BUDDLE FINDLAY
NEW ZEALAND LAWYERS

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To
Hamish Macdonald
General Counsel and Head of Policy
NZX Limited

From
Steve Nightingale
Simon Vodanovich
Nick Bragg
Sarah McEwan

By Email
consultation@nzx.com

Dear Hamish

Submission on second stage of NZX listing rule review – Consultation paper and exposure draft

We refer to the 'NZX Listing Rule Review – Consultation Paper' (**Consultation Paper**) and the 'NZX Listing Rules Exposure Draft' (**Exposure Draft**) released by NZX on 11 April 2018.

We set out in the schedule to this letter a table containing responses to certain of NZX's specific questions. The views expressed in this submission are those of members of our firm involved in the review of the Consultation Paper and Exposure Draft. We have prepared our submissions following discussion with some of our listed issuer clients.

Unless otherwise defined in this document, capitalised terms have the meanings given to them in the Exposure Draft.

We would be happy to discuss any of our comments with you and have no objection to the submission being made publically available on the NZX website.

The contact details for the persons responsible for the preparation of the submissions are Steve Nightingale (steve.nightingale@buddlefindlay.com), Simon Vodanovich (simon.vodanovich@buddlefindlay.com), Nick Bragg (nick.bragg@buddlefindlay.com) and Sarah McEwan (sarah.mcewan@buddlefindlay.com).

Yours faithfully
Buddle Findlay

Steve Nightingale
Partner

Direct: 64 4 498 7312
Mobile: 64 27 668 2832
Email: steve.nightingale@buddlefindlay.com

SCHEDULE

Questions in Consultation Paper	Submission/Comments
5. Feedback sought	
A. Do you agree with the proposed updated market structure?	Yes.
B. Do you agree with the proposed updated structure of the Listing Rules?	Yes, we agree with the modular approach.
C. Please provide feedback on the proposed minimum listing and ongoing listing obligations described above.	See our feedback on the specific obligations in the next section.
D. Please provide feedback on the process for the remainder of the review.	The proposed process seems appropriate. In particular, we welcome the comment at page 5 of the Consultation Paper that, depending on the feedback received, a further targeted consultation may be undertaken. We presume the footnotes in the current listing rules will be replaced as appropriate by guidance and that the proposed guidance will be consulted on, as indicated in section 4 of the Consultation Paper. We have identified some wording issues/typos in the Exposure Draft. We are happy to provide these to NZX separately and/or to participate in any 'drafting comments only' consultation on the final draft of the rules (an approach adopted by some regulators before introducing new rules).
E. Please provide feedback on transition arrangements.	We agree with the proposed 6-month transition period. However, clarity is required on whether there will be mandatory delisting of issuers who do not meet the proposed minimum $15 million capitalisation threshold, or whether those listings will be 'grandparented'. In addition, we would welcome discussion around what should happen to issuers whose market cap falls below the $15 million threshold in the future.
7. Appendix 2 – explanatory notes and specific feedback sought	
Glossary	
1. Is this an appropriate way to measure Average Market Capitalisation and Average Market Price of an issuer?	Yes, though we would welcome NZX's consideration of whether there is a way to make the volume weighted average price more accessible.

Questions in Consultation Paper	Submission/Comments

2. Do you agree with the proposed change to the definition of Associated Person to align with the FMC Act?	Yes, subject to the following comments.
	
	Despite the goals for this new definition, ie easy to apply and not too broad (see page 17 of NZX's 27 September 2017 discussion paper), the definition taken from section 12(1) of the FMC Act:
	
	• has limbs that are not bright lines and instead will require detailed factual assessment and judgement, eg "A is… accustomed to act in accordance with the wishes of B" and "A is able… to exert a substantial degree of influence over… B"; and
	
	• is still very broad (broader than the associated person test in sections 11 – 17 of the Australian Corporations Act 2001), eg:
	
	  ○ several limbs contain "or vice versa" which is similar in effect to the existing rule 1.8.5, which NZX proposed to delete (see page 17 of NZX's 27 September 2017 discussion paper where it was noted that rule 1.8.5 reverses the application of the primary association rules by deeming that a second person is an associated person of the first person as a consequence of the first person being an associated person of the second person); and
	
	  ○ limb (i) triangulates by deeming A and B to be associated if there is another person to which they are both associated.
	
	However, we acknowledge there is no simple alternative. The definition needs to be broad enough to cover a potentially unlimited range of relationships and to minimise scope for avoidance. We suggest NZX retain a guidance note similar to the existing guidance in rule 1.8 acknowledging that the definition is broad and that rulings on its application or waivers may be required in appropriate cases.

3 Do you agree with the proposed approach to Minimum Holdings?	Yes.
4. Do you agree with the proposed use of the term Senior Manager?	Yes. The current definition (in essence the CEO and direct reports) works well. However, provided there has not been uncertainty in practice in the implementation of the FMC Act definition, it makes sense for the definitions to be consistent.

Questions in Consultation Paper		Submission/Comments
5	Do you agree with the proposed use of Security?	Yes, it makes sense to align with the terminology relating to "financial products" in the FMC Act.
6.	Please provide feedback on the definition of a Disqualifying Relationship and the commentary under recommendation 2.4 of the NZX Code which will be used to assess independence.	Subject to the points below, we agree with the proposal, ie a principles-based definition with guidance in the NZX Code. In our view the wording "**might** influence" in the proposed definition of Disqualifying Relationship sets the threshold too low, resulting in the definition being too broad. Of note, the corresponding wording in the current definition of Disqualifying Relationship sets a higher threshold – "**could reasonably** influence" – and the proposed NZX Code uses the words "might **reasonably**" in its commentary (see page 12). We submit the proposed definition be amended as follows: "Disqualifying Relationship means any direct or indirect interest, position, association or relationship that ~~might influence, or~~ could reasonably be <u>expected or</u> perceived to influence, in a material way, the Director's capacity to bring an independent view to decisions…" The third factor listed in recommendation 2.4 of the NZX Code – "a recent or current material business relationship… with the issuer…" could be balanced by guidance to the effect that a director would not necessarily cease to be regarded as independent as a result of a one-off transaction where the director was interested but declared the interest and abstained from any vote on the matter. The final factor listed in recommendation 2.4 of the NZX Code – "having been a director of the entity for a length of time that may compromise independence" – is a bit vague. It would be useful to have an indicative timeframe (eg independence in this respect should be assessed after 3 terms) or some guidance as to relevant principles or considerations to apply when assessing this. The ASX's proposed 4th edition of its Corporate Governance Principles and Recommendations (currently being consulted on) has a similar factor but contains extensive commentary which focuses, for example, on long-serving directors' independence *from management and substantial holders*, and says that regular assessment should be made for a director who has served for more than 10 years.

Questions in Consultation Paper	Submission/Comments
Eligibility and Listing	
7. Do you agree with the proposed updated eligibility requirements for equity (rule 1.1) and funds (rule 1.4)?	Yes.
Reverse/Backdoor Listing Provisions	
8. Do you agree with the proposed updated approach to Backdoor Listings (rule 1.11.1)?	Yes.
Governance	
9. We propose deleting the special office exception. Do you agree with the proposed amendments to the director rotation requirements under rule 2.7?	Yes.
11. What is an appropriate time frame to allow issuers to update Governing Documents in response to amended rules?	We would propose 18-24 months to allow for an issuer to cycle approvals of such updates into their next standing meetings.
Disclosure	
12. Do you agree with the proposal to introduce a concept of constructive knowledge in respect of the continuous disclosure (rule 3.1.1) requirement?	Whilst we understand the rationale behind the proposed amendments to this rule, we are cautious about more onerous continuous disclosure obligations being placed on issuers, particularly as the existing rules can already be challenging for issuers to apply in practice. We query whether the issues that are intended to be addressed through the introduction of a concept of constructive knowledge might be addressed in another way. The main rationale for this constructive knowledge concept appears to be that "without this extension, an entity would be able to avoid or delay its continuous disclosure obligations by the simple expedient of not bringing market sensitive information to the attention of its officers in a timely manner" (see page 12 of ASX Listing Rules Guidance Note 8). NZX has also noted that it will view delays in information being escalated to directors or executive officers as an aggravating factor when assessing the seriousness of a breach of continuous disclosure obligations (see Investigation Report on Fletcher Building

Questions in Consultation Paper	Submission/Comments
	continuous disclosure, January 2018, page 12). Issuers should not be able to be wilfully ignorant about potentially material information. However, we believe an alternative approach to address this concern in a more direct way is to introduce a rule that requires issuers to establish, maintain and operate reasonable policies and processes for ensuring that all potentially material information is escalated to directors or executive officers. Introducing a positive obligation of this type will ensure that it is not viable to be wilfully ignorant but will, importantly, be more certain for issuers than the proposed constructive knowledge concept. Issuers would know that, in order to comply with the rule, they would need to put in place appropriate policies and processes and take reasonable steps to ensure compliance with those polices and processes. We think this type of positive obligation is preferable to the introduction of a constructive knowledge concept. However, if constructive knowledge is ultimately to be introduced to the continuous disclosure requirements as proposed, we (along with our issuer clients) would welcome and see as appropriate: • fulsome guidance on this amended rule including how any regimes for compliance and processes for escalation that an issuer has in place would be taken into account when determining whether an Issuer has constructive knowledge; and • further market consideration and discussion of possible defences, including the inclusion of a defence along the lines that an issuer would not be in breach of the continuous disclosure rules as a consequence of not being aware of material information it ought to have been aware of where the issuer had taken all reasonable steps to ensure it becomes aware of all material information in a timely manner (this reflects the type of defence under section 272 of the FMC Act for failure to comply with continuous disclosure obligations).
13. Do you agree with the proposal to remove the requirement for half year reports (rule 3.5 and 3.6) and the amendment of "immediately" to "promptly and without delay"?	Yes.

Questions in Consultation Paper	Submission/Comments
14. Do you have any feedback on the proposed updates to timing requirements within section 3 of the rules?	These updates seem appropriate.
Changes in Capital	
15. Do you agree with the new SPP threshold and placement thresholds?	*Placements* As set out in our 2017 submission, along with a number of other advisers, we believe that NZX should retain the placement threshold at 20%. *Share Purchase Plans* We assume the new SPP threshold allows sufficient headroom in practice, and on that basis have no objection.
Major Transactions	
16. Do you agree with the proposed treatment of Major Transactions?	We disagree in 2 respects. *"Scale"* The main change to the current treatment of major transactions is the introduction of the concept of scale, ie "a change to the nature **or scale** of the Issuer's business". We oppose this because: • It is unclear what "scale" means so the rule would be very difficult to apply, for both issuers and advisers alike. In the absence of significant guidance on, or effectively a definition of, what scale is in the context of the rule, on a practical level we would not feel assured of being able to clearly advise issuers on the applicability of the rule. We would expect this to be the same across the market generally, resulting in interpretation and application of this very open concept being extremely varied and inconsistent amongst issuers. • NZX has already rejected the previous proposal to lower the threshold for shareholder approval to 25%. We and other submitters disagreed with this proposal for the reasons given in the initial consultation (eg the current rule seems to work; delay and uncertainty due to the shareholder approval requirement may make listed companies uncompetitive in sale processes; etc). This "scale" change would also significantly lower the threshold for shareholder approval, and we disagree with it for the same reasons.

Questions in Consultation Paper	Submission/Comments

- Large transactions (in proportion to an issuer's balance sheet) already require approval under the major transaction provisions of the Companies Act 1993.
- Contrary to the statement on page 16 of the consultation paper that this proposal aligns with ASX, this proposal is considerably more restrictive on issuers than the ASX equivalent – see further discussion below.

Under ASX listing rule 11.1.1, if an issuer proposes to "make a significant change… to the nature or scale of its activities" it must notify ASX and, if ASX requires, get shareholder approval. So the requirement for shareholder approval is not automatic, unlike proposed rule 5.1.1(a).

Further, ASX Guidance Note 12 states that this rule was primarily designed to regulate back door listings (see eg pages 6-7) and that "while ASX can exercise its discretion in other circumstances, it is generally reluctant to do so, unless there are clear and compelling reasons to justify that course of action" (see page 16). This is said to reflect the following considerations (in summary):

- the Corporations Act 2001 and ASX listing rules already regulate an extensive range of transactions;
- the directors should otherwise have authority to decide; and
- the requirement for shareholder approval adds transaction costs and risks that could well be contrary to the interests of shareholders.

The same considerations apply in New Zealand. Further, the addition of "scale" isn't required to catch backdoor listings because this will be covered by new listing rule 1.11.1.

Therefore, in our view, it has not been shown that this proposal is necessary or that the benefits of the proposal outweigh the costs. In accordance with good regulatory practice, the change should not be made until there has been a proper cost/benefit analysis that demonstrates that the proposal is clearly better than the status quo.

"the transaction"

Existing listing rule 9.1.1 covers a "transaction or series of linked or related transactions…" that meets one of the thresholds.

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	ASX listing rule 11.1 covers "a significant change, either directly or indirectly, to the nature or scale of [the issuer's] activities…". It is clear from this drafting and ASX's guidance that such a change could occur as a result of more than one transaction. Proposed listing rule 5.1.1(a) applies where "the transaction… (a) would significantly change, either directly or indirectly, the nature or scale of the Issuer's business". We are aware of concerns raised about the current "series of… transactions" wording, however, we query whether the intention is to drop this altogether in the new rule or instead whether the intention is to rely on the general interpretation provision that the singular includes the plural (rule 2(f)). If the latter, we think it would be preferable to make this explicit in the rule and that guidance should be given about when a change that evolves over a number of transactions could be caught, such as that provided in ASX Guidance Note 12 at page 20.
NZX Foreign Exempt Issuers	
17. Do you agree with the updated scope for NZX Foreign Exempt Issuers?	Yes.
Debt	
18. Do you agree with the changes to settings for Debt?	Yes. We welcome the removal of the requirement for NZX Regulation to approve QFP debt offer documents. The removal of the current spread and free float requirements for debt issues is also supported.
19. Do you agree with the proposal to introduce a listing regime for Wholesale Debt Securities?	Yes.
NZX Review of Documents	
22 Do you agree with these proposed changes?	Yes.

Questions in Consultation Paper	Submission/Comments
Change to NZX Corporate Governance Code (NZX Code)	
23. Do you have any feedback on the proposed criteria for considering independence outlined in recommendation 2.4?	See our response to question 6 above.
24. Should this recommendation be broadened beyond Annual Meetings to cover Special Meetings as well?	No. Special meetings may need to happen urgently, so the minimum statutory notice period should continue to apply.