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M&A Forecast 2022

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Overview

A very big year

At the beginning of last year, we predicted that New Zealand's comparative success with its COVID-19 response was likely to favour acquisition activity in 2021. But nothing prepared us for the onslaught of deal-making that followed. In this, our fifth annual M&A Forecast, we look back on the biggest year for M&A activity on record. We examine what we think has created the conditions for all these transactions and we make some predictions for the year ahead.

A year ago, Shamubeel Eaqub noted that while deal making had been disrupted by the Pandemic in 2020, low interest rates, abundant liquidity and traditional income investors looking for better returns, were likely to lead to increased global M&A activity in 2021. We thought that continued belief that New Zealand was a 'safe-haven' would drive more than its fair share of that activity to our borders. Dealmakers certainly arrived (virtually) in droves. But what really led them here?

The beginning of the year was marked by the sale of Pioneer's K9 branded pet food business to global private equity giant KKR for what is widely believed to be a record domestic PE return. That deal appears to have been a precursor for steadily increasing activity, as many businesses came to market to take advantage of higher-than-normal valuations, pushed up by domestic and international competition. KKR alone made two more acquisitions (notably our client – Ritchies Transport in August).

Activity increased throughout the year. Technology, financial services and healthcare all figured heavily in the deals brought to market with rapid consolidation in certain industries, such as Radiology where upwards of six large transactions have already been announced (including the sale of three of our clients, Auckland Radiology Group, Bay Radiology and Hamilton Radiology/Midland MRI).

By August, many advisers were reporting that they were struggling with capacity. By September, we heard of buyers being put on financial due diligence waiting lists by overstretched transaction teams. By October, the whole M&A industry appeared to be swamped. By early November, W&I Insurers announced that they would not commit to insure any further deals in 2021 due to team resourcing issues. At least one insurer announced that (for the first time) it had reached its maximum capacity for exposure to W&I in the current financial year.

Our experience is that deal volume has almost doubled. There has been a frenzy of activity with our M&A and banking teams working on well over 50 transactions.

It is fair to say that it is a sellers' market. Bid processes are receiving a lot of interest. Sell side advisers are running tight processes with vendor-friendly requirements. Warranty insurance is now widely required (with sellers refusing to accept any gap coverage). Material adverse change clauses are now very rare. Buyers appear to have become comfortable with the uncertainty surrounding the Pandemic and are keen to press on with deals, for fear of missing out.

And New Zealand is not alone. There has been a global explosion of activity that matches the New Zealand experience. Early in 2021, experts were predicting the biggest year on record by volume (USD4.5 trillion in 2015, being the previous pinnacle). Volumes blasted past the USD5 trillion mark by the end of August with some predicting that the final full year figure will top USD6 trillion.

So why are we so busy?

Twelve months ago, we argued that our 'safe-haven' status was driving international buyers to our shores. However, with Auckland having had 107 days of continual lockdown with little or no discernible impact on deal-making activity, it seems increasingly less likely that this has been the cause of the current boom. It seems instead, that a number of other global and local factors have all had their part to play.

Show me the money

The extraordinary fiscal stimulus worldwide appears to have boosted the Global economy and Shamubeel notes later in this Forecast that New Zealand's economy has fared better than most. Interest rates are low. Capital is abundant and cheap. Private Equity managers have successfully raised funds throughout the Pandemic. Corporates have money to burn. In short, if you want to buy a business right now, there is someone willing to give you the capital to do it.

Competition driving buyers further afield?

With a boom in activity across the globe, investors are finding the competition pretty ferocious. We've had clients tell us that this increased competition has prompted them to look at other, more distant markets. Combined with more frequent large deals being brought to the New Zealand market (see more on that below), we are now frequently of interest to some of the World's most ubiquitous investors. While major global Private Equity firms have dipped their toes in New Zealand waters before, they are now regular visitors. Firms such as KKR, Carlyle Group, Platinum, EQT, Advent International, and TPG have all shown an increased willingness to participate in New Zealand transactions.

The arrival of the global private equity firms has opened up another exit opportunity for the (relatively) mid-sized New Zealand and Australian private equity firms for their investments in New Zealand. With New Zealand continuing to grow in prosperity, and now well and truly established as a market for major global transactions, this is a trend that we expect will continue.

Is now (finally) the time?

The New Zealand M&A industry has been talking about the problem of succession for over 15 years. In 2005, ANZ published its first Privately Owned Business Barometer and declared that a large number of New Zealand private businesses were held by owner-operators that needed to plan for their retirement. In the intervening years, there has been plenty of adviser activity aimed at convincing owners to plan for succession. Relatively few have. Indeed, in most cases, all that has happened is that these owners have aged by 15 years. One consequence of these private owners holding on to the reigns for longer than expected is that their businesses have grown. In 2005, there were a huge amount of 'mid-market' privately held companies. Now, there are also a number of very large ones. These big family companies, have in many cases, become some of New Zealand's best known and most iconic businesses.

Our observation is that COVID-19 may well be the catalyst that finally sees these companies coming to market. There can be few among us who have not taken stock of their priorities over the last 24 months. The "Great Resignation" is in full swing and owners are thinking the same way. Anecdotally, many private owners are telling us that it's time to get out. They've seen large, high-profile, privately held companies come to market and get great outcomes. Their businesses are now big enough to ensure overseas interest. Some (sadly) have suffered from health issues, but after being locked up through much of 2021, many just want to get on with enjoying the spoils from all their successful years in business. We expect this trend to continue throughout 2022, with more and more private businesses coming to market to take advantage of the current conditions.

Doing deals in your living room

One thing that has markedly changed from 2020 is that buyers are simply unfazed by lockdowns or by the Pandemic generally. In March 2020, almost every single one of the transactions that we were involved with, when Jacinda Ardern announced our first lockdown, were abandoned or went on hold. In January, we noted that some overseas buyers remained reticent about making acquisitions without having 'boots on the ground' in New Zealand, but all that has changed.

Those days are gone

Technology and some clever thinking from our corporate finance colleagues has led to the birth of the truly virtual deal. Management presentations, negotiations and even site visits are all now conducted seamlessly online. In fact, our observation is that the vast majority of meetings in the first half of 2021 were conducted virtually. That meant that when Auckland entered Level 4 lockdown on 18 August 2021, we didn't miss a beat. Not one of our live deals was abandoned or even slowed down. In fact, we signed or closed upwards of 20 deals during the lockdown period.

It is clear that these changes to the way deals are conducted are here for good. We've set out some observations on virtual deal-making later in this report.

New Zealand's 'sweet spot' industries

In recent years, New Zealanders have been creating and growing great businesses in some very hot sectors. In particular:

Tech

There is global recognition of New Zealand's emerging status as a developer of innovative tech companies, with a number of these being acquired by global tech companies in 2021 (examples being when we acted for EverCommerce acquiring Timely for NZD140 million; for Livestock Improvement Corporation on its asset sale to MSD Animal Health for NZD38.1 million; and for Soul Machines in establishing a relationship with the World Health Organisation along with contractual arrangements and intellectual property implications.)

Healthcare

There has been a marked increase in quality healthcare assets coming to market, with New Zealand's healthcare sector enjoying overseas investor attention (we acted on Rangatira's acquisition of Boulcott Hospital, the purchase by Proactive Rehab of Waikato Occupational Health Consultancy, the sale of Auckland Radiology Group and Bay Radiology to Infratil and the sale of Hamilton Radiology to IMed).

Financial services

Our booming financial services sector is attracting international attention (an example being the recently announced sale of MMC by our client, Pencarrow Private Equity). The sector has been busy all year with deals such as Macquarie's agreement to acquire the Australasian Global Equity and Fixed Income (GEFI) business of AMP Capital. In addition, we continue to expect (and are starting to see) interest in acquiring KiwiSaver businesses following the Government's shakeup of the sector through its review of KiwiSaver default scheme providers (we acted for Aon when it sold its KiwiSaver business to Fisher Funds). The insurance sector also remains active, particularly with respect to life insurance businesses. Finally, a transaction such as the agreement by Square to buy Australian fintech provider Afterpay for NZD41 billion is also likely to encourage some focus on New Zealand's fintech sector, where a number of companies are starting to gain traction and grow steadily.

Insolvency

A year ago, we predicted that the Pandemic would start to bite in the second half of 2021, leading to an increase in distressed acquisitions. We have continued to see a trickle of insolvency-related transactions, with the winery industry in particular experiencing a number of insolvencies and distressed asset sales, including the receiverships of the Sacred Hill winery group (where we acted for the secured lender) and Carrick Vineyards (where we acted for the receivers). We have also acted for purchasers on various distressed asset sales, including the purchase of Drymix (in receivership) by Cemix. However, it remains the case that the majority of these insolvencies have eventuated from systemic issues in the relevant businesses that existed pre-COVID-19. The question is – will the Pandemic eventually bite and lead to a glut of transactions?

We are not so sure. We predict an increase in re-financings in 2022, but the jury is out on whether that will lead to increased M&A activity. One observation is that for businesses that are truly Pandemic affected (such as tourism and travel) the position may be pretty binary. There are examples of tourism deals in the market (for example, we acted for Fullers Bay of Islands who sold their tourism business to Explore). But we fear that for many, rather than sales, these businesses may simply be shut down or put into liquidation.

For many other businesses, the recent lockdown may well have been the final straw and so we will watch with caution. We know that the targeted Government assistance largely worked last time. Much will depend on how quickly we can emerge from this latest scare and how quickly we can open borders and kick start supply chains. In the meantime, continued high levels of liquidity will cloak underlying weaknesses in many otherwise at-risk businesses and any predictions of mass insolvency-related deal activity will be put off for another six months.

Warranty Insurance – has the shine come off?

There was a huge resurgence in the popularity of warranty insurance in 2021. There have been a great deal of hotly contested processes and it's a no-brainer to insist that bidders take out buy-side insurance and release the sellers from liability. The industry has had such a big year that by November, most of the insurers had to start refusing new deals due to an inability to resource them. However, this contest for insurer attention has been reflected in much higher pricing and more stringent terms. Whereas 12 months ago, cover was available at premiums equal to 1% or less of the cover sought, now the same premiums are getting nearer to 2%. Insurers are also now insisting on more exclusions and more onerous due diligence requirements. This is causing some sceptics to question the value of a product which, on the face of it, often no longer covers the key risks for a particular transaction. There is a balancing act with W&I insurance. Insurers are well within their rights to exclude known risks or areas where there has been no due diligence focus. However, if the product starts to become too full of coverage gaps and the pricing stays as high (or gets higher) we may start to see dealmakers vote with their feet and revert to traditional vendor-to-purchaser warranty and indemnity packages.

2022 – more of the same?

It's fair to say that advisers in the M&A industry are working hard on hiring and retention strategies, in anticipation of another big year.

We are already experiencing a very busy start to the year as many deals that signed at the end of 2021 will seek to close as regulatory consents are obtained in the first few months of this year.

And the current trend seems set to continue in 2022. The pipeline of deals coming to market does not appear to be shrinking. Our expectation is that activity levels will remain high throughout this year and it's hard to see what could change that outcome. If borders do open as planned, we expect to see more and more buyers hit our shores. Sectors such as healthcare, technology and financial services look set to continue to run hot. But we also think that the food and beverage sector will play a big part in 2022.

Economic outlook

Shamubeel Eaqub
Economist, author and
commentator

The outlook for the New Zealand economy and dealmaking in 2022 is positive, but with more risks than in 2021. A move from eliminating to suppressing Covid will mean infections, restrictions, fear and economic activity are likely to come in waves. This means more volatility and uncertainty against a backdrop of reducing policy stimulus.

The New Zealand economy was resilient in 2020 and 2021 despite the trials and tribulations of the COVID-19 pandemic. Elimination strategy meant short sharp lockdowns, with normal domestic economic conditions except for closed borders. Cumulatively, New Zealand had less restrictions than other OECD countries.

Massive policy stimulus, both from the central bank and government, boosted the economy too. The central bank lowered the cost of borrowing. The biggest boost came from a surge in mortgage lending from easier credit setting for banks, but this did not lead to more lending to businesses. Government support was instrumental in keeping workers connected to firms during lockdowns, which reduced job losses and interruption in the recovery.

The New Zealand economy performed the best of all OECD countries except Ireland, which was boosted by technology companies domiciled there. Employment is at record highs and unemployment at historic lows. Inflation is increasing too, although so far mostly due to global factors.

New Zealand will move to a suppression strategy in 2022. This means sustained moderate levels of restrictions domestically, while border restrictions will be eliminated gradually through 2022. Experience from countries like Singapore suggest these restrictions will dampen economic activity a touch.

More importantly, infections and hospitalisations are likely to rise. In winter, there could be a double peak of influenza and Covid, which could overwhelm our health system – which is under-resourced compared to other OECD countries – and lead to new restrictions as we have seen in the Northern Hemisphere winter.

New variants could similarly lead to yo-yo tightening and loosening of restrictions, or people choosing to be less active. The pandemic is not over yet and will continue to affect health and economic policies around the world.

An open border from later in 2022 will allow investors to do on-the-ground due diligence. There is pent up demand from those who have not been confident to do deals online or via local agents.

Unless the health or economic outlook changes materially, both the central bank and government will withdraw support from the economy in 2022. This follows a similar pattern globally: low interest rates and quantitative easing will be gradually unwound over coming years. This period of transition, from loose to tightening will lead to more volatility in access to capital, increase the cost of capital, and potentially reduce price multiples – which are currently at historic highs.

But we should not frame this as a negative outlook. The experience of the last two years is that central banks and governments will intervene at pace and scale when there is clear and present danger. We have also seen extraordinary innovation, flexibility and resilience in the economy, both here and around the world.

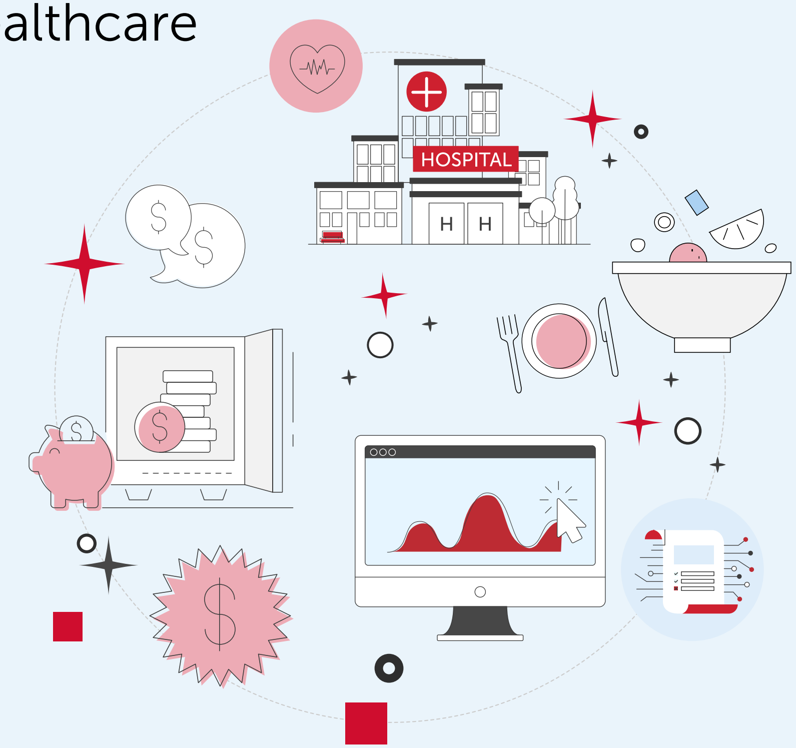
These paint an optimistic picture of the state of the economy, even if there are sustained risks from the pandemic, and growing risks from unwinding of policy stimulus. For dealmaking this means that demand for capital will remain high, but supply of capital and multiples less easy. Good deal making will need good advice and good networks, as always.

Trending sectors for 2022

We expect activity in the following key sectors to have an impact on M&A activity.

Healthcare

Food & beverage



Financial services

Technology

M&A trends – a breakdown by numbers

Private equity

Based on traditional holding cycles of three to five years, there are at least 86 investments ripe for divestment by Private Equity funds (both local and offshore). We expect many of these assets to come to market over the next few years.

M&A deals by the numbers

Source: MergerMarkets, 01/01/2021–23/12/2021

125 DEALS

- 50 Domestic
- 9 Public
- 75 Cross border
- 116 Private

Commerce Commission merger activity

Source: NZ Commerce Commission

- **10** Merger clearances
- **0** Declined
- **3** Withdrawn
- **8** Statement of issues given
- **0** Section 47 investigation*

*Where acquisition would substantially lessen competition in a market

Snapshot of sector deal activity*

* (where four or more deals have occured)

Source: MergerMarkets, current as at 23 December 2021

- Computer software – 21 deals
- Medical – 14 deals
- Consumer (other) – 11 deals
- Services (other) – 11 deals
- Consumer (foods) – 8 deals
- Transportation – 8 deals
- Industrial products & services – 7 deals
- Financial services – 5 deals
- Leisure – 5 deals
- Real Estate – 5 deals
- Manufacturing (other) – 4 deals
- Energy – 4 deals

Funding in the year ahead

Banking Prudential Requirements come into effect

From 1 July 2022, locally incorporated banks will need to hold more capital against their risk weighted assets to comply with the Reserve Bank's Banking Prudential Requirements. These requirements were meant to start in 2020 but were delayed in order to give the banks headroom to respond to the Pandemic. The requirements have essentially forced New Zealand banks to curb riskier exposures and improve their balance sheets (through divesting non-core assets, issuing more equity and/or reducing dividends).

Growth in sustainable finance products

Banks will continue to expand and increase their use of sustainable finance products as they play a leading part in promoting sustainability and environmental, social, and governance (ESG) principles. As demand grows (or borrowers are forced), more financiers and financial services firms will accelerate their speed to market for ESG products and services, such as green and social bonds, sustainability linked loans and new products seen in Europe, such as current accounts with sustainability and carbon-tracking features. There are calls for ESG regulations to be implemented to reduce the potential for greenwashing and to create opportunities for genuine products and innovative ESG service providers.

Rise in distressed financings

We expect to see more distressed financings in 2022 (off an albeit low base) as some borrowers simply won't be able to meet increasing interest costs, encounter supply chain issues and/or the struggle with continued effects of the Pandemic. However, given the number of cashed up private capital investors, private equity sponsors and alternative financiers providing flexible capital solutions throughout the capital structure, we expect many distressed financings will find a solution (for example, through restructurings) without being tipped into liquidation.

Competitive M&A financing landscape

We expect banks to compete strongly for proven borrowers, sponsors and industries. Given increased regulation in consumer and small trade finance, they may look to increase their lending to larger businesses, which is positive for leveraged M&A financings. They will continue to face competition from credit funds and non-bank institutions in the debt market, particularly as the high debt multiples are sought.

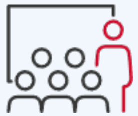
Virtual deals

The new norm

Nearly two years ago we were thrust into the world of 'virtual' deals – deals where every aspect of the transaction is conducted electronically, with no 'in-person' engagement at all between the vendor and purchaser or their advisers.

This meant endless Zoom/Teams calls on all aspects of the transaction, from management presentations, to due diligence, to deal negotiations. Our observation is that these processes often left purchasers feeling a little uneasy that they hadn't had the chance to really get to know the management team properly or to get a 'feel' for the business, before committing to the transaction. While deals still got done, there was that lingering doubt.

In early 2021 we started to see a return to what we would classify as normal transaction processes, especially for entirely New Zealand based transactions, with in-person negotiations, management presentations and site visits. However, as borders remained closed for all of 2021, any transaction that had a cross border element continued on a virtual basis, and once lockdowns hit in the second half of the year, all transactions reverted to this basis. As noted earlier in this M&A Forecast, the deal flow in 2021, especially in the second half of the year, reached levels that we hadn't seen before. This put a lot of pressure on client deal teams and adviser teams to be as efficient as possible when it came to managing 'virtual' deal processes.



What have we learnt?

So after nearly two years of virtual deals, what are some of the key things we've learnt about how to run an efficient virtual transaction process?

- Time spent planning the transaction process and a realistic transaction timetable is time well spent. This includes scheduling standing Zoom/Teams calls on the various workstreams so that time isn't wasted trying to align diaries. However, Zoom fatigue is real and just because a meeting is scheduled it doesn't mean it has to be held it if there is nothing to discuss.
- A short weekly all parties call with an agreed agenda to discuss workstreams is helpful to keep teams focused and on track – nobody likes having to admit on a Zoom call that they haven't done something they promised to do.
- Virtual due diligence, especially legal, tax and financial, can become frustrating for vendors. Vendor due diligence reports help with this, but we've also found that Zoom calls with advisers and clients shortly after the electronic data room is opened to explain the contents of the data room and answer questions about what may be missing is helpful and prevents unnecessary and repetitive Q&A. This is often useful as an add on to the management presentation. Anything material that comes out of this call can be confirmed as necessary in targeted responses to specific follow up questions in the electronic Q&A. From our perspective if you're acting for the purchaser, the key follow-up to this call is to find out what actually matters to your own client (and, as importantly, what doesn't matter), and focus on those key aspects.
- Unless the transaction is being run through financial advisers, regular Zoom/Teams calls between clients/senior management help build relationships that would otherwise develop during in-person meetings. Don't underestimate the value of these.
- Even though it's a virtual process, don't try to do everything by email. There's still no substitute for picking up the phone to resolve simple queries quickly and efficiently.
- Be careful that you don't end up negotiating the entire SPA by email, as you may end up conceding points you don't need to. If you and your client are well prepared, negotiations with the other side over Zoom can be just as effective as an in-person negotiation.

In our view, virtual deals are becoming the new normal and even when borders re-open we think that well planned and executed virtual transaction processes will be the preferred route. However, this will be combined with site visits and in-person meetings between purchasers and the management team/owners – although we think that these will largely be relationship meetings rather than in-person negotiations regarding the transaction terms.

New Zealand's overseas investment laws

Giving with one hand, taking away with the other

2021 was the "year of delivery" for the OIO, with the implementation of a number of long signalled changes to New Zealand's overseas investment laws. As we discuss below, some of those changes have helped provide clarity and more timing certainty for the OIO process, but others have significantly added to cost and complexity. In some cases, we think the changes have expanded the reach of the OIO.

On the positive side, November 2021 saw the introduction of changes to the much criticised "benefit to New Zealand" test that is required to be met before an overseas person can acquire an interest in 'sensitive land'. We expect this new test to provide more certainty and objectivity to the OIO process. It is accompanied by statutory timeframes and assesses the likely benefits of a proposed overseas investment in seven broad categories or 'factors' (economic benefits/creation of jobs, benefit to the environment etc). Importantly, the new test removes the previous requirement to measure the benefits against a "hypothetical New Zealand investor". Instead, it requires that the (net) benefits under each relevant factor are measured against the current state – which will mean that applicants are more easily able to demonstrate those benefits. In addition, the new law provides guidance to the OIO to apply proportionality in assessing the benefits having regard to the sensitivity of the land and the nature of the investment (i.e. the more "sensitive" the land the greater the benefits that will be required to be demonstrated). The changes retain the previous rules in relation to "farmland" (including agricultural/viticulture land), which impose a higher threshold (i.e. the benefits need to be substantial), and place more importance on the economic and New Zealand involvement benefits.

On the more frustrating side, changes have been introduced that require additional scrutiny and ministerial approval for significant business assets (transactions over NZD100 million) and "sensitive land" transactions where the applicant is classified as a "non-NZ government investor" (or involves a "strategically important business"). These changes could result in significant additional cost to applicants. While the changes have helped the situation by increasing the threshold for "non-NZ government investor" interests to be more than 25% (instead of 10%) and require the interests to be from the same country, we consider that more can be done. In the context of private equity funds and institutional investors, the "non-NZ government investor" test has been very challenging and has proved somewhat unclear and arbitrary. Determining whether a fund qualifies as a "non-NZ government investor" requires a considerable degree of analysis of the investor base and can turn on the way that the fund is structured. While it is possible for funds to apply for exemptions, we strongly believe that the law needs to be amended further to ensure that vehicles managed by private equity funds which have a relatively minor passive indirect investment from government vehicles or government backed superannuation funds, are not treated as "non-NZ government investors". This approach would be consistent with the approach taken in Australia.

The other major change in 2021 was the replacement of the temporary notification regime with the new screening/'call in' regime. In substance, this means that the OIO can review acquisitions of "strategically important businesses" (SIB) against national security and public order risks, even if the "significant business assets" or "sensitive land" tests are not triggered (i.e. for smaller transactions or transactions not involving sensitive land). The intent is to ensure that there is a screening process for all investments in "SIBs", although the regime is only mandatory for certain classes of SIB (military/critical direct suppliers), and voluntary for all others. The rules set out a list of the core "strategically important businesses" categories (ports, airports, telecommunication networks, financial services infrastructure etc), and additional categories can be included by regulation. The existence of the "call-in power" and its largely voluntary nature has created uncertainty for transactions. While it is possible to obtain confirmation from the OIO that it will not be used, the process has added another layer of cost and uncertainty. This is particularly the case in the healthcare and financial services sectors as businesses in those sectors tend to have large amounts of sensitive customer/patient data, which can fall within the "call in" regime.

We expect that 2022 will be a period of settling in, with the OIO and legal advisors becoming more familiar with the regime. We also hope to see some positive amendments and OIO guidance being issued to ensure that the positive steps taken by the government in relation to the OIO in the last few years can be fully realised.

Legal landscape

Case law shaping the scope of warranty protection

There were a couple of cases in 2021 which buyers should pay attention to. Buyers of a business will obtain warranties from the seller about the state of the business and assets being sold. If the warranties are breached, the buyer may be able to make a warranty claim against the seller. These recent cases provide a warning about the scope of protection such warranties actually provide to a buyer.

In *Williams v Tellens Systems NZ (2013) Limited* [2021] NZHC 1199 (Tellens), the High Court examined (again) the knowledge requirements for giving a warranty.

Tellens held that the duty to disclose under a warranty only exists where there is knowledge of that which should be disclosed.

Tellens involved a sale of shares in a company. The sale and purchase agreement included a standard warranty that, "the seller has disclosed to the buyer in writing all material matters and all material contracts". It turned out that the company had missed GST payments and was balance sheet insolvent at the time of the sale. The buyer brought a claim for a breach of the warranty. The seller's defence was that he did not know that the company was balance sheet insolvent so was not required to disclose the fact.

In interpreting the warranty, the High Court applied a previous case (*Tasman Liquor Company Limited v Nine Paddocks Limited* [2009] NZCA 593 (Tasman)) and said that the seller "would not be in breach of warranty for failing to disclose something he did not know" and that the duty to disclose under a warranty only exists where there is "knowledge of that which should be disclosed".

In both *Tellens* and *Tasman*, neither warranty provision explicitly detailed what level of knowledge was required. However, both agreements had other warranties with language that limited the warranty "to the seller's knowledge". The inference is that even when faced with active limitations in other provisions, the court may read in a requirement that the warrantor can only be liable for failing to disclose things they actually know.

Given a function of warranties is to allocate the risk of the unknown as between the buyer and seller, how can the buyer effectively allocate that risk to the seller should they wish to do so?

Two potential solutions are:

- obtain an indemnity from the seller where they agree to meet any liability and costs arising from the undisclosed matter; and/or
- be specific in the warranty about the level of knowledge required – e.g. the knowledge of a reasonably experienced person in the position of the seller, having made due inquiry.

In *Lendlease Capital Services Pty Limited v Arena Living Holdings Limited* [2021] NZCA 386 (Lendlease), the Court of Appeal clarified the requirements for a valid notice for a breach of warranty claim.

Lendlease held that warranty claim notices must provide clear and specific details of the relevant warranties that have been breached.

In *Lendlease*, the seller of five retirement villages provided warranties to the purchaser including a "Maintenance Warranty" and a "Watertightness Warranty". The terms of the agreement required any notice of a warranty claim to be in writing and to set out "reasonable particulars of the grounds on which [the claim] is based". It also needed be issued by a certain date.

When the purchaser became aware of "significant and systematic watertightness issues", it issued notice under the Watertightness Warranty specifically and "likely other Warranties". The key question on appeal was whether this inclusion met the notice requirements, judged by whether a reasonable recipient, knowing the terms of the agreement, would have understood the notice to raise a claim under the Maintenance Warranty.

The Court of Appeal held that including "likely other Warranties" was not enough to constitute notice under the Maintenance Warranty and that the purchaser was out of time to claim when the appropriate notice was eventually issued. The inclusion of "likely other warranties" was insufficient because the grounds for a breach were not expressly identified. Plus, the use of the word "likely" indicated a future claim, not notification of a current claim.

The learnings from this case around warranty claim notices are:

- Use definitive and active language;
- Give details of the type of the warranty being claimed under;
- Give details of the nature of the breach of the warranty; and
- The more specific the warranty, the more specific the notice needs to be.

Sample of our 2021 deals

Our M&A team

We are not afraid of a challenge or to innovate in the pursuit of our clients' goals.

With a reputation for tackling the most significant and complex transactions, our top tier M&A team continues to deliver excellent results to major international corporations, local trade buyers, listed companies, financiers and private equity funds on a variety of M&A and private equity transactions.

Home to one of the largest M&A teams in New Zealand, our Corporate team's expertise is recognised in the market and ranked as Band 1 in Chambers Asia Pacific and The Legal 500 international rankings.

Our market-leading partners are backed by highly qualified and talented corporate lawyers, ensuring the seamless delivery of astute commercial advice and excellent client service.

"

M&A team is always totally focused on enabling and supporting transaction objectives, while becoming an integrated part of the transaction team. They are more commercial, better connected, and are always contactable."

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