

## CORPORATE

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## CAPITAL RAISING SET TO GET QUICKER AND EASIER

*NZX reforms to capital raising and capital flexibility*

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On 26 November 2008, NZX released a set of draft changes (**New Rules**) to the Listing Rules of the NZSX/NZDX and NZAX Markets (**Listing Rules**) for consultation. The NZX is seeking to implement the New Rules on an accelerated timetable in light of current market conditions.

The New Rules seek to increase the speed and reduce the cost of capital-raising by allowing NZX-listed issuers (**Issuers**) to raise additional capital without the need for prospectus-length disclosure documents. It is proposed that Issuers would be able to rely on the material disclosed by them pursuant to their continuous disclosure obligations (**Continuous Disclosure**) under the Listing Rules and the Securities Markets Act 1988 and the distribution of a Term Sheet Offering Document. The directors of the Issuer would also be required to certify that the Issuer is in compliance with its Continuous Disclosure obligations.

The NZX has signalled it believes that these changes are required as a matter of urgency to help Issuers raise capital in a period of credit rationing and reduced options for capital-raising. As a result, the consultation period for feedback on the New Rules is short.

The New Rules have been promoted and are supported by the Capital Markets Development Taskforce (**Taskforce**). It is important to note that the Consultation Paper only relates to changes to the Listing Rules. Legislative amendments will be required to effect these key proposals in the

form of changes to the investment statement and prospectus disclosure regime under the Securities Act 1978. These legislative amendments will need to be initiated by the Securities Commission and the Ministry of Economic Development (**MED**). It is quite possible the recommendations to be put forward by the Taskforce will be further reaching. Until the Taskforce puts forward its recommendations and the Securities Commission/MED release their proposals, we will not know the full impact of this reform.

If implemented, the New Rules will be the most significant enhancement to the process of capital-raising by Issuers seen in the last decade. These changes will also put Issuers at a significant advantage when compared with un-listed entities.

#### Summary of New Rules

**Rights Issues.** The New Rules permit an equity Issuer in compliance with its Continuous Disclosure obligations to be able to raise unlimited equity, on a pro-rata basis, from its existing shareholders on the basis of a Term Sheet Offering Document rather than an investment statement and prospectus (see discussion below).

**Rights Issues – timetable.** The New Rules decrease the prescribed time period to complete a rights issue from six to three weeks.

**Debt Issues.** The New Rules permit an equity Issuer or debt Issuer in compliance with its Continuous Disclosure obligations to be able to raise debt on the basis of a Term Sheet Offering Document rather than an investment statement and prospectus.

**Per-shareholder capital offerings.** The New Rules extend the exemption under the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005 which permits limited fundraising by Issuers without an investment statement and prospectus from \$5,000 to \$25,000 per security holder in any 12 month period.

**Private placements.** The New Rules increase the threshold for issues of securities by NZSX Issuers by way of private placements from 15% to 20% of the class or number of that NZSX Issuer's equity securities in any 12 month period (and from 20% to 25% for NZAX Issuers). It is also proposed that directors of the NZSX Issuer and associated persons of such directors or employees of the NZSX Issuer should be able to participate in such private placements, subject to certain conditions being satisfied.

**Non-pro-rata issue of voting securities.** The New Rules change the requirement to obtain NZX approval for non-pro-rata offers if the 90% VWAP test on the issue price of voting equity securities is not satisfied. Instead, directors must certify they have made reasonable endeavours to get the best possible price for the issue of the securities if the issue price is less than 85% of the five day VWAP price for the securities.

**Remuneration of directors by stock.** The New Rules provide for directors to be remunerated by the issue of securities, with shareholder approval. Currently, the Listing Rules only contemplate monetary remuneration. This change will assist Issuers to align management and shareholder interests more closely and give companies more flexibility in the way they remunerate directors in periods of cash constraint.

**Related Party Transactions – materiality.** The New Rules increase the thresholds for entering into Related Party Transactions

from 5% of average market capitalisation to 10% for transactions and from 0.5% to 1% for the provision of services. This change reflects the impact of falling market capitalisations.

**Share buybacks and Employee Share Schemes.** The New Rules remove the restriction on the buyback of securities from employees, which is currently perceived as a costly prohibition for buybacks under employee share option schemes.

**Financial assistance to employees.** The New Rules increase the threshold of permitted financial assistance to employees from 5% to 10% of an Issuer's average market capitalisation. In addition, NZX suggests that the requirement under the Companies Act 1993 to provide shareholders with disclosure regarding the provision of financial assistance should be removed from the Companies Act.

**Minority shareholders and independent directors.** The New Rules stipulate that only minority shareholders may vote on the remuneration, appointment or reappointment of Independent Directors. It is unclear how the New Rules will deal with nominees, such as NZCSD, which may be a registered shareholder holding more than 50% of the Issuer's securities. Under the New Rules, a nominee would be prohibited from voting on such resolutions, even though it represents the interests of numerous minority shareholders which the rule is seeking to protect.

**Appraisal Reports.** The New Rules change the obligation to obtain an independent Appraisal Report under Listing Rules 4.5.8, 6.2.2 and 9.2.5 to an option to obtain such a report.

**Click to view the [NZX Release](#) and the [NZX Consultation Paper](#).**

### **Speed, flexibility, reduced compliance costs, investor protection**

The NZX states that the focus of the New Rules is to ensure that Issuers can react flexibly and quickly to current market conditions and to continue to invest for growth during credit rationing and the

drying-up of capital from other sources (e.g., banks) which have been relied on in the past. The NZX is concerned that, in certain areas, the current Listing Rules may impose unnecessary compliance costs that are disproportionate to any regulatory benefit being secured.

### Investor Protection

NZX identifies certain key principles for any capital-raising:

- Investors need comfort that all material information is in the public domain.
- Issuers in compliance with their Continuous Disclosure obligations should not have to repeat any historic disclosure in a new, costly and time-consuming disclosure document.
- The terms of the security being issued and any risks particular to that security should be disclosed.

### Guiding Principle: compliance with Continuous Disclosure obligations

Central to a number of the proposed New Rules is NZX's confidence that the Continuous Disclosure rules are well bedded-down in the market, so the foundation for the New Rules is reliance on the operation of that regime. That is, if Material Information is already in the market, there is no need for prospectus-length disclosure.

Currently the New Rules do not specifically require an Issuer to release to the market any Material Information which has not been released to the market due to reliance on one of the exceptions for disclosure under Listing Rule 10.1.1(a). In Australia there is such a requirement for similar rights issues where Issuers are required to issue a "cleansing notice" to the market disclosing all such information. It is possible that this concept may be included in any amendments to the Securities Act.

### Term Sheet Offering Document

NZX is proposing that for rights issues and debt issues, the requirement for a prospectus and investment statement would be replaced by a simple term sheet referred to as a Term Sheet Offering Document. The Term Sheet Offering Document, which must be signed by all of the directors, must provide the following details:

- all the terms of the securities being offered (e.g., price, rights offered and how to take up the offer);
- the material risks particular to that securities; and
- references to publicly available information such as most recent financial statements and annual reports. It is unclear whether the information must be information made public by the Issuer itself or whether it can include third party public information about the Issuer (e.g., expert's reports).

In addition, a warranty must be signed by the CFO, CEO and the Board stating that:

- the Issuer has complied with its Continuous Disclosure obligations in full;
- no Material Information has not been released in reliance on the safe harbour exemptions; and
- all new Material Information during the offer period will be disclosed to the NZX.

### Supporting legislative amendment

In addition to the changes to the Listing Rules contained in the New Rules, changes will be required to the Securities Act and Regulations, and the Companies Act. The NZX notes that it will be working with the Securities Commission and MED to achieve this.

We anticipate that, in the first instance, the legislative changes will be made by means of an Exemption Notice granted by the

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Securities Commission and limited to the existing prospectus and investment statement requirements of the Securities Act and the Securities Regulations as they apply to Issuers. In time, a more wide-sweeping reform of the Securities Act disclosure regime is required but this is likely to have to await the findings of the Taskforce.

As part of this process, no doubt the Securities Commission will be considering:

- whether the Term Sheet Offering Document that the NZX is proposing for Rights Issues and Debt Issues, will be available for all capital raisings by Issuers;
- whether, through the warranty process, directors will have personal liability for Continuous Disclosure obligations;
- what defences will be available for any misstatements in any Continuous Disclosure statements; and
- the relationship between these proposals and the Mutual Recognition regime with Australia.

These changes may impact on the manner in which Issuers prepare their shareholder communications (for example, annual reports of US listed companies include “risks factors” similar to that included in our current investment statements).

#### Other changes

The Taskforce has agreed that these New Rules should be released ahead of its package of urgent recommendations for New Zealand to be provided to Government before Christmas. At this stage, there has been no disclosure around what those further recommendations may comprise.

#### NZX Timetable

In the current market conditions, the NZX views the proposed amendments as a matter of urgency and has proposed the following timetable for making the changes to the Listing Rules of:

- 10 December 2008: Deadline for receipt of first round of submissions.
- 15 December: Exposure draft sent to submitters containing any changes.
- 22 December 2008: Deadline for receipt of second round of submissions.
- 30 December 2008: New Rules submitted to the Minister.
- Within 40 working days (i.e., by the end of February 2009): New Rules come into effect.

No timetable has been stipulated for implementation of the legislation which will be required to make some of the changes, although NZX is working closely with MED to push through those legislative changes.

#### Conclusion

We agree that a disclosure exemption which would allow Issuers, who are fully compliant with their Continuous Disclosure obligations, to raise capital quickly and cost effectively is a positive step in the right direction and is consistent with recent changes in Australia and proposed changes in the UK. However, it is dependent upon the full reform package being released by the Taskforce and the Securities Commission.

#### Next Steps

Bell Gully will be sending submissions to the NZX on the Consultation Paper. If you would like to discuss any aspect of the Consultation Paper, please contact any of the Bell Gully team listed on this page.