

“A new mandatory disclosure regime for directors and officers of listed companies will take effect on 3 May 2004.”

A new mandatory disclosure regime for directors and officers of listed companies will take effect on 3 May 2004.

The new regime replaces the regime set up by the NZX in December 2002 for directors of listed companies, and extends its application to officers of listed companies.

Although the Government recently announced a delay in the commencement date of these regulations – from 1 March to 3 May 2004 – it is imperative that all listed companies identify those affected by the new regime and make preparations for the Initial Disclosure.

This newsletter discusses the definition of these required to disclose and the content of the disclosure.

It also describes Bell Gully’s submission to the Securities Commission, requesting further exemptions from the Initial Disclosure requirements.

Overview

This new regime is contained in Subpart 2 of Part 2 of the Securities Markets Act 1988 (the Act) and the related Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003 (the Regulations).

From 3 May 2004, a director or officer of a listed company who acquires or disposes of a “relevant interest” in a security of that company must make disclosure in the form prescribed by the Regulations.

Disclosure must be made by filing the prescribed form with the NZX and the company (for inclusion in its interests register). Persons who fail to make the necessary disclosures commit an offence and are liable to fines of up to \$30,000. Such persons may also be ordered to disclose information by the Securities Commission.

The first disclosure notice must be delivered by 10 May 2004 for all directors and officers holding a relevant interest in the securities of the listed company on that date (the Initial Disclosure). Subsequent notices are required within five trading days of any trading in the relevant securities.

The disclosure requirement applies to all directors and officers of any listed company, but only with respect to securities of the company of which such persons are directors and officers and any “related body corporate” of that company.

Who must disclose – definition of “officer”

Who is an “officer” for these purposes?

Section 2 of the Act defines an “officer” of a public issuer as:

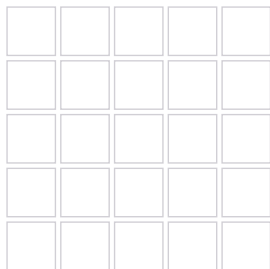
“a person, however designated, who is concerned or takes part in the management of the public issuer’s business”

The Regulations exclude from that definition, and therefore from the

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New directors' and officers' disclosure regime

disclosure obligations in the Act:

- any person who does not report directly to the board of directors of a public issuer (Person A); or
- any person who does not report directly to a Person A (Person B); or
- any person who does not report directly to a Person B; or
- any person who does not manage a principal business unit, division or function of a public issuer.

In determining whether someone is an “officer”, the critical question is whether a person is concerned or takes part in the management of a public issuer’s business. Only once this has been decided should companies then consider if any of the exemption categories apply.

A good description of the term “management” was given by the Supreme Court of Victoria in *Commissioner for Corporate Affairs v Bracht* [1989] 14 ACLR 728, when interpreting language similar to the Act’s definition of “officer” (although in a different context):

“management” ... comprehends activities which involve policy and decision making, related to the business affairs of a corporation, affecting the corporation as a whole or a substantial part of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs.

Both Bracht and other more recent Australasian decisions cite certain factors that tend to indicate that persons are concerned or taking part in management. Relatively high levels of decision-making powers, policy-making functions, leadership and control, supervision, and discretionary authority have tended to suggest a management function. Likewise, relatively low levels of these factors have tended to suggest a person is not management.

We view the policy or decision making function as the essence of management. Using this approach, the chief executive officer and the direct reports to that person (who are likely to include the chief financial officer, the chief operating officer and the general counsel) will almost always be considered management (and therefore “officers” for the purposes of the new regime).

Likewise if the listed company operates an executive office or team (comprising divisional and/or functional heads) involved in the overall management of the business then again such individuals will almost always be considered management.

Beyond these people, it is necessary to ask:

“is an employee empowered to make policy or decisions that affect the issuer as a whole or a substantial part of the issuer, to the extent that the consequence of making such policy or decisions may have some significant bearing on the financial standing or conduct of affairs of the issuer”?

Also helpful, but not conclusive, will be the way in which an issuer describes its own management in its public reports and communications.

In considering what is a “substantial part” of the issuer, we favour a pragmatic mix of qualitative and quantitative tests. Business units or functions accounting for less than 20% of consolidated profit or EBITDA are, in our view, unlikely to constitute “substantial parts” such that, even a person occupying an executive position at such unit, is unlikely, unless there are qualitative indications to the contrary (such as that person being a member of the executive office), to be considered to be taking part in management. For some listed companies, EBITDA may not be the only or most appropriate test.

We would expect both the Securities Commission and New Zealand courts to take a pragmatic view of what constitutes taking part in management and to adopt tests similar to those quoted above.

As stated above, the starting point for the analysis is whether a person is concerned or takes part in the management of a public issuer’s business. Importantly, we do not take the view that persons who are not excluded from the definition of “officer” by the Regulations are automatically presumed to be officers. In our view, the exclusions simply confirm a broad range of people who would not have been expected to fall within the definition of “officer” in any event, and provide little guidance as to who is an “officer”.

We also do not consider that the mere possession of non-public, price sensitive information is conclusive, though certainly the regular possession of this sort of information might tend to suggest that the person is involved in a managerial role.

To guide you through this process, we have prepared a series of questions, presented as a flow chart on page 5 which contains what we consider to be the crucial elements of any pragmatic analysis.

First, that certain positions within a company will almost always be considered to be occupied by those taking part in the management of the company (and who will therefore be “officers” for the purposes of this new regime). These positions are labelled “Executive Positions” in our decision tree.

Second, not every person who manages a part of a business will be considered to be an officer. In order for the manager to be an “officer” under our test, the person should manage a substantial part of the company such that the consequences of this management have some significant bearing on the financial standing of the company or on the conduct of its affairs.

What securities are covered by the disclosure rules?

Disclosure is required when an officer has a relevant interest in a security.

Securities are not simply confined to shares. They also include any debt

instruments issued by the public issuer or its group companies. Disclosure is required on the exercise of share options and on the issue of shares to officers under employee share schemes.

An officer has a ‘relevant interest’ in a security where the officer:

- beneficially owns the security either directly or indirectly, including under a family trust;
- is able to control, either by him or herself or jointly with others, the acquisition or disposal of the security by another person;
- has the power to control, either alone or with others, the exercise of any right to vote attached to that security;
- is able to influence the board of the company which itself controls votes or the acquisition or disposal of the security;
- controls a shareholding of 20% or more in a company that owns those securities;
- has any of those rights in the future by virtue of any arrangement.

Content of disclosure

Disclosure notices must detail:

- the nature of the relevant interest;
- the number and class of securities acquired or disposed of;
- the date of the acquisition or disposal;
- the consideration paid or received; and
- the date of the last disclosure by the director or officer.

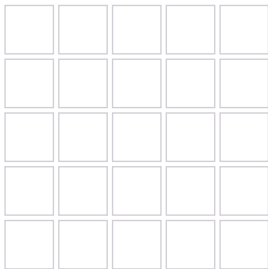
Exemptions from disclosure

The Regulations also provide exemptions for situations where, in the words of the Explanatory Note to the Regulations, disclosure would normally be required in accordance with the Act, “but in reality, disclosure in these situations would not convey any useful information to the securities market or would be unduly onerous.” These exemptions include the following:

- a partial exemption from the time requirements for ongoing offers such as bonus issues, share splits or buy-backs that are made on an equal basis to all security holders;
- an exemption for “technical” interests, where a person has a relevant interest, but the holder is subject to the over-riding control of others, such as in the case of a bare trustee or a sharebroker acting on behalf of clients;
- a partial exemption for employee share schemes, where interests held on behalf of the members of the scheme can change frequently; and
- an exemption for directors and officers that file a notice under the substantial security holder disclosure provisions of the Act.

NZX Listing Rules

Rule 10.9 of the NZX Listing Rules already requires directors of listed companies to disclose relevant interests in securities in a manner similar to the new regime prescribed by the Act.



New directors' and officers' disclosure regime

The new regime, however, goes further than the NZX Listing Rules by requiring disclosure by "officers". The new regime also imposes significant monetary penalties for non-compliance.

Bell Gully's submission to the Securities Commission

One aspect of the Disclosure Regime that has caused us concern is the scope of the Initial Disclosure required after the new regime takes effect on 3 May 2004.

The first problem involves the likelihood that directors and officers will not have at their disposal sufficient information about their current shareholding in order to allow them to comply with certain aspects of the new regime.

The problem arises because, in some cases, securities in a public issuer may have been acquired over a substantial period of time and in a number of different circumstances.

The second problem involves application of the Regulations to the available information. Even assuming that directors and officers have all the information required to fully complete Initial Disclosures, any reporting person who has acquired and disposed of a security over a period of time is given no guidance as to how to describe their net position.

Both of these problems could be addressed by requiring that the Initial Disclosure only contain the number and class of total securities held, the registered holder and the nature of the relevant interests.

If this approach is followed then the Initial Disclosure would be substantially the same

as that which directors (but not officers) have already provided under the NZX Listing Rules.

In these circumstances, we would suggest that, as a practical matter, no additional disclosure is necessary by directors who have already made the necessary filings under the Listing Rules.

We have requested that the Securities Commission exercise its powers under section 48(1)(a) of the Act to exempt as a class (i) directors and officers from the problematic aspects of Initial Disclosure identified above and (ii) directors who have already disclosed the information required by the Regulations in meeting their obligations under the NZX Listing Rules.

We are hopeful that some relief in these areas will be afforded by the Securities Commission prior to 3 May 2004 and we interpret the postponement of the regime's effective date as an indication that these sorts of issues are being actively considered.

Advice and information

Although the effective date for this new regime has been delayed until 3 May 2004, it is still important that issuers and directors and officers of issuers consider

the implications of the new regime within their company.

If you are an issuer, take a view on which employees are "officers." Contact these people and remind them of their obligations, and determine whether and how you will provide assistance to directors and officers in completing the required disclosure notices and in making timely filings with the issuer and the exchange. Remember, if you are an issuer, disclosure notices should be entered into the interests register of the company.

Next, ensure that you have a process in place to facilitate the timely filing of ongoing disclosure notices. Consider amending existing company securities trading policies or employment policies to reflect the obligations of "officers" under the new regime.

Bell Gully will contact clients if the Securities Commission accepts our submission and grants relief in the areas that we have requested.

Bell Gully can advise you more fully on the matters discussed in this newsletter. Contact your usual Bell Gully adviser or any member of the team at the numbers below for more information.

For further information, please contact your usual Bell Gully adviser or:

Auckland

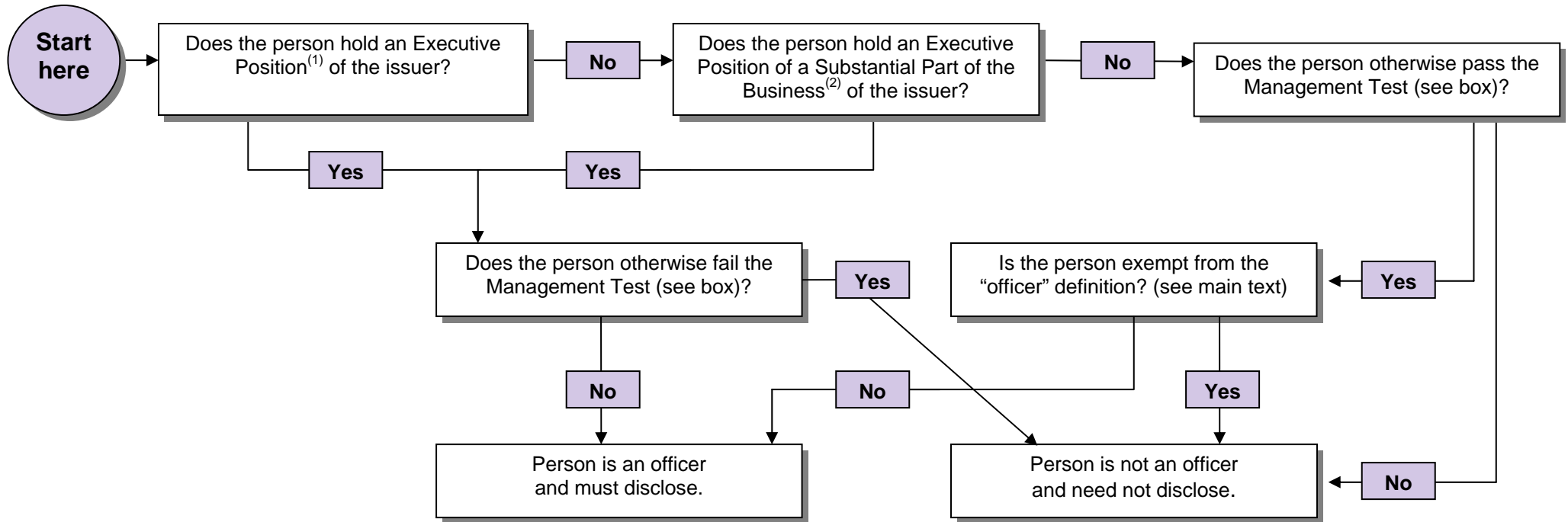
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Who is an Officer?

Securities Markets Act 1988



Management Test

"management" ... comprehends activities which involve policy and decision making, related to the business affairs of a corporation, affecting the corporation as a whole or a **substantial part** of that corporation, to the extent that the consequences of the formation of those policies or the making of those decisions may have some significant bearing on the financial standing of the corporation or the conduct of its affairs.
 (Commissioner for Corporate Affairs v Bracht [1989] 14 ACLR 728)

1. In our view, this group comprises the chief executive officer and the direct reports to the chief executive officer.
2. We would assume that any part of the business accounting for 20% or greater of the issuer's EBITDA (or other appropriate measure) is a "substantial part" of the business.