New Zealand

Negotiated M&A Guide

Corporate and M&A Law Committee

Contact

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1. <u>Introduction</u>

New Zealand is a common law jurisdiction. The laws governing the sale and purchase of businesses are a combination of contractual principles developed under common law and legislation. Specific statutes and regulations apply to acquisitions generally or to acquisitions in specific categories or circumstances (largely depending on the nature of the legal entities involved as well as the nature of the business or assets involved).

The principal statutes that govern negotiated M&A transactions involving non-listed companies in New Zealand are the Companies Act 1993, the Overseas Investment Act 2005, the Commerce Act 1986, the Contract and Commercial Law Act 2017, the Personal Property Securities Act 1999, the Fair Trading Act 1986 and the Income Tax Act 2007.

(a) Companies Act 1993

The Companies Act is the primary legislation regulating company law in New Zealand.

Key aspects of the Companies Act relevant to negotiated M&A transactions are:

- *Major transaction approval:* All "major transactions" entered into by New Zealand companies must be approved by a special resolution (requiring no less than 75% approval) from the company's shareholders. A major transaction is an acquisition or disposal of assets or the acquisition of rights or the incurring of liabilities that have a value greater than half the value of the company's assets prior to the relevant transaction.
- *Financial assistance:* A company is permitted to give financial assistance in connection with the acquisition of its shares provided that the Company can meet a statutory solvency test and the directors certify this to be the case.
- *Directors' duties:* When effecting a transaction, the duties of directors owed to a company and prescribed in the Companies Act should be considered by directors. Relevant duties include, acting in the best interests of the company and not allowing the company to trade in a way which would create a substantial risk of serious loss to the company's creditors.
- *Share dealing by directors:* If a director has information in his or her capacity as a director or employee which would not otherwise be available, and that information is material to the assessment of value of the shares, then the director may only dispose of or acquire those shares if, in the case of acquisition, the consideration is not less than fair value or, in the case of disposal, the consideration is not more than fair value.
- *Minority interest protection:* The minority interest provisions in the Companies Act provide an exit regime for shareholders who have unsuccessfully opposed certain fundamental changes to the structure or operations of the company (for example, major transactions, amendments to the company's constitution and amalgamation proposals). The regime enables these shareholders to have their shares purchased by the company at a "fair and reasonable" price.
- *Share buybacks:* The Companies Act permits a company to buy back its own shares. This mechanism may be used as a possible alternative to the sale of shares to a third party.
- *Merger by amalgamation:* Under Part 13 of the Companies Act, two or more companies incorporated in New Zealand can amalgamate and continue as one company. In a "long form amalgamation", shareholders of each amalgamating company must approve an amalgamation proposal by special resolution. In a "short form" amalgamation, which can only be implemented among companies in the same group, shareholder approval is not required. Once an amalgamation becomes effective, the surviving company succeeds to all of the property, rights, powers and

privileges of each amalgamating company, as well as all of its liabilities and obligations.

(b) Overseas Investment Act 2005

New Zealand has a regime that regulates foreign investment. This regime is administered by the Overseas Investment Office (**OIO**) and is governed by the Overseas Investment Act and the Overseas Investment Regulations 2005 (together the **OIO Legislation**).

Consent under the OIO Legislation is required before an "overseas person" acquires certain types of "sensitive" land, or if it acquires more than 25% of the shares in a company or assets where the value of the consideration or assets exceeds NZ$100 million. This dollar threshold is greater for Australian non-government investors seeking to acquire shares in a company or assets (provided that there is no "sensitive" land involved). If consent is required, the parties may make their acquisition agreement conditional on consent being obtained. The OIO Legislation and the timeframes for obtaining consent are discussed in more detail in section 4(h) of this guide (*"Conditions of completion"*).

(c) Commerce Act 1996

The Commerce Act governs competition law in New Zealand and is administered by the Commerce Commission. To promote competition in New Zealand markets, the Commerce Act prohibits the acquisition of the assets of, or shares in, another company if that purchase would have the effect, or likely effect, of substantially lessening competition in any New Zealand market. The Commerce Act applies equally to New Zealand and overseas companies where the conduct in question affects competition in New Zealand. Commerce Commission clearance may be necessary for the implementation of certain transactions. Consequently, the Commerce Act is considered in more detail in section 4(h) of this guide (*"Conditions of completion"*) and section 5 of this guide (*"Other issues"*).

(d) Contract and Commercial Law Act 2017

The Contract and Commercial Law Act, amongst other things, simplifies the common law relating to remedies for misrepresentation, repudiation and breach of contract. It removes the distinctions between the remedies available for misrepresentation, repudiation and breach of contract and allows parties to provide expressly for their own remedies. It is quite common for contracting parties to opt out of these aspects of the Act by setting down the agreed remedies in the transaction document.

(e) Fair Trading Act 1986

The Fair Trading Act applies to negotiated M&A transactions in that it provides a remedy if a party makes a false or misleading representation relating to, amongst other things, the goods or services being sold or engages in conduct that is misleading or deceptive or is likely to mislead or deceive. The parties cannot contract out of the Fair Trading Act.

(f) Income Tax Act 2007

The Income Tax Act is New Zealand's main taxing statute. It comprehensively imposes tax on income and includes numerous regimes that deal with companies, deductible expenditure, financial arrangements, foreign income, losses, tax avoidance and tax credits (among others). Although tax is imposed primarily on income and not capital gains, the Income Tax Act does treat certain gains as being of a "revenue" nature and therefore taxable as income (for example, a gain derived on the disposal of property that was purchased for the purpose of resale).

Two other significant tax statutes are the Goods and Services Tax Act 1985, which imposes a value added tax (**GST**) on the supply of goods and services, and the Tax Administration Act 1994, which deals with the administration of the tax system.

Listing Rules of the New Zealand Stock Exchange

In addition to the Companies Act, the Listing Rules of the New Zealand Stock Exchange (**NZX Listing Rules**) may be relevant in a negotiated M&A transaction if any party to the transaction is listed on the New Zealand Stock Exchange. The provisions of the NZX Listing Rules most likely to be relevant are those relating to continuous disclosure to the market of material information and those requiring shareholder approval for major transactions or related party transactions entered into by a listed entity.

Further discussion about the legislation referred to in this section of the guide (*"Introduction"*) is set out in section 4(h) of this guide (*"Conditions of completion"*).

2. Structure of a negotiated M&A transaction

Most negotiated M&A transactions are implemented under a share or asset acquisition agreement. The Companies Act provides statutory procedures for amalgamation under Part 13 (Amalgamations) and Part 15 (Schemes of arrangement). However these procedures are not frequently used in negotiated M&A transactions.

(a) Asset and share sales

In general, a seller will prefer to dispose of shares rather than assets. One of the main reasons for this is that a share sale does not require the separate transfer of assets and third party contracts, which are instead transferred "within" the target company by means of transferring title to the shares. This generally makes a share sale simpler than an asset sale. In contrast, a buyer will often prefer to acquire assets rather than shares.

An asset sale allows the buyer to acquire the business without unwanted liabilities. Whether a negotiated M&A transaction is implemented as an asset or share sale will depend on the circumstances and negotiating strengths of the parties.

Key considerations relating to asset and share sales include the following.

(b) Asset sale

- *Individual transfer:* Some assets may need to be transferred under specific related arrangements (in addition to the overarching acquisition agreement) (for example, different legislation processes apply to the transfer of land and trade marks).

- *Third party contracts:* These require either assignment or novation because to obtain the benefit of the contract, the buyer will need to replace the seller as the contracting party (for example, leases of premises, supply contracts, distribution agreements and licensing agreements).

- *Employment contracts:* Employment contracts cannot be transferred. If the buyer is to secure employees, it typically involves the seller terminating the existing employment agreements and the buyer offering employment on no less favourable terms, with "transfer" occurring at completion.

- *Liabilities:* The buyer only assumes specifically agreed liabilities.

- *Taxation:* Like other liabilities, income tax liabilities do not pass with assets. In addition, a seller may be liable for tax on those parts of the purchase price attributable to taxable items, such as trading stock and depreciable property, meaning that the allocation of the purchase price to different asset classes is important. The purchase price in an asset sale may attract GST, but the GST charged on the supply may be able to be applied at a rate of 0% if the asset sale comprises the sale of a taxable activity that is transferred as a "going concern" and the parties agree in writing that this is the case. A going concern involves the supply of a taxable activity (for example, a business), or a part of a taxable activity that is capable of separate operation, along with all of the goods and services necessary for its continued operation. The seller must also carry on the taxable activity up to the time of its transfer. Appropriate provision should be made in the acquisition agreement for any GST consequences arising in the event that the Inland Revenue Department disagrees with the treatment of the business being transferred as a going concern, such as which party bears the risk of any penalties.

(c) Share sale

- *Share transfer:* A company is sold by the shareholders transferring to the buyer title to the company's shares by way of a share transfer. The business, including assets, liabilities and employees, remain in the company and are transferred within the company, they are not separately transferred.
- *Third party contracts:* Contracts are not separately transferred, and the target company remains the party to the contract. Often contracts protect the third party by providing that a change in control of the target company, without consent of the third party, is a breach of contract. Therefore, a buyer may require the seller to obtain any required third party consent to a change of control.
- *Employment contracts:* Employment contracts are dealt with in the same manner as other contracts of the target company. The usual position is that a change of control will not terminate employment agreements.
- *Liabilities:* All liabilities (including contingent liabilities) of the target company remain and continue to be the target company's responsibility. Liabilities, like assets, will transfer within the target company (unless specifically agreed otherwise in the acquisition agreement).
- *Taxation:* The target company remains liable for its historical tax positions. A seller will typically not be taxed on the purchase price received for the sale of shares. Any gains made by sellers on shares will be free of tax if the shares are held on "capital account", rather than "revenue account." A sale of shares is treated by the GST Act as a supply of "financial services" and is therefore exempt from GST.
- *Shareholder continuity:* The sale and purchase of shares in a company may give rise to a breach of "shareholder continuity" which may have implications under the Income Tax Act. For example, a greater than 51% change in shareholding continuity will mean that a target company is unable to carry forward accumulated tax losses from the date of the shareholding change. A greater than 34% change in shareholding will result in the target company losing accumulated imputation credits at the time of the shareholding change. Imputation credits represent credits for tax paid by the company, which may be attached to dividends the company pays to alleviate double taxation of company profits. Imputation credits which would otherwise be lost can be utilised through the target company paying a pre-completion (i.e., pre-settlement) dividend or bonus issue to the seller.

(d) Share buy back

As previously mentioned, the Companies Act permits a company, in certain circumstances, to buy back its own shares. This mechanism can be used to facilitate the sale of shares as it does not involve a transfer to a third party.

3. Pre-Agreements in negotiated M&A transactions

(a) Letter of Intent

Use of a "letter of intent" (also known as a "heads of agreement" or "memorandum of understanding") is common in New Zealand, but not standard practice. A letter of intent may be made legally binding, whether in whole or in part. If all or any particular provisions are intended to be legally binding, it should be expressly stated in the letter of intent.

There is no prescribed form or content for a letter of intent. The document may be used to agree the scope and key terms of the transaction, record the current state of negotiations, set down general principles of the arrangement or fulfil a combination of these functions. Even if a letter of intent is non-binding, it may serve to clarify the parties' positions and draw out issues at an early stage. It should be borne in mind however that, even if a letter of intent is expressed to be non-binding, a party may develop expectations that the transaction will conform to the letter of intent. This can reduce flexibility at a later date.

Matters that a letter of intent may address include transaction terms (for example, parties, price, subject matter, warranties, conditions), the nature of the agreements to be entered into, timetable and process, regulatory approvals, due diligence, interim conduct of business, confidentiality, buyer exclusivity, costs, termination rights and dispute resolution.

In a letter of intent that is generally non-binding, it is common for the parties to make some provisions binding (for example, confidentiality and exclusivity).

(b) Process contracts

"Process Contracts" may be created where a negotiated M&A transaction involves a competitive bid process. The New Zealand courts recognise the existence of process contracts when a potential buyer agrees to follow a relatively detailed sales process established by a seller. A process contract can be created by express agreement between a principal and invitee, or may be inferred from dealings between the parties and the surrounding circumstances. The establishment of a process contract may be expressly excluded, and it is common for a seller in a competitive sales process to include wording to this effect in pre-contractual documentation (for example, in "letters of intent", information memorandum and tender documentation).

(c) Lock-up (or voting) agreements with major shareholders

Although more commonly used in the context of M&A transactions involving listed companies, in circumstances where the target shares or assets are owned by multiple stakeholders, a buyer may wish to obtain greater certainty that the transaction will proceed by first entering into a lock-up agreement in which one or more stakeholders agree to accept the buyer's offer on certain terms and conditions (if that offer eventuates).

The Takeovers Code Approval Order 2000 applies if the target company has 50 or more shareholders and 50 or more parcels of shares. In this situation, particular care should be taken to ensure that the lock-up agreement does not result in the buyer acquiring or controlling voting rights in the target company until there is acceptance of a takeover offer under the Code. It is necessary to ensure that the "equal treatment" requirements of the Code are not breached.

4. Acquisition agreements in negotiated M&A transactions

In New Zealand, it is common for negotiated M&A transactions to be recorded in a written acquisition agreement. However, there is no requirement for it to be in any particular form, nor for it to be subject to any particular formalities.

(a) Hold back and escrows

The use of contingent or deferred payment mechanisms is common in negotiated M&A transactions, but will depend on the circumstances of each particular transaction. Hold backs can arise for different reasons, including concern over the capacity of the buyer to repay money to the seller, or a buyer may link part of the purchase price to the company achieving agreed targets. Part of the price may also be held back pending finalising of accounts or the expiry of the warranty period. Post completion adjustments to the price may take many forms and include mechanisms relating to completion account adjustments, working capital adjustments, tangible asset adjustments or stock take adjustments.

Escrow arrangements are used in negotiated M&A transactions in a number of circumstances, including where part of the purchase price is to be held “in escrow” pending calculation of the final price, or pending expiration of a warranty period. Escrow arrangements may be contained in the acquisition agreement itself or may be set out in a separate agreement between the escrow agent and the relevant parties. As the escrow agent is unlikely to be a party to the acquisition agreement, escrow agents prefer that the escrow arrangements are set out in a separate document, typically an escrow deed. This document will often be negotiated between the escrow agent and the relevant parties. In addition, the escrow agent, as a party to the escrow deed, will be able to enforce the escrow deed without having to rely on any rights which may be included for its benefit in the acquisition agreement.

Escrow agents tend to be law firms or corporate trustees. If the amount of money is large or the escrow period is long, it is more common to use corporate trustees than lawyers. This removes any possible conflict of interest issues. Corporate trustees are usually more expensive than law firms and their fee is either a set amount or a percentage of the escrow amount.

(b) Warranty and indemnity insurance

There is a growing trend in New Zealand for buyers or sellers in negotiated M&A transactions to obtain warranty and indemnity insurance to cover any loss they may suffer as a result of a breach of warranty. This insurance is replacing (and in some instances supplementing) hold back and escrow arrangements.

(c) Representations and warranties

It is typical in a negotiated M&A transaction in New Zealand for a buyer to seek warranties from a seller. Warranties are contractual statements about the subject matter of the acquisition (for example, the target company’s assets, liabilities or state of affairs). The scope and breadth of warranties requested and agreed will depend on a number of factors, including the nature of the company, business or assets being acquired and the respective bargaining power of the parties.

Generally, a seller will attempt to limit the number, scope and application of warranties, so as to limit its contractual exposure to termination pre-completion (if the acquisition agreement gives this right) or to a warranty claim for damages post-completion. In contrast, the buyer will be seeking protection where it might not otherwise have protection under statute or the common law. Setting down warranties in the acquisition agreement also provides a degree of contractual certainty, especially if the agreement expressly excludes recourse to statute or to the common law.

For the buyer, warranties serve three main purposes:

- *Contractual protection:* enables the buyer to sue for a breach of warranty and recover damages in the event that the warranty is untrue, incorrect or misleading (although limits on recovery will generally be prescribed in the acquisition agreement);

- *Risk allocation:* establish if the seller or buyer will carry the risk in relation to a matter, (for example, a debt not being paid or the existence of an environmental liability); and
- *Facilitates disclosure:* warranties and the due diligence process are inextricably linked. A typical carve out from the warranties is matters disclosed in writing by the seller and extends to information in any data room or disclosure letter. If the buyer obtains a warranty on a matter, it is in the seller's interests to disclose any potential problems as part of the buyer's due diligence.

The number and categories of warranties will vary depending on whether the M&A transaction involves shares or assets. If the transaction is a share sale, the warranties will usually be more extensive because the buyer is acquiring all of the target company's assets and liabilities. Whereas in an asset sale, the buyer will only take agreed assets and liabilities.

Typical Warranty Categories

The range of warranties that a buyer requests is often extensive. Warranties that are often the subject of the most extensive negotiations are:

- *Information warranty:* dealing with the accuracy and completeness of information provided to the buyer;
- *Accounts/financial statement warranty:* dealing with the basis of preparation and accuracy of the financial information/accounts;
- *Environmental warranty:* dealing with environmental contamination and risk; and
- *Tax warranties (share deals only):* involving the tax liability of the company.

The other categories of warranties that are the subject of extensive negotiations will vary on a case-by-case basis. Other typical categories of warranty that might be seen in New Zealand acquisition agreements and be subject to a greater or lesser degree of negotiation include:

- *Due execution/authorisation warranty:* normally a mutual warranty from both seller and buyer;
- *Title warranties:* (i.e., title and absence of encumbrances);
- *Solvency of target company (share deals only):* solvency of the target company;
- *Plant and equipment:* condition;
- *Intellectual property:* sellers rights in it/no breach or infringement;
- *Business agreements:* no material breaches by seller or counterparty;
- *Real property:* condition and compliance with planning/zoning laws;
- *Litigation/legal proceedings:* no proceedings actual or threatened;
- *Statutory filings:* all filings have been made; and
- *Employees:* number, terms of employment and any claims.

(d) Discussion on specific warranties

Information Warranty

In New Zealand, this warranty can be the subject of protracted negotiation. Generally, information disclosed by a seller will qualify the warranties. For this reason, and the fact that the buyer's comfort from its due diligence is based on the accuracy of the information provided, a buyer will seek a comprehensive information warranty to the effect that:

- the information disclosed by the seller is true, accurate and is not misleading; and
- all information and circumstances relating to the business have been disclosed by the seller – commonly known as the "completeness" warranty.

As the information disclosed to the buyer in writing is usually carved out from the application of the warranties, sellers are generally prepared to accept some form of information warranty. A seller will, however, attempt to limit the scope of the warranty in a number of ways, including:

- by adding a materiality qualifier (for example, that the information is "accurate in all material respects");
- stating that the information must be "taken as a whole in respect of the particular subject matter";
- by rejecting the "completeness" aspect of the warranty on the basis that the seller is not underwriting the due diligence investigation of the buyer;
- by excluding forecasts and projections; and
- by excluding third party reports (for example, seller due diligence reports disclosed (especially if a buyer will be given reliance on those reports)).

Accounts/Financial Statement Warranties

A buyer's due diligence and offer will generally be heavily reliant on the seller's financial information.

A warranty sought by a buyer might seek confirmation that the relevant accounts:

- comply with the provisions of the Financial Reporting Act 1993 and have been prepared under prescribed accountancy standards and NZ GAAP, consistently applied, and are complete and accurate in all respects;
- have been prepared on a basis consistent with the basis on which the financial statements have been prepared in respect of a specified time period;
- give a true and fair view of the assets and liabilities and the state of affairs, financial position and results of the business;
- are not affected by any abnormal, extraordinary or non-recurring item;
- make full provision for all liabilities, including liabilities for long service leave and annual leave entitlements; and
- give full particulars in the notes of all contingent liabilities and commitments and any other liabilities which cannot be quantified under NZ GAAP.

A seller will look to limit the scope of these warranties. It will be concerned about the financial information it is warranting. It is usually more comfortable warranting audited accounts rather than special purpose accounts or management accounts as they are usually not prepared to the same standard.

At the "seller-friendly" end of the spectrum, a seller might simply warrant that the accounts present "fairly" the financial position of the company based on the relevant level of preparation, presentation, accounting policies and assumptions set out in the accounts.

If the buyer has relied on financial forecasts, the buyer may seek a warranty, not in relation to the accuracy of the forecasts themselves (which a seller is likely to reject), but in respect of the basis of their preparation and underlying assumptions. Sellers will generally strongly resist the inclusion of a warranty in relation to forecasts, and these warranties are not seen very often in New Zealand acquisition agreements.

Tax Warranties

In New Zealand, acquisition agreements for the sale and purchase of shares commonly contain a comprehensive set of tax warranties that cover the target company's actual and latent tax liability for the period up to completion. As would be expected, these warranties address the risk of any tax claim subsequently being made against the target company.

Most share acquisition agreements also contain a separate tax indemnity (discussed in more detail in section 4(i) of this guide (*"Indemnification provisions"*), in favour of the buyer for any tax liability of the target company attributable to the period before completion. Claims for breach of a tax warranty are generally required to be brought through the tax indemnity. In addition, the scope and limitations which attach to the tax warranties may extend equally to claims for breach of any tax indemnity.

Generally, the buyer would seek to obtain a comprehensive set of tax warranties from the seller, while the seller would seek to limit its undertakings. Sometimes, if a sufficiently broad tax indemnity provision is included in the acquisition agreement, and if the buyer has conducted adequate due diligence, it may be that no tax warranties are sought by the buyer and the buyer relies on the tax indemnity.

Nonetheless, whether to address specific concerns or simply to provide 'comfort', the seller's tax warranties will typically include statements that attest to: the full provision of tax liabilities in the company's pre-completion accounts; the timely undertaking by the seller of all pre-completion tax payments, withholdings and filings; the absence of any dispute with relevant tax authorities; and the absence of any previous tax avoidance, sham dealings, fraud or evasion on the part of the company.

(e) Limitations and exclusions

Monetary Limits

Sellers will typically limit their liability by including monetary limits in the acquisition agreement.

Typical categories of monetary limits include:

- *Maximum for all claims:* This covers both warranty claims and any other claim that might be brought under the acquisition agreement (for example, under an indemnity or for failure to complete under the agreement). Quite often, this cap is set at the purchase price.
- *Maximum for warranty claims:* This is a maximum cap on all warranty claims. The seller may attempt to set this as a percentage of the purchase price.
- *Individual de minimis:* Sellers usually exclude claims for amounts less than an agreed figure. They do not want to deal with "small claims". A claim for a breach of warranty can only be brought if this threshold is exceeded in respect of one claim or a series of linked or similar claims.
- *Basket de minimis:* No claim can be brought unless all warranty claims exceed this amount.

Typically these thresholds in New Zealand acquisition agreements will depend on a number of factors, including the purchase price and the relative bargaining strength of the seller and buyer.

Certain types of warranty claim may have different limits and thresholds. For example, the title warranty may not be restricted by the *de minimis* thresholds and claims under environmental or tax warranty, and/or indemnity may have different limits.

Time Limits

In general, the statutory time limit for bringing a claim in connection with an acquisition agreement is six years. A seller will generally seek to shorten this period for warranty claims in the acquisition agreement. Typically:

- a seller may seek to limit this to six to tweleve months; and
- a buyer will seek a longer period. In respect of tax, the buyer will usually factor in enough time for a complete audit cycle (for example, 18 to 24 months). Buyers usually require longer periods for environmental warranties.

Different time limits may apply to specific claims. For example, the time period for tax claims is usually separate and based on the statutory time bar, which restricts the ability of the Inland Revenue Department to increase an assessment of tax after a prescribed period of time.

General Limitations

Acquisition agreements in negotiated M&A transactions in New Zealand will contain a number of general limitations on claims. These will be the subject of negotiation between the seller and buyer. Typical general limitations include:

- *Information disclosed to the buyer:* A seller will generally want information disclosed to the buyer to be taken as disclosed against the warranties and prevent the buyer bringing a claim based on that information. This disclosure may include information disclosed in a data room, management interviews, information memoranda and seller due diligence reports. It is also usual in New Zealand for the seller to make disclosures against the warranties in a disclosure letter. As there is some uncertainty surrounding the standard of disclosure, based on the New Zealand common law, sometimes the parties agree the standard, for example they may set the standard of disclosure as "fairly disclosed" and then define this term (for example, "fairly disclosed" might mean "disclosure in a manner such that the matter, information or circumstance might fairly be expected to come to the knowledge of the buyer, its employees, agents or advisers in the ordinary course of carrying out the buyer's due diligence exercise.")
- *Seller's knowledge qualifiers:* Where giving a warranty, a seller may seek to qualify it to the extent of its knowledge. It is common for acquisition agreements to define what the "seller's knowledge" is. For example:
  - in a "seller-friendly" draft, knowledge may be limited to actual knowledge (excluding imputed or constructive knowledge) of named or a defined set of individuals (for example, certain directors or key employees of the seller). It may also state that it includes the knowledge those persons would have had after "reasonable" enquiry; and
  - in a "buyer-friendly" draft, "seller's knowledge", including imputed and constructive knowledge, could be the knowledge of all employees and directors (and may even extend to advisers). It may also state that it is the knowledge these persons would have had after due and careful enquiry.
- *Buyer's knowledge qualifier:* The acquisition agreement may set down that anything within the buyer's knowledge is deemed to be disclosed. The parties may negotiate if this includes actual, imputed and constructive knowledge, and who the buyer is for this purpose (i.e., whether it includes its advisers).

- *Publicly available information:* Information on public databases at a set time. In New Zealand, these might include:
  - the New Zealand Companies Office;
  - the PPSR;
  - the High Court, Court of Appeal and Supreme Court Registers in New Zealand;
  - Land Information New Zealand; and/or
  - the Intellectual Property Office of New Zealand.
- Change in law or tax rates.
- *Insurance:* The buyer is entitled to recover under an insurance policy – the seller and buyer may argue over whether the buyer must first pursue the insurer before bringing a claim and, in this case, the buyer will be conscious of the time limitations (if any) on pursuing the seller under the acquisition agreement for a warranty claim. The buyer will need to establish if under its insurance policies it can agree to effectively exclude its insurer's right of subrogation.
- *No contingent claims:* The seller cannot claim until the claim ceases to be contingent. If accepted, the buyer will generally look to factor this in when considering the time limitations on claims.
- *No double claims:* This provides that the buyer cannot recover under the acquisition agreement, if it has already recovered the loss under another claim. The agreement will usually provide that to the extent of double recovery by the buyer, the recovery from the seller is refunded to the Seller.
- *Exclusion of statutory rights to claim:* Exclusion of all rights to claim under statutory heads. This would include aspects of the Contract and Commercial Law Act.
- *Consequential loss:* No claim for any loss which is special, indirect or consequential. However, this exclusion is not always agreed. In addition, its scope is usually debated including if it extends to loss of profit, revenue and similar items.

Third Party Claims / Conduct of Claims

The seller will frequently want the right to defend third party claims or to have a significant role in the defence so as to minimise its liability under a warranty, and to conduct claims against a third party if the buyer has paid out to the third party and subsequently has a right to recover the payment. In some cases, the buyer may be reluctant to agree to these provisions as the third parties may often be customers or suppliers of the business. Generally the buyer may be prepared to agree to cede control subject to being indemnified for any loss it and the company may suffer and certain limitations and qualifications, one of which is that the seller must first admit liability before it can manage the claim. Sellers generally resist such a condition.

(f) Covenants of the buyer and seller

Pre-Completion Period

Where there is a period between the time of execution of the acquisition agreement and completion, a buyer will generally seek covenants from a seller relating to the operation and management of the business during this period.

The typical pre-completion clauses in New Zealand acquisition agreements deal with the following:

- restrictions on operation of the business;

- exceptions to those restrictions (i.e., permitted acts); and
- buyer's access to the target / business.

Restrictions

As a general rule, a seller will simply give a covenant to operate the business in the ordinary course. Depending on the nature of the business, a buyer will usually seek wider restrictions, including covenants not to do any of the following without its prior written consent:

- enter into, vary or cancel any business agreement over a certain value or term;
- dispose of assets over a certain value;
- create any encumbrances other than in the ordinary course;
- undertake capital expenditure over a certain monetary limit;
- employ any person;
- incur debts or liabilities over a set amount;
- undertake any related party transactions;
- change accounting policies; or
- instigate litigation.

In addition to these covenants, it is common for the buyer to require the seller to provide warranties on similar matters for a longer period running from the date of the most recent financial accounts used to value the business through to completion. This provides additional protection to the buyer, particularly in terms of the financial metrics used to determine the purchase price. For example, a buyer could base a claim on a warranty to the effect that the seller did not operate the business in the "ordinary course" from the date of the last relevant set of accounts with the result that the final EBITDA was inflated because of reduced ordinary course expenses or investments in assets.

Permitted Acts

A seller may request specific carve outs to any pre-completion restrictions. These carve outs may include:

- responding to emergency or disaster;
- meeting contractual obligations; and
- acting as permitted by the acquisition agreement.

Pre-completion Access

A buyer will generally seek pre-completion access to personnel and information of the target or business. It is typical to see such a clause in an acquisition agreement, but in some cases it may not commence until any conditions are satisfied or waived.

A seller will be concerned with not allowing the buyer's access to interfere with its day-to-day operations.

(g) Protection of the business (restraints of trade)

It is common in negotiated M&A transactions in New Zealand for a buyer to seek post-completion restrictions on the seller to protect the goodwill of the business.

These covenants can include:

- a covenant not to compete;
- a covenant not to assist competitors; and
- a covenant not to solicit employees.

A seller may agree to such restrictions but will be interested in:

- limiting it to the business being sold;
- restricting the restraints to as short a time period as possible;
- restricting the no-competition restraint by geographic area; and
- setting any specific exceptions to the restrictions.

The buyer should be conscious of not seeking a restraint that is unreasonable. If it is unreasonable, a New Zealand court may, under the Contract and Commercial Law Act, find that the restraint is unreasonable and therefore will:

- re-write it so that it will be reasonable; or
- delete the restraint clause and give effect to the amended contract; or
- decline to enforce the contract.

It is not common for the parties to include a clause allowing the modification of a non-competition clause in terms of time period or geographic area should a court find that the existing restraint is unreasonable. This is because it is unnecessary as the Court already has this discretion under the Contracts and Commercial Law Act.

(h) Conditions of completion

Conditions to completion are common in New Zealand acquisition agreements. These conditions could cover any number of requirements. Typical conditions include, conditions relating to regulatory requirements, such as Overseas Investment Act approval for certain acquisitions made by “overseas persons” and Commerce Commission clearance, due diligence conditions, financing conditions, conditions relating to the assignment of key business agreements, and conditions relating to the securing of tenure of key employees. The most usual conditions are discussed below.

In general, sellers will want to keep conditions to a minimum and, in order to ensure that there is no delay to completion, will require the conditions must be fulfilled within a specified period following which if the conditions have not been satisfied or waived, the acquisition agreement will terminate. Typically, rights of recourse against either party for non-fulfilment of conditions are contractually excluded.

Companies Act

If an acquisition constitutes a “major transaction” under the Companies Act then shareholder approval by special resolution will be required. If it is subsequently discovered that a major transaction has not been correctly approved, it may be ratified by special resolution of the shareholders. However, if the required shareholder approval is not obtained, the major transaction remains binding unless the court, in special circumstances, decides otherwise, but the directors of the company will not have complied with their duties under the Companies Act, and may be personally liable.

Depending on the number of shareholders in a company, it may be possible to obtain shareholder approval prior to entering into the transaction. However, where a company has a large number of shareholders, it is likely that a special shareholder meeting will be needed to pass the required resolutions. In this situation, there may be some delay in obtaining shareholder approval and therefore completion may be conditional on the relevant party obtaining the required shareholder approval.

Either party may request board approval as a condition to completion of a transaction. This may be required where a board is constituted by both executive and non-executive directors and the executive directors (or a group of executive directors) have been actively negotiating the transaction without consulting with the other directors.

New Zealand Listing Rule Requirements

In addition to any shareholder approval required under the Companies Act, where a company to a negotiated M&A transaction is listed on the New Zealand Stock Exchange, shareholder approval may also be required pursuant to the NZX Listing Rules. Consequently, conditions to completion may be included in the acquisition agreement which cater for the requirements of the NZX Listing Rules.

Overseas Investment Act

Certain types of transactions by “overseas persons” will require consent under the OIO Legislation. If consent is required but is not obtained, a court has power to retrospectively cancel or annul the transaction.

“Overseas persons” include a person who is neither a New Zealand citizen nor ordinarily resident in New Zealand, and a body corporate that is 25% or more owned by a body corporate outside of New Zealand or by other overseas persons.

In general, consent is required under the Overseas Investment Act in respect of any acquisition by an overseas person or an “associate” of an overseas person of:

- securities where as a result of the acquisition the overseas person or associate (either alone or together with associates) will have a 25% or more ownership or control interest in that person, or will increase an existing 25% or more ownership or control interest in that person, if the value of the securities or consideration provided or the value of the assets of that person (together with its 25% or more owned entities) exceeds NZ$100 million. This dollar threshold is greater for Australian non-government investors seeking to acquire shares in a company or assets (provided that there is no “sensitive” land involved);

- property or assets in New Zealand used in carrying on business in New Zealand if the total value of the consideration provided exceeds NZ$100 million. This dollar threshold is also greater for Australian non-government investors seeking to acquire shares in a company or assets (provided that there is no “sensitive” land involved);

- a freehold interest or leasehold interest (for a term of three years or more) in “sensitive land”; or

- securities of a company who owns or controls any such interest in “sensitive land” if, as a result of that acquisition, the overseas person or the associate (either alone or together with the associate) will have a 25% or more ownership or control interest in that company, or will increase an existing 25% or more ownership, or that person becomes an overseas person.

“Sensitive Land” includes non-urban land that has an area greater than five hectares, land on certain specified New Zealand islands, the foreshore or seabed, land that is held for conservation purposes and land that is a historic place or subject to a heritage order.

Under its delegated authority, the OIO considers most applications for consent. All applications for consent outside the OIO’s delegated authority, being consents involving “sensitive land”, are required to be determined jointly by the Minister of Finance and the Minister of Land Information.

There are additional procedures to be followed in respect of an application for consent involving “farmland” or “special land”. Farmland, or shares in a company that owns farmland, must be offered for acquisition on the open market to persons who are not overseas persons. In the case of some transactions involving “special land” (i.e., the foreshore, seabed, riverbed or lakebed), the Crown has a right of first refusal to purchase special land.

There is no statutory timeframe within which an application for consent must be decided. However, the OIO attempts to decide applications within 50 working days. Applications which are not straightforward, or which require consultation or which involve special land can take longer.

Typically, in competitive bid processes, bidders are encouraged to apply for OIO consent as soon as possible and before the “preferred bidder” is identified in order to avoid any delays in the bid process and completion of the transaction.

Competition

The Commerce Act prohibits the acquisition of assets of a business or shares if that acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market. While there is no compulsory requirement for parties to notify the Commerce Commission of a merger or acquisition, parties can voluntarily apply for clearance to complete a merger or acquisition. A clearance will be granted if the Commerce Commission is satisfied that the merger or acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. Where a transaction is likely to substantially lessen competition, authorisation may be granted where, on balance, the economic benefits resulting from the merger or acquisition outweigh any anti-competitive detriments.

If it is considered that Commerce Act clearance (or authorisation) is required, this should be included in the acquisition agreement as a condition to completion.

Historically, this has been more of a concern for buyers than sellers. However, the Court of Appeal has confirmed that sellers can also be liable under the ancillary liability provisions in the Commerce Act.

Due Diligence

In some cases a buyer may require that completion is conditional on the buyer being satisfied with its due diligence review of the business. This condition will not usually be included as the buyer will ordinarily complete due diligence before entering into the acquisition agreement and, in general, sellers are reluctant to accede to the inclusion of a due diligence condition.

A due diligence condition may not be appropriate (and may be resisted by a seller) if some due diligence has been undertaken, or the buyer has been given a seller’s due diligence report (seller’s due diligence reports are considered in section 5 of this guide (*“Other Issues”*)), or an extensive information memorandum has been given to the buyer.

If the buyer insists on a due diligence condition, a seller’s concerns may be reduced by either setting out specific parameters within which the buyer may withdraw from the acquisition or by providing for a break fee should the buyer wish to withdraw.

Finance

Conditions relating to the buyer obtaining finance to complete an acquisition are not uncommon.

Key Agreements

The buyer of a business that depends on ongoing contracts, including for supply of essential goods or services or for sales to key customers, will usually want to be satisfied that these contracts will still be in place after completion. In the case of key agreements such as leases of premises, supply contracts, distribution agreements and licensing agreements, the buyer may want completion to be conditional on it obtaining any required consents.

This is particularly relevant in acquisitions relating to the sale of assets or a business. In a transaction involving the transfer of shares, this is only relevant if these contracts contain change of control provisions.

Key Employees

It is common to include conditions relating to continuance of employment of key personnel when a business relies on the expertise or knowledge of particular employees.

Usually, in these circumstances, a buyer acquiring a business (as opposed to shares in a company) will want to maintain the value of the business by being certain of entering into new agreements with key personnel.

Under New Zealand law, when an employer sells a business, employees cease to be employed by their old employer, and their positions become redundant irrespective of whether or not the new owner of the business is prepared to re-engage the employees on the same or similar terms. Unlike in many other jurisdictions, employees will not automatically transfer with the business, unless the buyer enters into new contracts of employment with the relevant employees.

One of the unique aspects of New Zealand employment law is that all employers have a statutory obligation to consult with employees about any "proposal" that may have an adverse impact on the continuation of their employment with that employer. This includes any proposed redundancy, including one arising in the context of the sale of a business. This obligation to consult is an aspect of the employer's duty of good faith, set out in the Employment Relations Act 2000 (**ERA**).

In the sale of business context, the obligation to consult with all affected employees falls on the seller. The seller must consult with all employees whose positions may be made redundant as a result of the transaction, whether or not they will be offered employment by the new owner of the business.

Importantly, consultation must occur in relation to a "proposal". That is, consultation must occur before any final decision is made between the parties to proceed with the transaction. Consultation will involve, at the minimum:

- the provision of information by the seller employer about the proposal to sell their business;
- an opportunity for employees to provide feedback on that proposal (including an opportunity to put forward alternatives to redundancy);
- consideration of feedback by the employer; and
- announcement of the employer's decision in relation to the proposal.

The ERA provides that all employment agreements, both individual and collective, must contain an employee protection provision to provide protection for the employment of employees affected by a sale or transfer of an employer's business or part of it to another person, including where work is outsourced. Typically, the employee protection provision will address how particular steps in the consultation process will be carried out, as well as dealing with the manner in which employees and their entitlements are to be transferred to a new employer following consultation.

The ERA contains more stringent restructuring provisions in respect of employees employed by cleaning services, catering services, caretaking, or laundry services within certain sectors, facilities or places of work. Specifically, these groups of employees have an automatic right to elect to transfer to the new employer in a restructure situation.

Where an employee who elects to transfer to the new employer is a member of a union and covered by a collective employment agreement between the union and seller, the buyer (the new employer) may choose to become a party to the collective agreement in respect of that employee and will then be bound by its terms. If the buyer becomes a party to the collective employment agreement with the union, then this will ensure that it is able to offer employment on no less favourable terms and conditions than the employee enjoys with the seller.

In a share sale, employees will remain with the company and therefore, assuming there are no special provisions in their employment agreements providing for change of control situations, no further action will be required by the buyer to ensure the tenure of those employees.

(i) Indemnification provisions

Indemnities Generally

In acquisition agreements for negotiated M&A transactions in New Zealand, typical categories of indemnity sought by a buyer include:

- warranties being provided on an "indemnity" basis;
- specific indemnities in relation to particular risks (for example, environmental); and
- (on a share sale) the tax indemnity.

Indemnities, in certain circumstances, may provide a buyer with advantages over a right to claim damages for breach of contract, including:

- the ability to recover for loss on a dollar for dollar basis (this is useful if contractual damages are likely to be too difficult to quantify);
- no requirement to show causation (i.e., that the breach of contract caused the buyer's loss); and
- no requirement for the buyer to mitigate loss.

Where an indemnity is agreed, it is common for the seller to still seek to limit the indemnity by monetary caps and by including time limitations on claims.

A seller will resist the warranties being provided on an indemnity basis. A seller will prefer to limit its exposure simply to contractual damages for breach of warranty. While it does depend on the circumstances of the transaction and the respective bargaining power of the parties, it is not common in negotiated M&A transactions in New Zealand for warranties to be given on an indemnity basis.

It is more common for indemnities to be given in relation to specific risks (for example, an environmental risk). These will also be vigorously negotiated in terms of the breadth of application and monetary caps and time limits.

Tax Indemnity

As noted above, a tax indemnity is normally included in the acquisition agreement. The tax indemnity may, on its own, be relied upon by the buyer in relation to tax liabilities that are assessed on the target company at a later date but which are attributable to transactions or events occurring prior to completion (i.e., settlement).

The tax indemnity provision is generally the only way in which any tax claim may be brought by the buyer against the seller, including a claim for breach of any tax warranty. It follows that the scope and limitations which attach to the tax indemnity extend equally to the various tax warranties.

Another common feature of the tax indemnity is that "tax" is defined to include not only the usual forms of taxation (such as income tax), but also any "loss of relief". A loss of relief is defined broadly to mean a denial of any tax deduction, credit or refund previously claimed by the company. In this way, the tax indemnity protects the buyer not just against any subsequent imposition of tax relating to a pre-completion period, but also against the subsequent loss of any tax benefit previously claimed by the company in respect of a pre-completion period (for example, a deduction which is later disallowed as being of a capital nature).

There are several limitations on the buyer's ability to make a claim under the tax indemnity. A buyer is generally not able to make a claim under the tax indemnity where the relevant tax liability was met by the company or provided for in financial accounts prior to completion. In addition, it is common for tax indemnity claims to be restricted to the extent that the tax liability arises from:

- a voluntary change in accounting principles or the treatment of any item for tax purposes, where the change was not required by law; or
- a breach of shareholder continuity in the shares of the target company (which is inevitable in a share sale); or
- a failure on the part of the buyer, after completion, to make an election or provide any notice or consent that would have reduced or eliminated the tax liability.

The tax indemnity will also specify a limitation period, which can be either a fixed future date or an open ended period that ends when New Zealand tax authorities, due to a statutory time bar, become unable to reassess the target company in respect of pre-completion periods. If a fixed date is specified in the acquisition agreement, it usually mirrors the statutory time bar. The statutory time bar for a given tax year is four years from the end of the tax year (31 March) in which the income tax return for that year is filed. Where a fixed date is used, the buyer will want to ensure that returns for the year of sale are not filed late, as this will have the effect of deferring the application of the statutory time bar to a period in which the buyer will no longer have coverage under the tax indemnity.

Importantly, the tax indemnity provision indemnifies only the 'net' tax position. Any tax benefit that arises in favour of the buyer, and which relates to the tax indemnity period, will have to be deducted against the overall amount that would otherwise be payable by the seller under the tax indemnity.

A provision limiting the seller's maximum aggregate dollar-value liability can also be expected. The seller's maximum liability under the tax indemnity can stand on its own as a separate provision, or it can simply be subsumed under a wider maximum liability provision that applies generally to all warranty and indemnity claims (tax or otherwise) made under the acquisition agreement. The maximum liability provision can be expressed either as a fixed dollar amount or as a percentage of the purchase price.

The tax indemnity also makes provision for tax disputes. If, at some point following completion, the New Zealand tax authorities audit the target company and take the view that its tax position for a period prior to completion was incorrect, a formal disputes procedure between the company and the tax authorities will invariably commence. If the matter is covered by the tax indemnity, the target company could simply accept the increased tax liability, and the buyer could then claim against the seller under the indemnity. Often, a disputes provision is built into the tax indemnity, allowing the seller to participate in, or even control, any subsequent tax dispute between the company and the tax authorities that pertains to a pre-completion period. The extent of the seller's role in any dispute is negotiated by the parties. In this respect, it is reasonably common for the disputes clause to allow the seller to control the dispute and to meet attendant costs directly.

(j) Dispute resolution

In New Zealand, there is a number of mechanisms for resolving disputes. They range from negotiation and mediation (at one extreme) through to formal arbitration and court proceedings (at the other extreme). In between these extremes, there are a number of dispute resolution methods, including a combination of mediation and arbitration, early neutral evaluation, expert determination and mini-trials.

As you move along the spectrum, there is an increasing involvement of a third party in the process, the processes become more formal, the time and cost of the processes increase, and there is an increasing focus on the parties' legal rights as opposed to their interests. The parties' ability to control the process and the outcome also decreases.

Apart from negotiation, the three main dispute resolution methods are mediation, arbitration and court proceedings.

Mediation

Mediation is a non-binding process in which an impartial third party (the mediator) facilitates negotiations between the parties. The mediator does not have any power to make decisions. As a result, the parties maintain control over the outcome of the mediation.

Typically, mediation is a voluntary and consensual process, although in certain circumstances the parties may be required to attend mediation compulsorily. Mediation is a very flexible process. It is simple and informal, and can be used across a wide range of disputes. Mediations are ordinarily private and confidential. If successful, a mediation can result in a settlement agreement which is enforceable as a binding contract.

Arbitration

Arbitration is a formal judicial process like conventional litigation. It is a binding form of dispute resolution and involves a third party arbitrator imposing a decision by giving an award on the merits of the case.

Like conventional litigation, the likely overall costs and time associated with arbitral proceedings will depend upon the nature of any defence filed and how vigorously the proceedings are contested.

Some of the potential advantages are:

- The parties are free to choose an experienced or specialised arbitrator (say, a retired judge), which may save time and maximize the prospect of an acceptable decision. There is less possibility for intervention by the courts, apart from some minor instances (for example, stay of proceedings, interim relief).

- Arbitration is not fixed by court rules and therefore there is some flexibility to avoid time-consuming procedures which are unnecessary or inappropriate for resolving a particular dispute. In arbitration, the parties may agree a streamlined procedure, although often lawyers tend to replicate court procedures in the same way as conventional litigation.

- One of the major advantages of arbitration is that hearings are private and awards are confidential.

- Ordinarily, the entry costs for arbitration are lower than conventional litigation (there is no filing fee), but arbitration is not necessarily cheaper as the parties tend to replicate court procedures and must pay the arbitrator's fees and expenses. The question of costs and delay will depend on the extent to which the procedure is streamlined. Arbitration can be quick.

Court Proceedings

Conventional litigation is a formal judicial process. Court proceedings are conducted according to formal procedural rules. Decisions must be based on law and precedent.

There are several advantages to litigation. The parties receive a binding decision that sets a legal precedent; trials are conducted according to formal procedural rules which are designed to ensure a fair and just result; and judges are experienced in making difficult decisions concerning legal rights.

The main disadvantages of litigation include the time and cost of obtaining an outcome, and the uncertainty as to the result. Litigation lacks the flexibility of other dispute resolution methods. Additionally, litigation has the potential to destroy the parties' relationship. Finally, the parties have a limited opportunity to control the proceedings, they have no choice over the judge and no control over the outcome of the case.

5. Other issues

(a) Competition

The Commerce Act prohibits the acquisition of shares or assets of a business if that acquisition would have the effect, or likely effect, of substantially lessening competition in any New Zealand market. It applies to offshore acquisitions to the extent they affect a market in New Zealand.

The Commerce Act provides for a voluntary pre-transaction notification regime, permitting the acquirer to apply to the Commerce Commission for a clearance or an authorisation of the acquisition. The Commerce Commission will grant a clearance if it is satisfied that the acquisition will not, or will not be likely to, substantially lessen competition in any New Zealand market. There is also a more complicated authorisation process where the applicant believes the merger gives rise to a substantial lessening of competition but can show that economic public benefits arising solely from the merger exceed the detriments. Merger authorisations are very rare, although the Commerce Commission has recently developed a streamlined authorisation process which is intended to enable them to make quicker decisions on straight forward authorisation applications.

If an acquiring firm does not apply to the Commerce Commission for a clearance or an authorisation, and the Commerce Commission believes the acquisition gives rise to a substantial lessening of competition, it can commence proceedings in the High Court seeking an injunction to prevent the acquisition occurring, or penalties and divestment if it is able to prove that a breach of the merger provisions has occurred. Sellers can also be liable under the ancillary liability provisions of the Commerce Act. Third parties can also seek in the High Court damages from the buyer for breach. The Commerce Commission can also issue cease-and-desist orders, which are temporary administrative injunctions that prevent the continuation of anti-competitive behaviour. Cease-and-desist orders can only be issued where it is necessary to act urgently in the interests of the public and to prevent serious loss or damage.

The Commerce Commission must approve or decline an application for clearance within 10 working days. This time can be extended with the consent of the applicants, and inevitably is extended given that if the Commerce Commission is not *satisfied* a substantial lessening of competition is not likely then it must decline clearance. A clearance application will generally take at least 45 to 55 working days to be determined. It may be longer or shorter depending on the complexity of the issues raised and the Commerce Commission's workload at the time of filing.

Other Issues:

- Where a proposed merger involves two competitors, as in other jurisdictions, the parties must be careful not to 'jump the gun' before the acquisition occurs.
- Parties should be aware the Commerce Commission will frequently request copies of internal documents (such as management reports, board papers etc) as part of its consideration of whether a merger 'substantially lessens competition in a market'.
- The Commerce Commission has an active economics branch which tends to undertake extensive economic analysis to assist the Commission's assessment of mergers.
- The Commerce Commission can accept undertakings to divest assets or shares. However, under the Commerce Act the Commerce Commission is only able to consider structural (not behavioural) undertakings.

(b) Seller due diligence and reliance

In a competitive sales process, it is common for sellers to provide due diligence reports prepared on behalf of the seller to assist bidders. Successful bidders, and their financiers, are typically able to rely on these due diligence reports, subject to reaching agreement on the terms of a reliance letter.

(c) PPSA

The PPSA provides a single set of rules for security interests created by anyone including companies and individuals over personal property in all finance transactions, excluding those involving real estate.

The PPSA established a regime whereby priority in personal property is determined by the timing of creation and "perfection" of "security interests" over that property. Under the PPSA, "personal property" is broadly defined and most assets owned or used by a business can become subject to a security interest. However, as mentioned above, the ambit of the PPSA does not extend to interests in land.

A security interest is defined in the PPSA as "an interest in personal property created or provided by a transaction that in substance secures payment or performance of an obligation". The PPSA also deems certain interests to be security interests even though they are not true security interests in the traditional sense. This includes leases for a term of more than one year, transfers of accounts receivables and commercial consignments. Where the term "security interest" is used in this section of the guide it refers to both an actual and a deemed security interest.

In addition to regulating secured creditor's rights, the PPSA creates a procedure for registering security interests in personal property on an online register called the Personal Property Securities Register (**PPSR**). By registering a financing statement on the PPSR, creditors perfect their security interest and give "notice to the world" of their security interest. The PPSA sets out rules governing the priority of security interests once registered. The general scheme of the PPSA is that persons dealing with a company or an individual can search the PPSR to check whether any security interest has been registered over the personal property of the company or individual. The PPSR is publicly available and can be searched online.

The PPSA also provides that certain security interests known as "purchase money security interests" (**PMSIs**) can have super-priority over other general security interests. A PMSI is the equivalent of the traditional retention of title or romalpa interest and also includes new security interests such as a lease for a term of more than one year and a security interest of a consignor who delivers goods under a commercial consignment. PMSIs have to be registered on the PPSR within the time frames specified in the PPSA in order to obtain the benefits that attach to PMSIs.

The PPSA is relevant to negotiated M&A transactions for a number of reasons including:

- *Due Diligence:* Searches of the seller and target will indicate any encumbrances over shares or assets which may need to be released prior to a transaction completing.
- *Disclosure:* A seller will generally disclose information contained on the PPSR against warranties relating to encumbrances.

(d) Goods and Services Tax

As mentioned in section 2(b) of this guide (*"Asset Sale"*), where a sale involves the sale of assets, the default treatment is that the sale will attract GST at a rate of 15%. However, GST will be charged at 0% if the assets constitute a going concern, and the parties agree this is the case. The parties must also intend that the supply is of a taxable activity capable of being carried on as a going concern. As these are questions of both fact and law, in some circumstances, buyers may wish to seek comfort regarding whether a particular group of assets constitute a going concern and therefore may wish to obtain a binding or non-binding ruling from the Inland Revenue Department.

Where the sale cannot be zero-rated as a supply of a going concern, the parties can achieve a similar result by procuring a GST offset arrangement. This is an arrangement whereby the seller's GST liability arising from the sale is satisfied by the buyer transferring to the seller the benefit of the buyer's input tax credit entitlement arising from the sale. The net result is that no cash is required to be paid to satisfy the GST liability. However, such an arrangement requires the consent of the Inland Revenue Department and can also carry significant risks. To deal with this, the acquisition agreement should contain provisions to provide for the consequences arising in the event that the Inland Revenue Department disagrees with treating the supply as zero-rated, or does not approve a GST offset.

(e) Environmental

In negotiated M&A transactions involving interests in land, it is usual for buyers due diligence to include an environmental investigation. Depending on the circumstances, this may include engaging third party environmental consultants.

Environmental investigations, by their nature, may take considerable time to complete. A "phase one" investigation usually involves a "desk top" review and a site inspection but no "drilling" or similar invasive activity. While this can provide very useful information, it does not identify any previously unknown contamination.

A "phase two" investigation is more comprehensive than "phase one" and includes detailed investigation to establish if there is an unknown contamination or the extent of any known problems.

Buyers usually seek warranty protection for environmental risk from a seller. Warranties may include that there is no breach of environmental law (which would include the Resource

Management Act 1991 – a key environmental statute), and that all necessary environmental consents are held.

Buyers often also attempt to obtain an environmental indemnity. It is no uncommon to have an environmental indemnity if there is an identified environmental issue.

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