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Dear Garth

NZX CONSULTATION PAPER

This submission is made by the Listed Companies Association in respect of the Consultation Paper released by NZX on 25 November.

The Association in general supports the proposals in the Consultation Paper, and the broad thrust of NZX's statements under the heading "Focus" in the paper.

Timetable

In the Association's view, the timetable proposed by NZX is unrealistic. It is very substantially different to the timetable set out in the NZX Guidance Note on the process for amending NZX conduct rules.

The Association agrees that change is urgent. However, the changes proposed here are radical. Some (and in particular the proposed new Rule 3.3.5A) are likely to be contentious. There is a great deal of detail which needs to be thought through properly. The initial draft raises a myriad of issues, which will doubtless be dealt with in the submissions received.

Against this background, NZX has allowed two weeks for initial submissions and then proposes to issue a further exposure draft within five days, obtain comments on that in a week (by the last general working day of the year) and submit the rules to the Minister on 30 December. The Association is concerned that that timetable is likely to lead to provisions which are inadequately considered and drafted.

The Association urges NZX to consider a timetable whereby a further exposure draft is released before Christmas, submissions called for in mid-January, and the amendments completed by the end of January. In view of the very limited commercial activity in January, this is unlikely in the Association's submission to lessen the practical value of the amendments.

Submissions in respect of each individual proposal in the paper are set out below. They are where appropriate divided into comments on the policy of the proposed amendment, and comments on detailed drafting issues.

1 & 2 Paragraphs 1 and 2 - Pro Rata Rights Issues and Listed Debt Issues

Policy

The Association supports the amendments proposed here. The amendments will give listed companies the choice (in the case of rights issues and debt issues) of using the short form Term Sheet Offering Document instead of the longer form documents required by the Securities Act. The Association makes the following points:

(a) A responsible issuer is likely to undertake a due diligence exercise to satisfy itself that there is no undisclosed Material Information, which may be as extensive as the due diligence exercise to support an offer based on long form documents.

(b) In the case of debt issues, a trust deed complying with the Securities Act will still need to be entered into.

However, whilst these are matters that listed companies will need to bear in mind, they are not reasons for not making the amendments.

If a legislative change is proposed, care should be taken that that change does not take the offers made under these provisions outside the scope of the Australia/New Zealand mutual recognition regime. To ensure this, Part II of the Securities Act will

need to continue to apply to the offers (regulation 8.2.01 of the Australian Corporations Regulations 2001).

Detailed Comments

No change is proposed to the rules to provide for the content of a Term Sheet Offering Document, presumably on the basis that the content will be governed by the Securities Act exemption notice, or by legislation if legislative amendment is required. The Association makes the following comments:

(a) In subparagraph (ii) in paragraph 1 of the paper, the final wording should make it clear that the reference is to material risks relating to the particular security, as opposed to material risks relating to securities of the issuer generally.

(b) In paragraph (iii), it will be necessary to identify the precise published information which must be referred to. Apart from the financial statements and annual reports, what is intended?

(c) The nature of the "signed warranty" needs to be clarified. Who is this addressed to? What liability attaches if it later proves inaccurate? We suggest that the required statement should be set out in the exemption notice or legislation. A useful example is contained in clause 19 of schedule 1 to the Takeovers Code. The form of statement might read:

> To the best of our knowledge and belief, after making proper enquiry, as at the date of this certificate:
>
> (a) all Material Information of which the **[**company**]** is aware has either been released to NZX or is contained in the **[**offer document**]**; and
>
> (b) the **[**company**]** is not withholding the release of any Material Information in reliance on the proviso to **[**NZSX**][**NZDX**]** Listing Rule 10.1.1(a).

Liability for inaccuracies in this statement should be governed by the provisions of sections 55 to 58 of the Securities Act 1978. The statement will form part of an "advertisement" for the purposes of the Securities Act so that (in the absence of any legislative change) it will be governed by those provisions. However, under the Securities Act as it stands that liability will

attach to directors, but not to the chief executive officer or chief financial officer.

The redraft of the final paragraph of rule 7.1.1 is not in the Association's view correct. The first sentence of that paragraph deals with offers governed by the Securities Act, and the second sentence with the other circumstances referred to in rule 7.1(b) and (c). The paragraph should read to the following effect:

> If the Issuer or applicant is required (or but for an exemption granted by the Securities Commission under section 5 of the Securities Act 1978, would have been required) to register a Prospectus under the Securities Act 1978, the Offering Document shall be either:
>
> (a) an Investment Statement; or
>
> (b) if a Term Sheet Offering Document is permitted by **[**exemption notice/legislation**]** a Term Sheet Offering Document.
>
> In other circumstances, the Offering Document shall be a Profile.

It is presumably intended that a Term Sheet Offering Document may be used for renounceable rights offers (so that shares may be issued to parties who are not already shareholders). The exemption notice or legislation which provides for the use of a Term Sheet Offering Document should make this clear.

3. Per Shareholder Capital Offerings

Policy

The Association supports this proposal. The Association notes that under Rule 7.3.4(c), a company which makes a share purchase plan offer under Rule 7.3.4(ba) may place shares which are not taken up under the offer with any person. The obvious effect of increasing the maximum amount under Rule 7.3.4(ba) is to increase the amount which is likely to be available to be placed under Rule 7.3.4(c).

4. Private Placements

Policy

The Association supports this proposal.

Detailed Comments

There are three principal issues:

(a) the extent to which persons other than Directors, Employees and their Associated Persons must participate in any issue;
(b) the relationship of the amended rule to Rule 9.2;
(c) the nature and effect of the declaration the board is required to sign.

The rule provides that the terms of issue "to all persons under this Rule" must be the same, and that the level of participation of directors, etc. must be determined according to criteria applying to "all persons participating in the offer". An obvious question is the extent to which other persons must be eligible to participate in the offer. If (for example) 19.99% of a company's capital is issued to directors, and .01% is issued to some other person, is it sufficient that the terms of issue to the directors are the same as the terms of issue to that other person? Does there need to be some genuine level of participation by other persons?

Also, there is a difficulty with the reference to "criteria applying to all persons participating in the offer". By its very nature, an issue under Rule 7.3.5 will not be made to existing shareholders pro rata to their shareholding, and is likely to be made to selected persons. What criteria can determine the "level of participation" of persons participating in such an offer?

The Association is not clear as to the meaning of the sentence:

> Note that amendment would also be required to the definition of "Material Transaction" contained in Rule 9.2.2 to the extent that this may be a Material Transaction requiring a waiver.

Is this saying that Rule 9.2 will not apply at all to issues made under Rule 7.3.5? The effect would of course be that new shares equal to 20% of a company's capital could be issued to directors or their associates without any shareholder approval.

That is, in the Association's view, too liberal. The Association believes that Rule 9.2 (amended as proposed in paragraph 8) should continue to apply to issues under Rule 7.3.5. However, if Rule 9.2 is to continue to apply, it needs to be amended to provide that what is taken into account for the purposes of the 5% (or 10% if amended) threshold in that rule is the value of securities issued to directors, employees, and their associated persons, not the value of all securities issued (as is presently the case under Rule 9.2).

The draft rule 7.3.5(b)(i) provides:

> The Board signs a declaration that their participation is in the best interests of the Issuer and shareholders generally;

The Association proposes that this be replaced with:

> (i) All Directors of the Issuer sign and deliver to NZX a statement that in their opinion the participation in the issue of the persons referred to above is in the best interests of the Issuer and is of benefit to the holders of Equity Securities who are not to participate in the issue.

By way of explanation:

(a) the reference to "all Directors" makes it clear that the certificate cannot be signed just by a majority of the board;
(b) the statement must always be one of opinion by the directors;
(c) the concept "of benefit to" shareholders not participating in the issue is analogous to the concept in sections 61(1) and 71(1) of the Companies Act.

Paragraph 4 contains the note:

> Please note that the following proposed Listing Rule changes require legislative change to the Securities Act.

Why is that the case?

5. Rights Issue Reduced Time Frames

The Association supports this proposal.

6. Listing Rule 8.1.3: Issue of Equity Securities Carrying Voting Rights

Policy

The Association supports this proposal. However, the Association is not clear why the volume weighted average price over the last five Business Days is referred to in this rule, whilst 20 day VWAP is used for the purposes of the new Rule 7.3.6B, Rules 7.3.5(d) and 7.3.6(f), and the definition of "Average Market Capitalisation".

Detailed Comments

The only comment of detail is that the word "stock" in the last line of the re-drafted Rule 8.1.3(b) should be deleted.

7. Remuneration of Directors by Stock to Levels Approved by Shareholders

Policy

The Association supports this proposal. However, it should be made clear that Rule 7.3.6B does not prohibit other methods of remunerating by way of equity (as for example participation in employee share plans, now expressly permitted by Rule 7.3.7AA).

Detailed Comments

The new Rule 7.3.6B should be 7.3.6A. There is no existing Rule 7.3.6A.

In the new Rule 7.3.6B(c) the words "at the end of" might be replaced by "after the end of".

If the new Rule 7.3.7AA is introduced, the second to last paragraph in Rule 7.3.6 needs to be deleted.

8. Related Party Transactions: Materiality

The Association supports this proposal.

9. Employee Share Schemes and Stock Issuance

Policy

The Association supports this proposal.

Detailed Comments

The new Rule 7.6.1(f)(i) should read:

> (i) is made from any Person who is not a Director or Associated Person of a Director of the Issuer; and

10. Financial Assistance

Policy

The Association supports this proposal.

In respect of the proposal to abolish the prior disclosure document required by section 78(5) of the Companies Act, the Association makes the following comments:

(a) if the financial assistance is less than 5% of shareholders funds, it is possible to use the procedure under section 80 of the Companies Act, which provides for brief disclosure to shareholders **after** the assistance is given;

(b) the same concept of a prior disclosure document required by section 78(5) applies in the case of share buybacks (section 61(5)) and redemption of shares (section 71(5)). It would not be logical to change section 78(5) without also changing sections 61(5) and 71(5). There would probably be resistance to removing all three requirements;

A less major change, which would be useful to listed issuers, would be to permit the disclosure document to be provided to shareholders electronically (perhaps by a process analogous to that applying to annual reports under section 209 of the Companies Act).

Detailed Comments

In the new Rule 7.6.5(b)(i) the words "and the period from the date on which the Issuer was Listed to the date of giving of the financial assistance," have been omitted.

11. Minority Shareholders and Independent Directors

The Association does not support the new proposed Rule 3.3.5A.

The proposal would introduce a very significant change to New Zealand practice, and would significantly affect a number of large New Zealand listed companies. However, it is supported by no discussion or analysis, or evidence of the need for a change. So far as the Association knows, no other comparable jurisdiction has a similar rule.

The obvious effect of the proposal is to disenfranchise majority shareholders on an important issue. That is likely to reduce the incentive for parties to hold between 50% and 100% of a listed company. That is a very undesirable message in the present market conditions.

The proposal might also encourage parties such as hedge funds to take a reasonably small stake in a company with a major shareholder, in order to be able to control the appointment of a disproportionate number of directors. For example, in a company with a single shareholder holding 75%, a hedge fund or the like could probably control voting of the minority shareholders, and thus the election of at least two independent directors, with a 5% stake.

All directors owe their duties to the company (section 131 of the Companies Act) and thus indirectly to all shareholders. The paper speaks of independent directors having a "direct accountability nexus" to minority shareholders. That is not right. Directors associated with the majority shareholder have just the same accountability to minority shareholders, and independent directors have just the same accountability to the majority shareholder. Directors of a listed company are not, and should not be, divided into "camps".

The proposal is that a majority shareholder should not vote on the remuneration of independent directors. However the majority shareholder in substance pays more than 50% of the remuneration of independent directors. Is it not reasonable that the majority shareholder would have some say on that remuneration?

In any event, there is a logical problem with the proposal. If the new rule were introduced, a shareholder holding 50.1% of shares of a listed company would not be able to vote on the remuneration, appointment or reappointment of independent directors. However, if that shareholder reduced its holding to 49.9%, it would be able to vote, and would still inevitably control the voting at the meeting. An attempt to remedy this problem by reducing the level of shareholding at which the rule applies (for example to 40% or 30%) would make the rule only more arbitrary and undesirable, and would still face the same logical problem.

There is another fundamental issue with the proposal. The new Rule would provide that the majority shareholder could not vote on the election of any independent director. This raises two issues:

(a) In a number of companies, the number of independent directors is greater than the proportion of shares held by minority shareholders. For example, in the case of Air New Zealand Limited, the minority shareholders hold 24% of shares, but all of the eight directors are identified as independent directors. In the case of Vector Limited, the minority shareholders hold 24.9%, and six of the eight directors are identified as independent directors. The proposal, unless amended, would have the extraordinary effect that the majority shareholder would have the right to vote in respect of none, or a minority, of the total board.

(b) Leaving aside the issue in (a), consider the situation if (for example) a company has six directors, of which two are independents, and shareholders nominate another five independent directors for election at a shareholders' meeting. Those five could be elected by the minority shareholders, and the control of the board would change, against the wishes of the majority shareholder.

It may be suggested that the way to address the issues raised above would be to provide that the majority shareholder is restricted from voting only in respect of a number of independent directors equal to the minimum number required by Rule 3.3.1(c). However, that in itself will raise difficult questions. What if more than that minimum number is nominated for election at a meeting? What if the majority shareholder itself nominates independent directors and then votes for them?

The effect of all of this is likely to be, in the submission of the Association, the reduction of the number of independent directors on the boards of companies with a major shareholder.

In summary, the Association sees the proposed amendment as ill conceived. It is likely to meet very considerable opposition, and that could delay the adoption of the whole package of amendments, which the Association agrees is urgent.

12. Appraisal Reports

Policy

The Association does not support this proposal.

The Association believes that compulsory appraisal reports serve a valuable role in respect of resolutions to consider related party transactions, and issues of the nature referred to in rule 6.2.2(b). If the proposed change to Rule 9.2 is made, the circumstances in which an appraisal report will be required will in any event be less frequent.

In respect of resolutions required by Rule 7.5, the Association's view is that Rule 7.5 serves no useful purpose, and should be deleted. The fundamental issue at which rule 7.5 is directed (a party obtaining increased control by virtue of an issue, acquisition, or redemption of securities) is governed by the Takeovers Code.

13. Capital Markets Development Taskforce

There are some inconsistencies between the proposal in the Consultation Paper and the interim report of the Capital Markets Development Taskforce released on 27 November. These are:

- The Taskforce does not deal with the concept of a Term Sheet Offering Document for equity issues (although it does deal with that document for debt issues).
- The Taskforce believes that a company should be able to use a Term Sheet Offering Document for debt issues only if it already has equity listed on NZX. NZX anticipates that a company which has equity **or** debt listed should be able to use the Term Sheet Offering Document for debt issues.
- In respect of rule 7.3.5, the Taskforce agrees that the limit should be raised from 15% of capital in any year to 20%. However, the Taskforce says "this

exception does not allow share issues to related parties". NZX of course proposes that the rule should be amended to allow issues to related parties.

- The Taskforce regards the changes proposed by NZX in respect of related party transactions and in respect of appraisal reports as "changes which require some further consideration".
- The Taskforce does not deal at all with the change proposed by NZX to the effect that majority shareholders cannot vote in respect of the appointment or remuneration of independent directors, of with the changes proposed in respect of buybacks of securities from employees and financial assistance to employees.

The Association does not know whether these matters represent a fundamental difference of opinion between the taskforce and NZX. It would be valuable to resolve this as soon as possible.

We look forward to meeting with the NZX team to discuss the above submissions. In the meantime, please do not hesitate to contact me.

Yours sincerely

Linda Cox

Chair

Listed Companies Association