors: Because of the overseas person status of the Maui Capital Funds, Maui Capital is at a disadvantage compared to other New Zealand managers when bidding for assets. This status also removes any competitive advantage Maui Capital has over overseas bidders for a New Zealand investment; an outcome that is perverse where Maui Capital can practically be described as a New Zealand controlled person.

The issue for a vendor is not only the conditionality of the offer and inconvenience of the OIO consent process, but the potential for Maui Capital's status as an overseas person to push the relevant company over the 25% overseas investment threshold (a situation which has arisen previously).

(c) Costs extend beyond application cost: The cost for an application to the OIO is in the region of $90,000 on a per transaction basis, including OIO fees. However, the implications of the overseas person status go beyond the costs of the application. This includes the cost of due diligence requirements for every transaction involving sensitive land, greater risk of losing a deal (and then bearing the costs of time, money and resources allocated to a transaction over a number of months) and costs relating to delay.

(d) Timing: timing and delay can be critical for a number of reasons, including in relation to a seasonal based investment. We have previously lost transactions because of the delays involved in the OIO process.

29. As noted above, these adverse impacts are not justified by reason of better achieving the objectives of the Act. Under the Maui Capital Funds structure there is negligible, if any risk of the Maui LPs exhibiting influence and / or acting contrary to New Zealand's interests.

30. Maui Capital has also found itself in the perverse position where it is an overseas person in both New Zealand and Australia (under the equivalent Australian legislation) yet has majority New Zealand investors and is wholly managed and controlled out of New Zealand.

Options

31. The options outlined in the Consultation Document for bodies corporate and portfolio investors could be adapted with criteria and requirements that reflect the unique features of limited partnerships.

Proposal: Individual exemption application (similar to Option 4 for bodies corporate and Option 4 for portfolio investors)

32. We submit that the Act should be amended to provide for an individual exemption application process that would be available to a relatively small number of New Zealand limited partnerships that are effectively New Zealand controlled.

33. An exemption application option would provide clarity for investors about how exemptions for limited partnerships would be applied while retaining a degree of flexibility for Ministers to address applications on a case-by-case basis. That is, a Minister would have be able to consider a particular limited partnership structure when assessing New Zealand effective control and could include further conditions to address any perceived risks.

34. Core criteria to be met in order to be considered for an exemption could include:

(a) the General Partner is New Zealand owned and controlled; and

(b) restrictions in relation to management and investment under the LPA are reflected in the partnership agreement and management structure.

35. In relation to any additional criteria, as a first point, the Schedule 1 veto / approval powers for investment decisions in the LPA should be accepted as appropriately limiting control of a limited partner. These powers are distinct from, and lower risk, than negative control powers arising from 25% or more shareholdings in companies (which are in themselves relatively low risk). Further, the veto / approval powers on investment decisions in the LPA sit within a highly prescribed regulatory environment intended to encourage investment in New Zealand from private capital investors who do not seek control.

36. Criteria to enable vetting of the partnership / fund structures in relation to considerations other than investment decisions could include matters such as:

(a) the partnership agreement / and or fund management structure prevents a limited partner from changing a General Partner or a contractor engaged by a General Partner (this could also be dealt with in conditions – see below); and

(b) the limited partnership and / or the General Partner connected with the limited partnership has a history of facilitating the growth of private capital investment in New Zealand.

37. The criteria could be supplemented by requirements that any exemption must be conditional on:

(a) the limited partnership not changing the nature of its business;

(b) the general partner or contractor engaged by the general partner remaining the same;

(c) no transaction entered into by the limited partnership / fund structure will result in majority overseas ownership in the target investment; and

(d) maintaining any other specified structural and management arrangements, if any, that were taken account when granting the exemption.

38. While the criteria should be sufficiently clear to enable a limited partnership to understand how the exemption application is likely to be assessed, ideally, they should provide flexibility to consider various structural arrangements that enhance New Zealand control of the limited partnership / investment in New Zealand companies.

39. As is proposed for an exemption for portfolio investors, the exemption would mean that another entity would not become an overseas person solely because of its connection with the exempted limited partnership.

40. In terms of assessing this option against the reform criteria in the Consultation Document, it would not have a negative effect in terms of managing risk and would likely be strongly positive in terms of supporting investment and improving predictability (as for the assessment of the exemption application options for bodies incorporate and portfolio investors in tables 4 and 5 of the Consultation Document).

Concluding remarks

41. The proposals above are consistent with options and reasons in the Consultation Paper for other entities that are effectively New Zealand controlled or owned and which are unnecessarily captured by the Act.

42. Ensuring that exemptions were available to New Zealand controlled limited partnerships will best ensure investors who pose low risk are not being unnecessarily impeded in their ability to grow private capital for the benefit of New Zealand. As noted above, we would be happy to provide any additional information in relation to the proposal above.

Yours Sincerely

John Sandford

Chief Operating Officer