Guidance Note

COSTS RECOVERY

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TAKEOVERS PANEL
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www.takeovers.govt.nz

Contents

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This Guidance Note summarises how costs reimbursements operate under the Takeovers Act 1993. It also provides information on how the Panel considers claims for reimbursement should be made and key aspects of the Panel's approach to dealing with disputes which come before it.

1 Introduction

1.1 The Takeovers Act 1993 provides that target companies and their directors are entitled to be reimbursed for certain costs (see sections 48- 53).

1.2 Specifically:

(a) in accordance with section 48(1), a director of a 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"; and

(b) in accordance with section 49(1), the 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]

1.3 This guidance note summarises the relevant provisions of the Takeovers Act and relevant case law. In addition, this guidance note sets out the Panel's expected approach in the event that any costs disputes come before it.[2]

1.4 While the Panel has sought to provide guidance on how it will approach relevant matters, it is conscious that it will likely develop and refine its views as disputes come before it. As this happens, the Panel will revise this guidance note to include any additional guidance it considers to be of general assistance.

2 Cost reimbursement procedure

Making a claim and providing expense information

2.1 A costs recovery process is initiated by a party making a claim to the person liable for the relevant amount.

2.2 The Code does not specify what information a target company (or director) is required to provide to an offeror (or target company) in relation to the expenses it is seeking to recover.

2.3 However, the Panel would expect the target company (or director) to provide the offeror (or target company) 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 offeror (or target company) to be satisfied that the expenses are "properly incurred" for the purpose of section 49(1).

Interim invoicing

2.4 In the ordinary course of events, the Panel expects that claims for costs reimbursements should be made following payment by the target company (i.e., reimbursements should be made during the course of a takeover).

Negotiation first

2.5 The Panel strongly encourages parties to negotiate and agree costs reimbursements themselves. If negotiation is successful, the amount to be reimbursed is the amount agreed to by the relevant director and the target company,

[1] The directors' costs, which the target company reimburses in accordance with section 48(1), may, in turn, be passed on to the offeror under section 49(1).
[2] Please note that each matter will be assessed on a case-by-case basis in light of the relevant facts.

or by the target company and the offeror, as the case may be (see sections 48(2)(a) and 49(2)(a) of the Takeovers Act).

Reimbursement Applications

2.6 Although negotiation is encouraged, an application requesting that the Panel determine the amount to be reimbursed (a **Reimbursement Application**) may be made by any party to a reimbursement dispute. Although the target company is more likely to make an application, the bidder may also make an application disputing the expenses or the amount to be reimbursed. A Reimbursement Application may be made at any time.

2.7 A Reimbursement Application must be made in writing and can take a number of forms. However, the Panel would expect the following:[3]

(a) a letter or statement that sets out:

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

(ii) details of expense items which have been (or are to be) reimbursed which are not in dispute;

(iii) details of each expense item in dispute, with a submission explaining how it meets the criteria provided in section 48(1) or 49(1) (as applicable);

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

(v) any other relevant information; and

(b) an affidavit from a director or a member of the applicant's board (as applicable):

(i) attesting that all costs for which reimbursement has been claimed were appropriate and properly incurred;

(ii) providing factual evidence of all statements/matters referred to in paragraph 2.7(a) and cross referenced for the Panel's attention;[4] and

(iii) attaching all primary documents.

Panel process on receipt of a Reimbursement Application

2.8 The Crown Entities Act 2004 provides that the Panel has the power to regulate its own process. In the exercise of its functions and powers, the Panel will comply with the principles of natural justice. The rules of natural justice generally require that:

(a) the procedure is fair;

(b) a person who might be adversely affected has the right to know the case against them and the right to be heard; and

(c) the adjudicators of the issue are free from bias.

2.9 The Panel will typically provide a copy of a Reimbursement Application to the other parties to the dispute. If a party wishes for any information to be withheld, it must clearly identify the relevant information and demonstrate why it should not be disclosed. If the Panel agrees to grant confidentiality, the party is required to provide a copy of the relevant document with the relevant information redacted which the Panel may provide to the other parties to the dispute.

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[3] See paragraph 2.9 below regarding the identification of any privileged information.
[4] This includes invoices, terms of engagement, and any other primary documents necessary for identifying the basis of each expense claimed.

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

2.11 The Panel will then determine the amount to be reimbursed, and make reimbursement orders on the basis of that determination. This amount will constitute the sum of each of the costs "*properly incurred in relation to the offer or takeover notice*". The Panel's interpretation of this test is summarised in sections 3 and 4 below.

2.12 The Panel's determination under section 50(a) may 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.

2.13 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. The Panel may also 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.

2.14 As with section 32 meetings, the Panel acts as an inquisitorial body and questioning of witnesses will be led by the Panel and its counsel. The Panel does not allow cross-examination of witnesses by other parties, but may allow limited additional questions to be put to a witness through the Chair of the Panel division.

2.15 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 to 53 of the Takeovers Act.

2.16 The Panel reserves the right to publish its determination and statement of reasons.

3 Costs that are "properly incurred"

Expenses incurred by a target company (section 49(2)(b))

3.1 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 must be assessed on a case-by-case basis, in light of the relevant facts.

3.2 In general terms, the Panel's view is that the principles put forward by the High Court in *Abano Healthcare Group Limited v Healthcare Partners Holdings Limited* [2018] NZHC 817 ("*Abano v HPH*") in considering the meaning of "properly incurred" expenses should be applied to section 49(1).

3.3 In interpreting section 49(1), the Panel will apply the following broad principles articulated in *Abano v HPH*:

(a) the use of the term "any" implies full recovery of properly incurred expenditure;

(b) expenses must be properly incurred in relation to an offer or a takeover notice, but the term "in relation to" is broad and should be read widely;

(c) expenses must be reasonable and proportionate, and reasonableness and proportionality should be assessed with reference to circumstances at the time, not with the comfort of hindsight; and

(d) properly incurred expenditure in relation to a takeover notice is not a normal incident of the target company's business, and hence is not an expense the target company should bear.

3.4 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 was not incurred while engaging in any activity prohibited by the Code (for example engaging in "defensive tactics" which are prohibited by rule 38 or engaging in misleading or deceptive conduct in relation to a transaction regulated by the Code (see rule 64));

(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.

3.5 For clarity, the Panel does not envisage that the following would necessarily be properly incurred for the purposes of sections 48(1) and 49(1):

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

(b) costs involved in making a Reimbursement Application to the Panel; and

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

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

3.7 The Panel considers that properly incurred expenses will generally fall into the following categories, although they are not exhaustive:

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

(b) expenditure incurred safeguarding offerees' interests (**Category 2**); and

(c) director reimbursement for expenses properly incurred in the interests of shareholders (**Category 3**).

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

3.8 In broad terms, this category is directed to the regulatory obligations of target company boards in responding to takeover offers. The Panel recognises two parts to this general category:

3.9 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:

(a) preparation, printing and supply of the target company statement;

(b) preparation, printing and supply of the independent adviser's report;

(c) the supply of the share register;

(d) 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; and

(e) attendances with the Panel in relation to the target company statement.

3.10 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, this may include:

(a) costs of meeting NZX requirements;

(b) costs of meeting Financial Markets Conduct Act requirements (e.g., substantial product holder and continuous disclosure requirements);

(c) the target company's costs of obtaining advice to satisfy itself that it is not engaging in defensive tactics in breach of the Code (or would not do so if it took a certain course of action);

(d) costs of monitoring the offeror's compliance with the Code for issues which may affect target company shareholders;

(e) costs incurred in instigating complaints (provided they are not vexatious or an abuse of process) to the Panel which arise from actions of the offeror which may affect target company shareholders; and

(f) costs incurred in responding to complaints made to the Panel by the offeror or associates of the offeror (other than in respect of actions or omissions of the target company, which the Panel determines have caused a breach of the Code).

3.11 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. Offerors should not be expected to pay for relentless target company actions regarding legal compliance.

3.12 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.

Category 2 (expenditure incurred safeguarding offerees' interests)

General

3.13 The Panel considers that a broad view should be taken of offerees' interests, consistent with the Code's focus on merits. This covers, in the Panel's view, the following broad categories of expenses:

(a) expenses incurred by directors in fulfilling their fiduciary responsibilities in a takeover to act in the interests of the shareholders. However, generally the Panel envisages that expenses incurred in seeking competing offers are unlikely to be sufficiently proximate to the relevant transaction to be recoverable;

(b) expenses incurred in ensuring that shareholders are properly informed, there being two aspects to this:

(i) 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; and

(ii) the communicating of received advice to shareholders, effectively and appropriately. Depending on the circumstances, this may give rise to the need to retain communications consultants; and

(a) expenses incurred in countering communications from the offeror 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 offeror 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. Again, depending on the circumstances, this may give rise to the need to retain communications consultants.

3.14 If the target company, for whatever reason, proposes to pay broker handling fees to brokers whose clients vote in a particular way in relation to a shareholders' meeting in relation to a takeover offer, then the Panel would see the cost of such fees as not being recoverable under section 49(1).

Properly incurred expenses – sufficient nexus and reasonableness

3.15 Expenses must be properly incurred in relation to an offer or a takeover notice to be recoverable. Consequently, the party seeking recoverability must demonstrate that there is an appropriate nexus between the expense and the relevant transaction. For example, general retainer fees agreed to prior to the takeover being announced may not be recoverable.

3.16 The recoverability of an expense will also depend on its reasonableness. This will be assessed in the particular circumstances in which the underlying fee was agreed or expense incurred. The Panel will consider the reasonableness of any particular expense or fee by reference to both:

(a) the nature of the expense or fee (including the manner in which it is structured – see further below); and

(b) the quantum of the expense or fee.

3.17 Importantly, the decision in Abano v HPH does not preclude fixed fees or other non-time-based fees (e.g., success fees, contingency fees or outcome-based fees) from being recovered. The structure of a fee does not, in and of itself, mean that the fee is not recoverable. Rather it is the reasonableness of the fee that is relevant. Further, when considering the nature of a fee, the Panel will look to its substance rather than its form.

3.18 Accordingly, legal and advisory fees may be structured in a number of ways and still be recoverable. Target company boards are entitled to seek the advice that they consider necessary for the discharge of their legal or fiduciary obligations.

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

3.19 This category includes expenses incurred by the individual directors in relation to additional board attendances to consider the merits of the takeover and other takeover matters.

3.20 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.

3.21 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 undersection 49(1). Whether such additional directors' remuneration is properly incurred, and therefore recoverable undersection 49(1), will need to be determined on a case by case basis in the light of the relevant facts.

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

3.22 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.

3.23 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.

3.24 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.

4 Costs incurred "in relation to" the takeover process

General

4.1 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.[5]

4.2 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.

4.3 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.

Expenses prior to takeover notice

4.4 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 offeror. *Abano v HPH* does not address the issue of recovery of expenses incurred prior to the target company receiving an offer or takeover notice.

4.5 Generally, it will be easier to show that expenses incurred after a takeover notice is received (as opposed to those incurred before receipt) were incurred in relation to an offer or a takeover notice. However, this does not preclude the recovery of expenses incurred prior to receiving a takeover notice, provided that:

(a) such expenses were properly incurred in relation to an offer or a takeover notice; and

(b) a takeover notice is actually sent.

4.6 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).

4.7 Regardless of whether the expenses were incurred prior to, or after, the receipt of the takeover notice, such expenditure will only be recoverable from the offeror 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.

4.8 Target boards are free to contractually agree with potential offerors that certain pre-bid expenses, such as due diligence costs, will be recoverable from the offeror 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-offer expenses.

5 The Panel's fees

5.1 The Panel will charge for its time relating to Reimbursement Applications in accordance with the Takeovers Regulations 2000.

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[5] If the takeover notice is never actually sent, costs cannot be claimed under sections 48 – 50. However, where a takeover notice is sent, but never followed by an actual takeover offer, costs in connection with the takeover notice may be claimed from the prospective offeror. This is because these sections refer to recovery from an "offeror" or a "target company" (as applicable). These terms bear their definitions from the Code (see section 47). In general terms,

(a) an "offeror" includes a person who gives a takeover notice as well as a person who makes an offer under the Code; and

(b) a "target company" includes a company which has received a takeover notice and a company whose voting securities are subject to an offer under the Code.

5.2 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.