



BARRISTERS AND SOLICITORS

**By email**

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Dear Damas

**Conduct Rule Review - Submissions**

**Introduction**

Thank you for the opportunity to provide submissions on the Consultation Paper dated 22 September 2005.

Our submissions are intended to assist NZX and are provided on the basis of our experience with the Rules. They represent the collective input of a number of our partners and senior lawyers experienced with the NZX, NZDX and NZAX Rules. Please note that the views expressed in this letter do not represent the views of any of our clients.

**Rule 1.1.2 – Disqualifying Relationship**

We agree that it would be useful to clarify the situation regarding distributions (such as dividends) being excluded from “annual revenue”. If distributions are to be excluded, then this should only be where all security holders are treated identically in relation to the distribution.

**Rule 1.1.2 (NZAX LR A1.1.2) – Equity Security**

We agree that there is some circularity within the definition of “Equity Security”. However, in practice, we do not believe this has caused any issues for us or our clients.

Given that the provisions are workable in practice (and rulings could readily deal with any situations where this was not the case) and the potentially significant new and unknown issues which may arise as a result of trying to rectify the drafting, we suggest the best outcome is for the status quo to be maintained.

**Rule 1.1.2 (NZAX LR A1.1.2) – Ex Date, and Rule 7.10.9(a) (NZAX LR A3.5.8(a))**

The proposal to move to a regime whereby Securities are quoted “Ex” three business days prior to the Record Date is sensible given international market practice.

In our view, the suggested amendments to give effect to this move outlined in the Paper are appropriate and effective.

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**Rule 3.1.1(a) and Appendix 6 (NZAX LR A3.1.1 & Footnote) – Requirements for Constitutions**

We agree with the proposal to significantly reduce the number of Rules (in Appendix 6) which are required to be incorporated in issuer's constitutions.

We also agree with the proposal to maximise the choice of approach for issuers.

**Rule 3.2(b) – Requirements for Trust Deeds (maturity)**

We agree with the proposal to delete Rule 3.2(b) entirely.

**Rule 3.2(c) – Requirements for Trust Deeds (redemptions)**

We agree with the proposal to delete Rule 3.2(c) entirely.

**Rule 3.3.1 – Board composition**

We do not believe that the proposal to require that Debt Issuers have at least one resident New Zealand director is desirable. Our reasons are that:

- (a) Having a director resident in New Zealand would not necessarily make it any easier to enforce the Rules. Contacting an offshore director should be no more difficult than contacting a resident director.
- (b) Debt only issuers may be SPV treasury companies of global banks/corporates which may not otherwise have a director in New Zealand. The requirement to appoint a resident director may have adverse tax or administrative costs which outweigh the perceived benefit of having a resident director. This is quite different from equity issuers who are likely to have a substantial New Zealand business presence.

**Rule 3.3.2 (NZAX LR B2.1.1) – Director nominations**

We agree with NZX's view that a notification requirement is beneficial. We also consider that the focus should be on the closing date for nominations (rather than both opening and closing dates as is currently the case). Requiring only a closing date notification would avoid the need for issuers to make a separate announcement of the date of their annual meeting and the date nominations open. Issuers should be able to announce the date of their annual meeting and the closing date for director nominations at the time they announce their full year results.

On 24 October ASX announced that it had amended the timetable for the closing of director nominations to 35 business days before the shareholders meeting "*or as otherwise stated in the constitution.*"

Given the amendment to the ASX Rules, we consider that the NZX rules should retain the two month closing of nominations requirement. Our experience has been that 35 business days can be too short a period of time for issuers who wish to send out the notice of annual shareholders meeting at the same time as their annual report.

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**Rules 3.3.3 and 3.3.9 (NZAX LR B2.1.3) – Directors retiring following appointment**

We have no strong view on the question of whether executive directors should be subject to the requirement for shareholder confirmation at the next annual meeting following appointment and the three year retirement by rotation rule.

From a governance perspective, we asked ourselves whether it was appropriate for any director to be able to remain on the board without having been subject to any shareholder approval. That led us to conclude that executive directors should be subject to the confirmation requirements.

**Rule 4.5.11(b) (NZAX LR B3.5.11) – Compliance with disclosure obligations**

We had some mixed views on this internally, but on balance suggest that given the significance of the subject, the advice be from the directors. The fact that the disclosure obligation under Rule 10.1 rests with the issuer can be accommodated if the Rule was changed such that “the Directors advise the NZX that the issuer has complied with Rule 10.1”.

**Rules 4.7.3 and 4.7.6 (NZAX LR B3.7.3 and B3.7.6) – Exercising default powers and limitation of remedies**

We also had some mixed views on this internally, but again on balance agree with the proposal to place the obligations on the directors.

**Rule 5.2.3 - Spread requirements**

The inclusion of multiple ways to indicate the existence of a satisfactory market would be a very positive change, although it does seem logical that the number of shareholders remains at least partially relevant. Perhaps a range of factors could be taken into account.

**Rule 6.1.3 (NZAX A5.1.2) – Independent Solicitor’s opinion**

We suggest that continuing with the requirement for an independent solicitor’s opinion is appropriate. In our experience, the reviews add to the integrity of the documentary process.

Some of the alternative proposals outlined in the Paper could give rise to more complications than they avoid.

**Rule 6.2.6 (NZAX LR A5.1.7) – Proxy Forms**

We agree with the proposal contained in the second discussion point of the Paper. It would seem sensible to recognise options of abstentions and proxy discretion. However, we also agree with the proposal that maximum flexibility is desirable, with issuers having a choice as to what approach they wish to take.

**Rule 7.1.1 – Definition of Profile**

We agree that it would be desirable to clarify the position regarding prospectus exemptions.

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**Rule 7.1.7 (NZAX A3.4.3 Footnote) – Statement relating to NZX**

Bell Gully agrees with the proposal to ensure consistency between this Rule and the currently permitted pre-prospectus advertising.

**Rule 7.3.4(ba) (Rule 7.3.4(ba) in Appendix 1 of the NZAX Rules) - \$5,000 offers**

We agree with the proposal to conform the Rules if the Securities Commission exemption is granted.

**Rule 7.6 (Rule 7.6 in Appendix 1 of the NZAX Rules) – Buybacks and redemptions**

Bell Gully agrees that the definitions of “buybacks” and “redemptions” would be useful. We believe the points of difference are those articulated in the second discussion point.

**Rule 7.6.5 (Rule 7.6.5 in Appendix 1 of the NZAX Rules) – Limits on Financial Assistance**

We agree with the proposal to conform to a Market Capitalisation measure.

**Rule 7.6.6 (Rule 7.6.6 in Appendix 1 of the NZAX Rules) – Time limit in which financial assistance, redemptions and acquisition of Equity Securities with approval of Holders must be completed**

We agree with the proposal to conform the timelines for these activities to those applicable to new issues.

**Rule 7.11.1 (NZAX Rule A3.6.1) – Time for Allotment**

Bell Gully agrees that the time limit for allotment should be driven off closing dates.

**Rule 8.1.3 – Issue price for Equity Securities**

We agree with the logic of the proposal to extend Rule 8.1.3 to cover the issue price of Securities that may convert into Voting Securities. However, we note that a precise formulaic approach such as that currently applied to new issues of Equity Securities may be very difficult to achieve. Given the nature of such securities their value will be dependent upon a range of factors. A formula which prevents issues at a substantial under value will not suit every type of security. It is better therefore to state this in a general way, such that directors are reminded of their obligation not to under value the security and instead rely on directors' duties contained in the Companies Act .

**Rule 9.1.1 (NZAX LR 9.1.1 of Appendix 1) – Major Transactions**

We do not support the proposal to require Rule 9.11 approvals to be by way of special resolution of security holders. We consider the current ordinary resolution criteria appropriately balances the rights of shareholders to approve important transactions with the needs of the company to be able to enter into transactions which the Board has determined to be in the best interests of the company. At a philosophical level, we agree that if section 129 of the Companies Act were to be applied on a group basis then this should be a change made by Parliament and not effectively through the operation of the Rules.

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### **Rule 9.2.1(d) (NZAX Rule B4.1(d)) – Related Party Transactions**

Our experience is that there are difficulties in determining the treatment of service contracts under the existing Rules and suggest it would be timely for NZX to undertake a wider review of this provision.

We consider that that review should begin with first principles on questions such as: (1) how to best value service contracts for Related Party Transaction purposes; (2) what is the appropriate threshold given that valuation method; and (3) how to enable issuers to have certainty from the date of entering into such arrangements (rather than having to review it on an annual basis).

In terms of value, it will be necessary to recognise some elements of judgment exist as to the best estimate of value/cost of the contract over the duration of the contract. One alternative might be to determine the npv of the estimated gross cost over expected life. These matters are not easily resolved. We therefore favour NZX undertaking a further and separate consultation on this item to obtain a best outcome result.

We support the current de minimus amount of \$250,000 becoming the greater of \$250,000 or 0.1% of Average Market Capitalisation (such that an issuer with a market capitalisation of NZ\$1 billion would have a de minimus threshold of NZ\$1 million for the purposes of the related party rules).

### **Rule 9.2.3 (NZAX Rule B4.3) – Definition of Related Party**

(a) Proposal 1

Bell Gully favours the adoption of the concept of an “Executive Officer” and adding a guidance note to the effect that an “Executive Officer” means the chief executive officer and any person undertaking all or some of the duties of the chief executive officer of the issuer.

(b) Proposal 2

We are in favour of the security holder threshold being raised from 5% to 10% without any qualification. We agree with the discussion point that if a security holder holds less than 10% of an issuer’s shares but has the ability to appoint a director, then the appointment of the director would result in that security holder being a related party for the purposes of this rule. For this reason, we do not see a need for any qualification to the 10% requirement.

(c) Proposal 3

We support the common director exception which has been proposed by NZX. We suggest an additional condition being that the director has declared his or her interest and did not participate in the decision made by either company.

(d) Proposal 4

We agree that it would be appropriate to replace the current wholly-owned subsidiary exception with a new subsidiary exception on the conditions that:

- (i) no related party of the issuer has any material direct or indirect economic interest in the subsidiary or joint venture; and
- (ii) the issuer is entitled to participate directly or indirectly in half or more of the income or profits, and the assets, of that subsidiary or joint venture.

We see it as appropriate to allow 50/50 joint ventures to come within the exception.

#### **Rule 9.2.4 (NZAX LR B4.4) – Exceptions to Related Party Transactions**

We strongly support the proposal that the exceptions set out in rule 9.2.4(a) be amended to include any transaction entered into by the issuer with a Bank that is on arms length, commercial terms and in a normal course of banking business. We consider the proposed amendment reflects reality and avoids the need for issuers to undertake an unnecessary compliance step of obtaining a waiver.

#### **Rule 9.3.1 (NZAX LR 9.3.1 of Appendix 1) – Voting restrictions**

We consider the NZX proposal to limit voting restrictions on non-renounceable rights issues to any director of the issuer or any Associated Person of a director of the issuer makes common sense .

#### **Rule 10.1.1 (NZAX LR B1.1.1) – Continuous Disclosure**

We agree that it makes common sense that an issuer should be able to share financial information, such as financial statements, with its parent.

We suggest that the best approach is to recognise this in the Rules. We suggest it is still important to ensure that it is only that disclosure (outside the issuer) that is excluded from the continuous disclosure regime. If the information was otherwise subject to the disclosure rules (for example if it were Material Information), then an announcement should still be required (unless one of the other exceptions apply). We suggest that the parent be required to enter into an appropriate confidentiality deed with the issuer to ensure the parent retains the confidentiality of the material. (We see no need for the deed to be approved by NZX).

#### **Rule 10.7.4 – Disclosure of acquisitions or dispositions**

We agree with the proposal that Rule 10.7.4 be deleted and the guidance note to listing 10.1 be changed to refer to a transaction where the consideration is 5% or more of the Average Market Capitalisation of the issuer.

#### **Rule 10.8.2 (NZAX LR B1.8.2) – Copies of communications to be provided to NZX**

Electronic submission of notices of communications provided pursuant to Rule 10.8.2 makes complete sense.

#### **Appendix 1 (NZAX LR Appendix 1A) – Preliminary Full Year/Half Year announcements**

We consider that this should remain without change (other than for the update in connection with the adoption of IFRS) and possibly the EPS information (if brokers and others so wish).

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## **Appendix 2 – Minimum Holdings**

From the recent offerings we have been involved in, we think a \$2000 minimum holding should apply for issues of debt securities.

## **Appendix 7 (NZAX LR Appendix 7) – Notice of events affecting Securities**

We do not consider that Appendix 7 should be amended to include a reference to franking credits.

## **Appendix 16 - NZX Corporate Governance Best Practice Code**

We do not favour adding a guidance note regarding the appropriateness of the qualifications of the person undertaking the company secretarial role. We consider that, in the scheme of things, this is not such a significant matter as warrants attention under the Governance Code.

## **NZAX Rules A1.1.2, A3.3.2, A3.3.8(vi), A3.5.1 and Appendix 2 – Approval and conduct of NZX Sponsors**

The proposal that all NZX Sponsors are approved and governed by the same process and subject to the NZX Discipline Rules seems sensible.

## **Other Proposals – (1) Payment of dividends and interest**

We have no comment on the proposal that all dividend and interest payments made by issuers should, by default, be made by direct credit to bank accounts (as opposed to payment by cheque). Issuers and registrars will no doubt have views on what is best in practice.

## **Other Proposals – (2) Odd lots in relation to Debt Securities**

We have no comment on the proposal that the Rules be amended to specifically prevent the trading of Debt Security odd lots.

## **Other Proposals – (3) Creation/linking of CSNs**

We have no comment on the proposal that where issuers issue any of their securities the Rules require the issuer to ensure that (where necessary) CSNs are created for new Security holders and holdings are linked to existing CSNs.

We would be happy to discuss and elaborate any aspect of our submission and for our submission to be published.

Yours faithfully  
**Bell Gully**

*[Sgd: Andrew Brown / Garry Downs]*

**Andrew Brown / Garry Downs**  
Partner / Partner