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TAKEOVERS PANEL

Guidance Note on the Process for Costs Reimbursements under the Takeovers Act 1993

Introduction

1. Until an amendment to the Takeovers Act 1993 was made in 2017, takeovers costs disputes were governed by rule 49 of the Takeovers Code. Reimbursement disputes under rule 49 were adjudicated by the District or High Court, although were often settled out of court.

2. The replacement of rule 49 with new sections 48-53 of the Takeovers Act transfers to the Panel the role of primary adjudicator of reimbursement disputes.[1]

Cost reimbursement procedure under the Takeovers Act

3. The Panel strongly encourages parties to deal with the question of costs through negotiation. If negotiation is successful, the amount to be reimbursed is the amount agreed to by the relevant director and the target company, or by the target company and the offeror (as the case may be) in accordance with sections 48(2)(a) and 49(2)(a) of the Takeovers Act.

4. However, at any time, before or during any negotiation, an application may be made to the Panel by any party to the reimbursement dispute for the Panel to determine the amount to be reimbursed (a "Reimbursement Application"). In accordance with section 50, if a Reimbursement Application is received, the Panel must:

   (a) determine the amount to be reimbursed; and

   (b) order that amount to be paid.

5. The parties entitled to be reimbursed are:

   (a) directors of a target company, by the target company (section 48); and

   (b) the target company, by the offeror (section 49).

6. The Panel will not usually commence processing a Reimbursement Application while a takeover is ongoing.

7. A Reimbursement Application must be made in writing and include the following:

   (a) an overview of the transaction and the parties involved;

[1] Sections 47-53 of the Takeovers Act apply in relation to an offer or a takeover notice only if the takeover notice is received by the target company on or after 31 March 2017, the date on which the new provisions came into force.

(b) a formal request for a determination under section 50(a) and for orders under section 50(b) of the Takeovers Act;

(c) all primary documents relating to costs for which reimbursement is sought; [2]

(d) a submission for each item of expenditure explaining how it meets the criteria provided in section 48(1) or 49(1) (as the case may be); and

(e) any other relevant information.

8. On receipt of a Reimbursement Application, the Panel will seek written submissions from the other parties to the Application.

9. The Panel will then determine the amount to be reimbursed, and make reimbursement orders on the basis of that determination.

10. Any of the parties identified in sections 48 or 49 may appeal to the High Court against the Panel's determination. The appeal process is set out in sections 51-53 of the Takeovers Act.

Determining the amount to be reimbursed

11. In accordance with section 48(1), the director of a target company is only entitled to be reimbursed by the target company for *"any expenses properly incurred by the director on behalf, and in the interests, of holders of equity securities of the target company in relation to the offer or takeover notice."*

12. In accordance with section 49(1), the target company is only entitled to be reimbursed by the offeror for *"any expenses properly incurred by the target company in relation to the offer or takeover notice, whether as a result of section 48 or otherwise."*

13. If a Reimbursement Application is made to the Panel under section 48(2)(b) or 49(2)(b), then in accordance with section 50(a), the Panel will determine the amount to be reimbursed. This amount will constitute the sum of each of the costs *properly incurred in relation to the offer or takeover notice.*

14. The Panel's determination under section 50(a) will usually be made "on the papers", meaning that it will be a factual assessment of the primary documents and other information provided to it, without holding a hearing.

15. The Panel may, if it considers that it would be beneficial, seek oral submissions from the parties to the Reimbursement Application. If the Panel hears oral submissions from one party, it will ensure that all parties have the same opportunity.

16. The Panel may exercise its powers to receive evidence on oath under section 31MA or to summon witnesses under section 31N of the Takeovers Act, if the Panel believes that it is appropriate to do so for the proper determination of the Reimbursement Application.

[2] This includes invoices and any other primary documents necessary for identifying each expense claimed.

Costs that are "properly incurred"

Determination for the purposes of section 49(2)(b) - expenses incurred by a target company

17. No two takeovers are alike. For that reason, it is not possible to prescribe in advance which of the expenses incurred by a target company in responding to a takeover notice or takeover offer will be recoverable under section 49. Each item of expenditure will be assessed by the Panel on a case-by-case basis, in light of the relevant facts.

18. However, the Panel considers that for an item of expense to have been properly incurred under section 49(1), the claimant must prove (to the civil standard) that the following four elements have been satisfied:

    (a) that the expenditure falls under any of the following three categories:

        (i) expenditure incurred in complying with the Code and the law, and the directors' fiduciary obligations which touch on the target company's response to a takeover;

        (ii) expenditure incurred for the purpose of safeguarding the offerees' interests (including the countering of propaganda). The merits of a bid (with value representing a subset thereof) should be used as a key measure of the offerees' interests; or

        (iii) expenditure incurred in reimbursing directors for expenses properly incurred on behalf of, and in the interests of, the offerees in relation to the takeover offer or notice;

    (b) that it was reasonable (with reference to circumstances existing when the expense was incurred) to incur the expense by engaging in that kind of activity;

    (c) that it was reasonable (with reference to circumstances existing when the expense was incurred) to spend that amount on that kind of activity; and

    (d) that there is a sufficient nexus between the incurring of the expenditure and the takeover offer or notice.

19. Full information on the three categories identified in paragraph 18(a) above is set out in the Schedule of this guidance.

20. In addition to the four elements described above, the Panel's consideration of whether an item of expense was properly incurred may involve an objective assessment of why the expense was considered necessary by the board of the target company.

21. Examples of items of expenditure that the Panel considers are not properly incurred for the purposes of sections 48(1) and 49(1) include:

    (a) expenses incurred by engaging in defensive tactics (the meaning of which is taken from rule 38 of the Code);

    (b) expenses incurred by the board of a target company in investigating or seeking competing offers; and

(c) costs imposed by the Panel under the Takeovers (Fees) Regulations 2001 for enforcement action taken under section 32 of the Act.

22. The Panel also does not envisage that the following would necessarily be properly incurred for the purposes of sections 48(1) and 49(1):

(a) success fees;

(b) costs associated with negotiating settlement of a reimbursement dispute; and

(c) costs involved in making a reimbursement application to the Panel.

23. However, there may be appropriate circumstances in which the Panel could decide otherwise.

Determination for the purposes of section 48(2)(b) – expenses incurred by a director

24. The Panel's determination of the amount to be reimbursed under section 48(2)(b) will be made on a case-by-case basis in light of the facts and circumstances before it.

25. However, as a guideline, the Panel's determination will constitute the sum of each of the costs that it considers to have been:

(a) properly incurred; and

(b) incurred on behalf, and in the interests of holders of equity securities of the target company.

26. The Panel's consideration of whether an item of expenditure was incurred on behalf, and in the interests, of, holders of equity securities in the target company will include an objective assessment of why the item of expenditure was considered necessary by the director.

<u>Costs incurred in relation to the takeover process</u>

27. Sections 48 and 49 provide an entitlement to claim costs incurred in relation to a takeover offer or takeover notice. The words "*in relation to*" have a very broad meaning. For the purposes of the Panel's determination under section 50(a), costs which may be reimbursed according to section 48(1) or 49(1) may include those incurred prior to receipt of a takeover notice by the target company, provided that:

(a) the costs were properly incurred; and

(b) the takeover notice was eventually sent.[3]

[3] If the takeover notice is never actually sent, costs cannot be claimed under sections 49-50. This is because these sections refer to recovery from an "offeror", being a person who makes an "offer" under the Code. However, where a takeover notice is sent, but never followed up with a takeover offer, costs may be claimed under sections 49-50 from prospective offerors. This is because interpreting the word "offeror" to include prospective offerors is consistent with rule 41 of the Code, which sets out the requirements for the sending of a takeover notice by an "offeror."

28. As a general guideline, the Panel will consider the takeover process to have ended on:

    (a) the date on which the offer becomes unconditional, or closes (whichever is the later);

    (b) the date on which the offer lapses; or

    (c) the date on which the takeover notice lapses.

29. However, the Panel reserves the discretion to include in its determination under section 50 costs incurred subsequent to the times described above, if:

    (a) the costs were properly incurred; and

    (b) the costs were incurred within a reasonable time from the end of the takeover process.

The Panel's fees

30. The Panel will charge for its time relating to Reimbursement Applications in accordance with the Takeovers (Fees) Regulations 2001.

31. The Panel will usually bill its fees equally to each party to the Reimbursement Application, unless there is good reason to charge one party more than the other.

Schedule: Recovery of expenses under the Takeovers Act 1993

1. Introduction

1.1 This Schedule provides guidance as to the scope of expenses falling within the category of *properly incurred* under section 49(1) of the Takeovers Act 1993. Section 48(1) of the Takeovers Act provides:

> *"(1) Despite anything in the constitution of a target company, each director of the target company is entitled to be reimbursed by the target company for any expenses properly incurred by the director on behalf, and in the interests, of holders of equity securities of the target company in relation to the offer or takeover notice."*

Section 49(1) of the Takeovers Act ("section 49(1)") provides:

> *"(1) A target company is entitled to be reimbursed by the offeror for any expenses properly incurred by the target company in relation to the offer or takeover notice, whether as a result of section 48 or otherwise."*

1.2 In general terms the view of the Takeovers Panel ("Panel") is that the principles put forward by the high Court in *Canterbury Frozen Meat Company Ltd v Waitaki Farmers' Freezing Company Ltd* [1972] NZLR 806 ("Canterbury Frozen Meat") in considering the meaning of "properly incurred" expenses can be applied to section 49(1). *Canterbury Frozen Meat* was in respect of section 11(2) of the Companies Amendment Act 1963, which was similarly worded to section 49(1).

1.3 The expenses scrutinised by the Court in that case were consistent with the corporate takeovers environment at that time and the facts of the case. Those expenses were relatively confined in nature and included a consideration of expenses incurred in relation to defensive tactics, described by the Court as actions resisting the takeover.

1.4 In the Panel's view, it is not correct to treat the expenses actually approved by the Court in *Canterbury Frozen Meat* as being exhaustive of what expenses might be properly incurred whether in 1972 or in the current takeovers environment. What is critical is the nature of the expense and whether it falls within the general category of expenses identified by the Court. In making such a determination, regard must be had to the legal and corporate environment in which takeovers occur.

1.5 Since 1972, law and practice as it affects takeovers has undergone substantial change. The responsibilities, accountabilities and expectations to which target companies and their boards are now subject in the face of a takeover offer, bear upon the actions they take and the expenses which they incur.

1.6 The Panel received conflicting submissions from market participants on its original draft of this guidance. Some submissions urged that the categories of recoverable expenses should be expanded considerably, without restriction (other than reasonableness), to expenses such as success fees charged by professionals to target companies. Others urged restricting the recovery of costs to expenses related to notices and target company statement obligations alone.

1.7 The Panel recognises that a proper balance must be maintained between ensuring that target companies and their shareholders on the one hand are not financially disadvantaged by unmeritorious takeover offers, and on the other hand are not denied the opportunity to consider meritorious bids by reason of the concern of bidders at the potential cost if their bid is made (whether successful or not).

1.8 In considering this balance, the Panel reached the view that to restrict the recovery of costs effectively to expenses related to notices and target company statement obligations would not address this balance properly in the modern New Zealand takeover environment. Specifically, the Panel considered that to restrict the recovery of expenses in this way would not only be inconsistent with *Canterbury Frozen Meat* but, more importantly, would be inconsistent with section 49(1) of the Act.

1.9 The Panel wishes to assist market participants in identifying what costs are properly incurred in terms of section 49(1). Section 2 of this Schedule note discusses *Canterbury Frozen Meat*. Section 3 highlights the demands made of target companies and their boards in the current takeovers environment. Section 4 considers how the

expenses arising from these demands should be categorised in terms of the general categories recognised by the Court in *Canterbury Frozen Meat*.

1.10 The Panel has jurisdiction to determine expenses to be reimbursed under section 49(1). The amount to be reimbursed may also be agreed between the target company and the offeror.

2. Canterbury Frozen Meat

2.1 In *Canterbury Frozen Meat* the Court was of the view that before an item of expense can be allowed the target company must prove:

(a) that the expense comes under one of the following four categories:

Category 1 – expenditure incurred in and incidental to the fulfilment of the target company's obligations in respect of notices, the target company statement and related out of pocket expenses;

Category 2 – expenditure incurred in countering propaganda by the offeror which is calculated to influence the offerees' choice;

Category 3 – expenditure incurred otherwise for the purpose of safeguarding the offerees' interests in relation to the takeover scheme, for instance, in keeping offerees informed of developments which might affect the value of their shares;

Category 4 – expenditure incurred in reimbursing directors for expenses properly incurred on behalf of, and in the interests of, the shareholders of the target company in relation to the takeover scheme; and

(b) that it was reasonable to incur the expense by engaging in that kind of activity; and

(c) that it was reasonable to spend that amount on that kind of activity.

2.2 The Court was also of the view that:

- in examining any particular item of expenditure, reasonableness should be judged with reference to circumstances existing when the expense was incurred and not with the benefit of hindsight to what, in the light of events, may have proved to be strictly necessary;
- expenses incurred for the purpose of resisting a takeover bid are not recoverable.

3. Changes in the corporate landscape

3.1 The market environment in which takeovers now take place is significantly different from, and more complex than, that which existed in 1972, when *Canterbury Frozen Meat* was decided. The changes include:

- significant changes in the law – principally reflected in a greater overall compliance requirement. For example, compliance with:
  - Financial Markets Conduct Act 2013 (including substantial product holder disclosure, directors' and senior managers' disclosure, insider trading and market manipulation prohibitions)
  - NZX listing rules
  - Takeovers Act 1993 and Code and the establishment of the Panel as the expert body regulating takeovers
- continuous disclosure requirements, requiring (in certain circumstances) a listed target company to take ongoing action;
- laws regarding misleading or deceptive conduct (embodied in rule 64 of the Code);
- generally harsher penalties imposed for non-compliance;
- a greater expectation placed on company directors by shareholders and the commercial community with the development of Codes of Conduct for directors;
- a greater public scrutiny of the performance of target company directors;
- a more litigious commercial environment.

3.2 One consequence of the above changes is that, to a much greater extent than in past years, the target company may need (and perhaps would be expected) to engage professional advisers, consultants and experts (e.g. lawyers, accountants, financial advisers, analysts, public relations experts, market sector experts, etc.) to assist it throughout the takeover process. As a result it should be recognised that target companies in the modern

takeover environment may properly incur costs that would not have been incurred, or may not have been seen as properly incurred, at the time *Canterbury Frozen Meat* was decided.

3.3 This environment means that companies subject to takeovers suffer from not only a significant diversion of resources when a bid occurs, but also very real cost which, in some cases, can be quite disproportionate to the size or assets of the target company. Takeover offers can be hostile and in any event do not require the agreement of the target company to be made. Therefore it is important that section 49(1) is applied in a manner which reflects the realities of a modern takeover and enables all properly incurred expenses to be recovered.

4. Applying Canterbury Frozen Meat to section 49(1)

4.1 The Panel considers that *Canterbury Frozen Meat* should be applied to section 49(1) as set out below.

Category 1 (expenses related to notices and target company statement obligations)

4.2 In broad terms, this category is directed to the regulatory obligations of target company boards in responding to takeover offers. The manner in which the category is expressed by the Court reflects the limited regulatory requirements of both the Companies Amendment Act 1963 and the law generally in 1972. Applying the principle to which this category is directed in the light of today's takeover environment, the Panel recognises two parts to this general category:

- *Part 1* – costs incurred in complying with the procedural requirements of the Takeovers Code. By way of example, such costs would include costs associated with:
  - preparation, printing and supply of target company statement
  - preparation, printing and supply of the Independent Adviser's report
  - the supply of the share register
  - approving variations to the takeover offer where prior approval of directors of the target company has been sought under rule 44(1)(b)(ii) of the Code
  - attendances with the Panel in relation to target company statement.
- *Part 2* – costs incurred in complying with the law and directors' fiduciary obligations which touch on the target company's response to a takeover. By way of example, such costs may include costs for:
  - meeting NZX requirements
  - meeting Financial Markets Conduct Act requirements (e.g. substantial product holder and continuous disclosure requirements)
  - satisfying itself through advice, that it (the target company) is not engaging in defensive tactics in breach of the Code
  - monitoring the bidder's compliance with the Code for issues which may affect target company shareholders
  - instigating complaints (provided they are not vexatious or an abuse of process) to the Panel which arise from actions of the bidder which may affect target company shareholders
  - responding to complaints made to the Panel by the bidder or associates of the bidder (other than in respect of actions or omissions of the target company, which the Panel determines have caused a breach of the Code).

The line between complaints about matters which affect target company shareholders and complaints designed to frustrate the course of the bid can be a fine one. Bidders should not be expected to pay for relentless target company actions regarding legal compliance.

4.3 Expenses which are incidental to the above should also be recoverable. It is recognised that there may be some overlap between Part 1 and Part 2.

4.4 Costs imposed by the Panel under the Takeovers (Fees) Regulations 2001 for enforcement action taken under section 32 of the Takeovers Act 1993 are not recoverable.

Category 2 (expenditure incurred for the purpose of safeguarding the offerees' interests – including expenses for countering propaganda)

4.5 The Panel considers that the category of expenses identified by the Court in *Canterbury Frozen Meat* as countering propaganda is an appropriate category, but should be treated as a subset of the category defined as safeguarding offerees' interests (which is an appropriate category of expense to be recovered by a target). Accordingly, the Panel treats *Canterbury Frozen Meat*'s Categories 2 and 3 as a combined Category 2.

4.6 The Panel notes that the Court in *Canterbury Frozen Meat* suggested that share value might be a key measure of *offerees' interests*. In the modern New Zealand takeover environment the Code identifies the merits of the bid as a key measure of *offerees' interests*, and value as simply a subset of this, with its importance varying depending on the nature of the relevant bid. For example, in a partial bid, the consequences of the bid both in terms of the control of the target company and the effect on a shareholder's holding are of critical importance.

4.7 The Panel considers that a broad view must be taken of *offerees' interests* consistent with the Code's focus on merits. This focus covers, in the Panel's view, any steps taken in relation to matters such as:

- expenses incurred by directors in fulfilling their fiduciary responsibilities in a takeover to act in the interests of the shareholders;
- expenses incurred in ensuring that shareholders are properly informed; there being two aspects to this:
  - the directors putting themselves in a position to be able to give advice to shareholders on the merits of the bid. It needs to be recognised that takeovers are rare events in the life of a company and, as such, directors commonly have no experience of takeovers and consequently little knowledge of how to respond to them. In order to respond properly they may need to retain an expert or experts versed in these matters (whether financial, legal, strategic or otherwise) to provide advice so that they are in a position to ensure that shareholders are properly informed.
  - the communicating of received advice to shareholders, effectively and appropriately. Depending on the circumstances, this may give rise to the need to retain PR consultants and the need to provide that communication by way of public notices. However, there should be demonstrated a clear justification for employing these strategies in substitution for, or in addition to, direct communication with shareholders.
- expenses incurred in countering propaganda calculated to influence the offerees' choice are a part of seeing that shareholders are appropriately informed. The situation sometimes arises, particularly in hostile takeovers, where target company shareholders receive information from the bidder extolling the virtues of the bid and/or criticising the performance of the incumbent management and board. The target company must be able to respond to such information in a balanced and meaningful way and should be able to recover its costs in doing so. There should be clear justification for employing the use of PR consultants and/or public notices in substitution for, or in addition to, direct communication with shareholders.

Category 3 (Director reimbursement for expenses properly incurred in the interests of shareholders)

4.8 The Panel considers that this is an appropriate category. This category would include expenses incurred by the individual directors in relation to additional board attendances to consider the merits of the takeover and other takeover matters.

Reasonableness of expenses judged by existing circumstances

4.9 The Panel agrees with the Court's view that in examining any particular item of expenditure, reasonableness should be judged with reference to circumstances existing when the expense was incurred and not, with the benefit of hindsight, as to what, in the light of events, proved to be strictly necessary.

Expenses for resisting a takeover bid

4.10 In *Canterbury Frozen Meat* the Court took the view that expenses incurred for the purpose of resisting a takeover bid are not recoverable. In the Panel's view, a distinction needs to be made between:

- first, expenses incurred by the board of the target company in *resisting a bid* by engaging in defensive tactics which are not permitted by rule 38 of the Code. The Panel considers that these expenses are what the

Court considered as being not properly incurred in *Canterbury Frozen Meat*. These expenses, which may include items such as the costs of sale of key assets, are not recoverable under section 49(1); and

- secondly, expenses incurred by the board of the target company in resisting a takeover bid considered by the board not to be in the interests of shareholders of the target company. These expenses, mostly related to communications with shareholders, should be recoverable under Category 2 above, as they are incurred in trying to ensure that shareholders are fully informed when making a decision as to whether to accept or reject a takeover offer. There should be clear justification for employing the use of PR consultants and/or public notices in substitution for, or in addition to, direct communication with shareholders.

4.11 Expenses incurred in *resisting a bid* are not always easily identifiable as falling within either of these categories. Whether they are *properly incurred* will turn on an objective view of the reason why they were considered by the board to be necessary.

Competing offers

4.12 The Panel is aware that in the United States directors may have a fiduciary obligation to maximise value for shareholders when presented with a takeover offer, by seeking competing offers. In New Zealand there is no established law requiring directors to seek competing offers. However, target companies are able to seek competing offers if they wish to do so, provided they do not breach rule 38 of the Code, and must consider any such offers should they come forward.

4.13 The Panel considers that because the decision to seek a competing offer is a voluntary decision of the board and is not made pursuant to a legal or fiduciary obligation, the expenses in investigating or seeking competing offers are not recoverable under section 49(1) as they do not properly fall within any of the above Categories of recoverable expenses.

4.14 The Panel suggests that if a target company board wishes to investigate or seek competing offers, then it should structure its adviser mandate in such a way that the expenses relating to the seeking of competing offers are clearly identifiable and separable from other expenses (i.e. expenses which may be recoverable under section 49(1)).

4.15 For the purposes of section 49(1) each competing offer should be viewed in isolation, to the effect that the offeror under the offer is only liable to pay the properly incurred expenses of the target company relating to that offeror's offer and not expenses incurred in relation to any competing offer.

Success fees

4.16 Sometimes in a takeover transaction advisers' fees (usually financial adviser fees) are structured so that the adviser receives a larger fee if a certain result is achieved (e.g. a larger fee if the initial offer is increased).

4.17 The key role of advisers, in the context of the Code, is to assist the target company board in carrying out its duties under the Code by providing objective expert advice. By engaging the adviser it is expected that the board of the target company will receive the required advice, regardless of whether a "success" outcome has been achieved or not. Most commonly, the adviser is engaged to assist the board in deciding on the appropriate response in the face of the takeover. To specify a success fee outcome in advance of receiving the advice required by the board to determine the target's response suggests in itself that the fee is not properly incurred for the purposes of section 49(1). Whether or not this might be the case, as the adviser is expected to provide the target company board with appropriate objective advice in any event, any "success" component of the fee must relate to an outcome that is not of itself an outcome that must be achieved as a legal or fiduciary obligation of the directors of the target company under Category 1.

4.18 For these reasons, the Panel takes the view that while the target company may have sound commercial reasons for entering into a "success fee" arrangement with the adviser, it is difficult to envisage the circumstances in which the costs incurred under such an arrangement could be regarded as being *properly incurred* and therefore recoverable under section 49(1). However, that does not necessarily rule out success fees from being recoverable under section 49(1) in appropriate circumstances.

Direct or indirect inducements

4.19 Target companies may consider making payments to shareholders to encourage them not to accept a particular takeover offer.

4.20 The Panel has seen no examples of direct inducement payments. The Panel considers that if they were to occur the costs of any such payments would not be recoverable under section 49(1) as they do not properly fall within any of the above Categories of recoverable expenses.

4.21 If the target company, for whatever reason, proposes to pay broker handling fees as indirect inducements to reward brokers whose clients vote against a partial takeover offer, then the Panel would similarly see the cost of such fees as not being recoverable under section 49(1) as they do not properly fall within any of the above Categories of recoverable expenses.

Directors' fees

4.22 All Code companies face the possibility of takeover offers made under the Code. Accordingly, the additional duties, responsibilities and attendances that arise for directors of Code companies on receipt of a takeover notice or offer, are an ordinary risk of holding office.

4.23 The Panel recognises that some takeover offers may be of such legal and commercial complexity that directors' attendances may significantly exceed those attendance levels that would normally be expected for a takeover situation. In these circumstances, it may be proper and reasonable for a Code company to compensate its directors for the additional attendances involved and these remuneration expenses may be recoverable under section 49(1). Whether such additional directors' remuneration is properly incurred, and therefore recoverable under section 49(1), will need to be determined on a case by case basis in the light of the relevant facts.

Expenses prior to takeover notice

4.24 Section 49(1) provides that expenses properly incurred by the target company in relation to an offer or a takeover notice are recoverable from the bidder. *Canterbury Frozen Meat* does not address the issue of recovery of expenses incurred prior to the target company receiving an offer or takeover notice.

4.25 It is the Panel's view that, although generally speaking it will be easier for the target company to show that expenses incurred by it, after the target company had received a takeover notice, were incurred in relation to an offer or a takeover notice, this does not preclude the recovery of expenses incurred by the target company prior to receiving a takeover notice, provided that (i) such expenses were properly incurred in relation to an offer or a takeover notice and (ii) a takeover notice is actually sent. The requirement that a takeover notice be sent is because section 49(1) allows recovery of expenses from an "offeror", being a person who makes an "offer" under the Code. No "offer" can be made under the Code without a takeover notice first being sent. Similarly, if a takeover notice has been sent, but no offer was made to shareholders, section 49(1) allows recovery of expenses incurred in relation to the takeover notice from a prospective offeror (being a party that has sent a takeover notice).[1]

4.26 Regardless of whether the expenses of the target company were incurred prior to, or after, the receipt of the takeover notice by the target company, such expenditure will only be recoverable from the bidder if there is a sufficient nexus between the incurring of the expenditure and the offer or the takeover notice. Such nexus can only be determined on a case by case basis.

4.27 Target boards are free to contractually agree with potential bidders that certain pre-bid expenses, such as due diligence costs, will be recoverable from the bidder and also the circumstances in which they will be recoverable. The Panel suggests that by contractually agreeing such matters from the outset, the parties may minimise the risk of a dispute later arising over the recovery of pre-bid expenses.

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[1] Interpreting the word "offeror" to include prospective offerors is consistent with rule 41 of the Code which sets out the requirements for the sending of a takeover notice by an "offeror".

Provision of expense information

4.28 The Code does not specify what information a target company is required to provide to a bidder in relation to the expenses it is seeking to recover from the bidder.

4.29 The Panel would expect the target company to provide the bidder with sufficient details of the nature of the advice provided by advisers and/or the services provided by suppliers in respect of which recovery of expenses is sought, to enable the bidder to be satisfied that the expenses are "properly incurred" for the purpose ofsection 49(1).

5. Summary

5.1 No two takeovers are alike. For that reason, it is not possible to prescribe which of the expenses which may be incurred by a target company in responding to a takeover offer are payable pursuant to section 49(1).

5.2 Drawing on the principles enunciated inthe *Canterbury Frozen Meat* case, but having regard to the Code itself and the environment in which modern takeovers occur, the Panel considers that before an item of expense can be allowed under section 49(1), the target company must prove that the following four elements have been satisfied:

(1) Application of general principles of proper expenditure – that the expenditure falls under one of the following three categories:

(i) *Category 1* – expenditure incurred in:
- complying with the procedural requirementsof the Code;
- complying with the law and directors' fiduciary obligations which touch on thetarget company's response to a takeover.

(ii) *Category 2* – expenditure incurred for the purpose of safeguarding the offerees' interests. Consistent with the law as set out in the Code, the merits of a bid (with value representing a subset thereof) should be used as a key measure of the offerees' interests. This category also includes expenditure incurred in countering propaganda (which was treated as falling under a separate additional category in *Canterbury FrozenMeat*).

(iii) *Category 3* – expenditure incurred in reimbursing directors for expenses properly incurred on behalf of, and in the interests of, the shareholders of the target company in relation to the takeover offer or takeover notice.

(2) Nature of expense reasonable – that it was reasonable (with reference to circumstances existing when the expense was incurred) to incur the expense by engaging in that kind ofactivity;

(3) Quantum of expense reasonable – that it was reasonable (with reference to circumstances existing when the expense was incurred) to spend that amount on that kind of activity;and

(4) Nexus with takeover – that there is a sufficient nexus between the incurring of the expenditure and the offer or the takeover notice.

5.3 Whether expenses incurred by the board of the target company in resisting a takeover bid considered by the board not to be in the interests of shareholders of the target company are *properly incurred* will turn on an objective view of the reason why they were considered by the board to be necessary. If those expenses were incurred by engaging in defensive tactics which are not permitted by rule 38 of the Code they will clearly not be *properly incurred*.

5.4 Expenses incurred by the board of the target company in investigating or seeking competing offers are not recoverable under section 49(1), as they do not properly fall within any of the three Categories of recoverable expenses.

5.5 The Panel takes the view that it is difficult to envisage the circumstances in which "success fees" could be regarded as being *properly incurred* and therefore recoverable under section 49(1).

5.6 Direct and indirect inducement payments intended or likely to influence shareholders to either reject a takeover offer or vote against such an offer are not recoverable expenses for the purposes of section 49(1).

5.7 Directors' remuneration for additional attendances may be a recoverable expense under section 49(1). Whether such remuneration expense will be recoverable must be determined on a case by case basis in the light of the relevant facts.