New Zealand Deal Firm of the Year – 2017 Australasian Law Awards

Large Law Firm of the Year – 2016 New Zealand Law Awards
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In this publication we look at recent developments in New Zealand corporate governance and identify trends for the year ahead.

We have created a new data series, which will be updated in subsequent years, based on a detailed analysis of recent annual report disclosures from the top 75 listed issuers by market capitalisation (the “top 75”).

Volatility and disruption

In recent years, political and economic volatility have been a constant for boards, particularly in global-facing businesses. More generally, directors have faced an uncertain business environment and a step-up in expectations for workplace health and safety and, more recently, management of cyber risk. Shareholders, customers and employees have demanded greater transparency of decision-making.

Trends at a glance

Key themes we expect to see in the governance area this year are:

- a more activist shareholder culture
- a greater focus on director accountability
- increased professionalisation of directors
- more boardroom diversity, and
- enhanced disclosures.

These trends will be given a push-along with the implementation this year of NZX’s revised Corporate Governance Code.

We also expect a continued regulatory focus on board conduct by the Financial Markets Authority (FMA) and continuing scrutiny from institutional and retail investors, including through the activities of the New Zealand Shareholders’ Association (NZSA).

1 Market capitalisation as at 31 March 2017. Overseas listed issuers and exchange traded funds have been excluded.
Shareholder activism

Shareholder activism is still relatively rare in New Zealand but may be on the rise, reflecting international trends.

Recent examples include:

- the defeat of a resolution at the Rakon AGM to reappoint an existing director, who was a member of the company’s founding family, which still owns a 24% stake in the company, and
- the successful manoeuvring by Augusta Capital and institutional investors to vote down a proposal recommended by the NPT board and to replace three of the board’s four directors.

The two cases are very different. The first involved retail investors, coordinated by the NZSA, asserting their will over a company’s board and management. The second was a strategic play by a significant shareholder, which ultimately won majority shareholder support.

The Augusta example highlights some shortcomings in the existing regulatory framework. While investors holding 5% or more of voting shares can require a board to call a shareholders’ meeting to consider a shareholder proposal, the Companies Act provides no timeframe within which that meeting must be called—an omission that allows boards to prevaricate unless under threat of costly court action.

We recommend NZX consider a listing rule specifying that a requisitioned meeting must be held within 30 working days. This would align more closely with Australian law.

Proxy advisory firms – is more guidance needed?

The role of proxy advisory firms in Australia is currently under the spotlight after a series of challenges in the 2016 AGM season concerning executive bonuses and misleading underlying profit figures. Although we haven’t seen such campaigns here, some of the features stoking the debate in Australia also apply here.

Notably, both markets are dominated by the same two players – Risk Metrics Institutional Shareholder Services (ISS) and CGI Glass Lewis (CGI). This increases the likelihood that, if Australia moves to regulate proxy advisers, New Zealand will follow. Most comparable jurisdictions have already moved, including Canada, the EU and the US.

Key issues are whether the proxy firms have too much influence over voting results, what drives their decision-making and how they manage conflicts of interest. Support is gathering in Australia for the introduction of an industry code of conduct supervised by ASIC to promote greater transparency and accountability.
Hybrid meetings are here to stay.

Since 30 August 2012, New Zealand companies have had the ability to hold online shareholder meetings, including voting on resolutions, either as a “virtual” AGM or in conjunction with a traditional physical meeting – a “hybrid” AGM.

Most of the larger issuers have taken up hybrid meetings to some extent, and we expect they will become more accepted and more entrenched with the passage of time and as “digital natives” start to feature more largely within the shareholder population.

After a dismal turnout at its AGM last year, Z Energy announced that it would hold a virtual-only AGM this year.

However, in an example of shareholder pressure at work, the NZSA mounted a feisty campaign in defence of the shareholders’ right physically to attend AGMs – the result of which was that Z reversed its decision and opted to hold a hybrid meeting instead.

The NZSA’s position is that the hybrid physical/virtual option is the best way to achieve broad participation. It is also the preferred choice of shareholders, as revealed in a recent NZSA member survey. Features of the physical AGM which shareholders valued were the ability to ask oral questions and the ability to “eyeball” board members.

Given these findings, and the NZSA’s strong attachment to the traditional AGM, issuers could consider improving attendances by setting meetings for times most convenient to shareholders. According to Brian Gaynor, the “ideal time” is in the morning because people prefer to avoid the post-school and post-work rush. We reproduce his figures to the right.

Are online shareholder meetings the future?

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Last annual meetings of 50 largest NZX companies

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<th>12 to 14.5pm</th>
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<td>Total</td>
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Source: Brian Gaynor, NZ Herald, 1 April 2017

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Key audit matters (KAM)

The UK experience suggests KAM disclosure will prompt more shareholder questions at AGMs.

For balance dates after 15 December 2016, audit reports for listed issuers must include a "Key Audit Matters" section, which draws attention to those issues the auditor judged most significant or concerning when conducting the audit. Typically, these will involve some complexity and will require an element of judgement.


A report by the Chartered Accountants Association of Australia and New Zealand on KAM disclosures to date found that the content has been diverse and "bespoke to each entity and its industry", but there has been a common focus on revenue recognition, goodwill impairment, provisions and asset valuation.

In the UK, where the KAM requirement has been in force since 2013, it has been welcomed by shareholders for the insight it provides into the company’s performance and risk profile.

New Zealand will go further than other jurisdictions, including Australia and the UK, by extending the regime beyond listed issuers to a broader range of “FMC Reporting Entities” – such as registered banks, insurance companies and non-bank deposit takers. This will take effect from 31 December 2018.

KAM reporting has the potential to conflict with a range of competing considerations, including continuous disclosure obligations, confidentiality of commercially sensitive information and prejudice to litigation, and litigation privilege. With the greater transparency from KAM reporting, auditors should expect more informed shareholder questions at AGMs.

Other changes to the audit report

Audit reports must present the auditor opinion at the top of the report, and name the individual audit partner responsible for the audit. Previous practice was to bury it at the end of two to three pages of largely standard wording.

Implications for directors

Responsibility for deciding the contents of the KAM sits with the auditor and must be exercised with independence. But, directors will need to be aware of the matters which are raised and to ensure that any steps taken to mitigate the risk are documented. The experience from the UK is that the KAM will be a primary focus for shareholder, analyst and media attention.
Board composition

Our data series objectively shows the state of board structure.

**Board size**

The average board size was 5.8. Fletcher Building and Heartland Bank currently have the largest boards, of nine directors each. There is a rough approximation between the size of the board and the size of the company, with boards generally getting smaller further down the list. Only Airwork Holdings had three directors, the minimum number permitted by the NZX rules (and it has recently increased this to five).

**Independence**

76% of boards had a majority of independent directors, and 21% had only independent directors. Of the top 40 issuers, only two (EBOS and Tilt Renewables) had a minority of independents. 77% of boards had an independent chair with the proportion rising to 90% among the top 30. The balance of independence is affected to some extent if the CEO is on the board. Only 35% of the top 20 had their CEO on the board, but among the top 75, the proportion was 44.4%.

The top 75

The top 75 market capitalisation ranged from around $8b for Auckland International Airport to $185m for Abano. Hallenstein Glasson has been listed by NZX and its predecessor exchanges for almost 70 years. Other longstanding listings include The Colonial Motor Company and The New Zealand Refining Company (each 55 years) and Steel & Tube (nearly 50). Tilt Renewables, spun-off from TrustPower in 2016, is the most recent top 75 listing. The overall average time since listing is 17.6 years.
Multiple board roles

Multiple directorships were comparatively rare, with only six directors holding four top 75 directorships, 13 holding three positions and 45 holding two. A small number of directors also held significant board roles outside the top 75, on boards of banks or Crown agencies.

Three governance issues can arise from multiple directorships:

- conflicts of interest between the director’s various duties to different companies, or between the duty to the company and the director’s own interests
- compromised ability to gain a satisfactory understanding of each company’s business or to have sufficient time to devote to each company, and
- compromised capacity to effectively monitor executive management and therefore to exercise the desired level of independence.2

There is no “one size fits all.” Multiple directorships can also enhance what the director brings to each company.

The top 75 had 469 directors altogether.

2 Lawrence, Multiple Directorships and Conflicts of Interest: Recent Developments in Directors’ Duties (1999) Company & Securities Law Journal
Length of service

The average length of service on boards among the top 75 varies widely. The average across the entire sample is 5.8 years but the highest board average is 18.9 years with a peak individual period of service of 29 years.

Extended length of service may compromise independence, especially if a director becomes close to management. On the other hand, listed entities and shareholders can be well served with a mixed tenure board including longer serving directors with a deep understanding of the business and newer appointees who can bring fresh ideas and perspectives. The chair frequently falls into the first category.

Future directors

Only seven boards of the top 75 (9%) were active participants in the Future Directors programme – essentially a mentoring scheme under which a talented potential director can participate on a board for a year, learning what good governance looks like while bringing the benefits of a bright young mind and a fresh perspective to the boardroom.

Founded by Sir Stephen Tindall (The Warehouse/Tindall Foundation), Michael Stiassny (President IoD) and Des Hunt (NZSA) in 2013, Future Directors is intended to help develop the next generation of directors to ensure the director pool is wide enough to support New Zealand’s economic growth.

We think it is an excellent initiative and hope to see an uptick in the participation rate.
How often do boards meet?

The law does not mandate the number of times a board should meet in any year. What is appropriate will depend on a range of factors, including the complexity of the company’s business, the experience of the board, and the need to deal with any extraordinary events – such as selecting a new CEO, responding to a takeover, or dealing with a financial crisis.

66 of the top 75 issuers disclosed in their annual report the number of occasions the board met. Most of these also reported on the frequency of board committee meetings. The number of full board meetings ranged from three to 18, with an average of almost 10 in a 12-month cycle.

Directors’ average length of service – continued
Diversity

There has been a lot of discussion about the need to improve boardroom diversity in the last five years.

Initiatives have included:

- the launch of the 25 Percent Group in 2012, comprising chairs, directors and senior managers of some of New Zealand’s leading companies and organisations, to lift female representation on boards to 25% by 2015
- the establishment of the Institute of Directors’ Mentoring for Diversity programme, which has been running since 2012
- the formation in 2015 of Champions for Change New Zealand, a Global Women initiative engaging public and private sector leaders to promote the value of diversity and inclusiveness through the wider New Zealand business community, and
- published research from the Auckland University of Technology on the proportion of New Zealand women on boards of the top 100 NZX listed companies.\(^3\)

And, at the regulatory level:

- the introduction by NZX in July 2012 of a Diversity Listing Rule requiring issuers to provide a breakdown of the gender composition of their directors and officers and, if they have a formal diversity policy, to evaluate their performance in respect to that policy
- the inclusion in 2014 by the FMA in its Corporate Governance Guidelines of commentary to the effect that boards should consider “gender, ethnicity, cultural background, age and specific relevant skills” in recruiting directors, and
- most recently, a substantial sharpening by NZX of the reporting on diversity policies as part of the new NZX Corporate Governance Code.

NZX Corporate Governance Code, Recommendation 2.5

An issuer should have a written diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving diversity (which, at a minimum, should address gender diversity) and to assess annually both the objectives and the entity’s progress in achieving them. The issuer should disclose the policy or a summary of it.

Published diversity policies will enable future top 75 reviews to consider diversity beyond gender.

Components of diversity

- Age
- Religion
- Race
- Disability
- Sexual orientation
- Gender
- Language
- Ethnicity

\(^3\) Unlike our research, AUT’s includes boards of exchange traded funds and some overseas listed issuers
Diversity reporting

NZX publishes quarter-on-quarter comparisons of the overall gender diversity ratio among those who provide this information, with comparative data for the previous equivalent period.

The NZX reporting is of limited value because of the small sample sizes, particularly for the December period, and because the composition changes year-on-year with changes in listings.

Our analysis of the top 75 disclosures indicates a higher proportion of female directors among top 25 listed issuers, but only a small increase in the proportion of female directors between 2015 and 2016.

The proportion of women directors was highest among issuers that have been listed for more than 10 years at 20.75%. Among those listed for less than 10 years it was 19.8%. And, among those listed within the last five years, it was 18.2%. 17 boards (23%) had no female directors.

NZX also requires reporting of gender diversity among “officers” (the CEO and those that report to the CEO). In both 2015 and 2016, the ratio was unchanged at about 23.5%. Only one CEO in the top 75 was female (Chorus), and only 11.4% of CFOs were female.
The courts are going to continue to scrutinise director failings.

ASIC v Flugge

This case will be of particular interest to directors of companies exporting to regimes that are known to be corrupt.

Trevor Flugge was the chairman of AWB Ltd, an Australian grain marketing business which exported extensively to Iraq. He and five other directors or senior executives were charged by ASIC with making illicit payments to the Iraqi Grains Board (IGB) under the UN Oil for Food Program to give Iraq access to foreign currency in defiance of UN sanctions.

Only two of the charges made it to court, those against Flugge and AWB’s Group General Manager over the relevant period, Peter Geary. The other actions were either settled out of court or discontinued by ASIC.

The Victoria Supreme Court dismissed the allegations against Geary but found that Flugge had breached his duty of care as a director by failing to investigate the legitimacy of the fees.

The Court accepted that Flugge had not participated in and did not have any knowledge of the offending and that he had believed an assurance given to him by the company’s then Managing Director that the fees had UN approval. But it held that a reasonable person in Flugge’s position would have delved more deeply into the issue.

Relevant to this finding was that Flugge had attended a meeting with the Australian Trade Commissioner in Washington DC at which attendees were informed that the UN had concerns about the company’s contracts with Iraq, that another country had alleged AWB was making irregular payments to the IGB, and that the UN wanted detail on all contractual terms between AWB and the IGB.

The Court ruled: “If facts have come to the attention of a director that have awoken his suspicion that something is amiss... then the director has a duty to inquire into the matter. Further, the director is not excused from making his own inquiries by relying on the judgement of others...”

New Zealand law vs Australia

There are several similarities but also some differences between New Zealand and Australian law. We do not sue officers, only directors, and we do not have a penalty sanction in civil liability cases – only banning orders and compensation orders.

However, we have the same duty of care and good faith provisions, and we have the same defences available, so – apart from the fine – Flugge would probably have met much the same fate had he been sued under the New Zealand Companies Act as under the Australian Corporations Act.

A Chapman Tripp commentary on earlier cases involving directors’ duties, and reliance on others (Directors’ backsides exposed if “noses in, fingers out” becomes “hands off, eyes shut”), is available here.
**Prain & Schroeder v FMA**

Justin Prain and Mark Schroeder were charged with failing to deliver financial statements and an auditor’s report for the years ending 2011, 2012 and 2013. There was no dispute about that failure (which was ongoing after 2013). At issue was whether they could establish the statutory defence that they had taken all reasonable and proper steps to comply with their reporting requirements.

They were both directors of Apple Fields Ltd which, at the time the non-reporting occurred, was almost entirely engaged in a subdivision development in Christchurch on land owned by Noble, a company controlled by Gordon Stewart. Apple Field’s fortunes depended on Noble to the extent that their accountant advised them in 2011 that, under newly-adopted accounting standards, Noble would need to be consolidated into their annual accounts and would, therefore, need to be audited by Apple Fields’ auditor.

Noble refused to accept that consolidation was necessary and would not provide the required financial information. And there things stuck until the FMA took proceedings against Prain and Schroeder.

The FMA argued that they were remiss in not seeking a second opinion, ideally from a “top tier” accountancy firm, given that non-registration was a serious matter. This argument had succeeded in the High Court but was rejected by the Court of Appeal which took the view that:

“On the evidence, there is no reason to suppose that Apple Fields could compel Noble to comply. It does not control Noble in any orthodox sense”. Further advice would have made no difference to this situation.

**FMA enforcement focus**

The FMA has a particular focus on board conduct and an active enforcement policy, including through the courts.

In its updated Strategic Risk Outlook, released in February, the FMA reaffirmed that “governance and culture” remains its number one of seven priorities for the foreseeable future.

The FMA has a number of cases before the courts relating to directors’ duties and will receive a funding bump of $9.8m a year from 1 July through the new levy structure.

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**The Dick Smith legacy – watch this space**

Ferrier Hodgson, the receivers for failed electronics chain Dick Smith, is seeking to recover almost AU$90m from the former directors, CEO and CFO. This includes about AU$30m for the interim and final dividends paid in 2015 when the company was already treading water and about AU$60m for losses sustained as a result of poor stock management.

The four non-executive directors will defend the allegation that they breached their duty of care by failing to put in place adequate systems to manage supplier rebates and inventory. The statement of claim has been filed in the New South Wales Supreme Court and will be watched with interest on both sides of the Tasman.
Emerging developments

Climate change is now on the radar in Australia as a risk for directors.

The galvanising event was a roundtable organised in October last year by the Australian Centre for Policy Development and the Future Business Council.

On the agenda was a legal opinion they had commissioned on the extent to which corporate law permits or requires directors to consider and respond to climate-related risks to their company. The analysis is relevant to New Zealand because the directors’ duties that create the relevant obligations in Australia also apply with equal force here.

Key findings are that:
- climate change effects as they occur will be regarded by the courts as foreseeable and, to the extent they intersect with the company’s interests, may be relevant to a director’s duty of care and diligence
- directors are not legally restricted from taking into account climate change and related economic, environmental and social sustainability risks where those risks are or may be material to the company, and
- directors who fail to consider the impact of such risks now could be found liable for breach of duty in the future.

Excerpt from the legal opinion

Directors who do turn their minds to the impact of “climate change risks” on their business will need to form their own assessment and make their own decisions as to what action, if any, is to be taken. This is likely to include obtaining and relying upon information and advice provided by employees or experts.

Key conclusions

It’s only a matter of time before we see litigation against a director who has failed to perceive, disclose or take steps in relation to a foreseeable climate-related risk that can be demonstrated to have caused harm to a company (including, perhaps, reputational harm).

To consider climate change risks actively, and disclose them properly, will reduce exposure to liability, and maximise the potential for activating the “business judgment” rule.
Climate change reporting

The NZX Corporate Governance Code 2017 gives a big push to non-financial disclosure, including material exposure to environmental, economic and social sustainability (ESG) risks.

NZX recommends that issuers explain how they intend to manage ESG factors, that they report against a recognised international framework such as the Global Reporting Initiative and that they describe how the business is performing against its strategic objectives.

So what to do?

A good place to start is with the guidance produced in December last year by the 32 member multi-national Task Force on Climate-Related Financial Disclosures, chaired by Michael Bloomberg.

Their report was focused mostly on the financial sector, but it is broadly applicable across a range of sectors. They recommend four layers of disclosure (see below).

Obviously, to provide this level of information, a board will need to set in place procedures to ensure that it is kept informed of the company’s climate change risk profile and of potential impact of climate change effects on the business.

New NZX Corporate Governance Code Recommendation 4.3

“An issuer should provide non-financial disclosure at least annually, including considering material exposure to environmental, economic and social sustainability [ESG] risks and other key risks. It should explain how it plans to manage those risks and how operational or non-financial targets are measured.”

Recommended four layers of disclosure

- **Governance** – the organisation’s governance arrangements around climate-related risks
- **Strategy** – the actual and potential impacts of climate change on the organisation's business strategy and financial planning
- **Risk management** – the processes used to identify, assess and manage climate related risks
- **Metrics and targets** – the measurements used to guide and evaluate performance
The director and the great disruptor

Artificial Intelligence (AI) already pervades almost every aspect of our lives, is developing at a rate and scope which is by turns exhilarating and unnerving, and will create winners and losers.

The challenge is to try to stay ahead of the curve in the protection of the company’s and the shareholders’ interests.

Bruce McClintock, Chapman Tripp representative on AIFNZ, says:

“Directors should be encouraging experimentation. They should be challenging their leadership teams on their plans to incorporate AI into operations, products and services.

Companies may have to think more deeply and explicitly about what good behaviour means. Just as engineers ensure “safety in design”, so also will companies start to tackle “values in design”.

At a technical level, governance of AI requires assurance that it is legally compliant, sufficiently safe, controllable and transparent in its decision-making. Beyond that, good governance of AI may require values alignment. Once moral and ethical judgements are involved, AI must be taught what moral and ethical behaviour is, what is right and fair, beyond simply what brings greater utility.”

The potential for disruption – social and economic – is unprecedented and will require a considered response at the government and the board level. With this in mind, the Institute of Directors and Chapman Tripp last year issued Artificial Intelligence – Opportunities and Challenges for New Zealand: A call to action. It can be accessed on our website www.chapmantripp.com

The response has been encouraging. Supported by funding from the Ministry for Business, Innovation and Employment, the Artificial Intelligence Forum of New Zealand (AIFNZ) has been set up and is currently embarked on a major piece of research to produce a benchmark report this year on AI activity and capability in New Zealand, including specific analyses of the banking and finance, agribusiness, healthcare and transport sectors.

The Forum’s web page can be accessed at http://aif.nz
Chapman Tripp is a foundation member of AIFNZ.

The report is available here.
Governance of corporate groups

There is an inherent tension between the commercial objective for subsidiaries in a corporate group to act seamlessly in accordance with the policies and objectives of their parent, and the need for them to maintain separate legal liability.

*Lewis v Steel & Tube*

This case is relevant to directors faced with managing parent-subsidiary company relationships. The message is to be careful to maintain the subsidiary’s independence, because failure to do so may make the parent liable for the subsidiary’s debts.

Lewis Holdings Ltd (Lewis) leased property to Stube Holdings Ltd (Stube), a wholly owned subsidiary of Steel & Tube Holdings Ltd (Steel & Tube). When Stube went into liquidation, Lewis filed a proof of debt which the liquidators sought to obtain from Steel & Tube. The circumstances that gave rise to the subsidiary’s liquidation were entirely attributable to the parent company because, having created a 21-year obligation on Stube by renewing the lease, it then withdrew the funding it had previously provided to pay the rent and rates. The Court also gave some weight to the argument that as the parent company was publicly listed and had a company solicitor, it should have conducted the group’s affairs in a way that gave effect to each entity’s separate legal personality, rather than treating the group “as a single economic enterprise”.

The Court found that Steel & Tube had full liability for the debts because Stube was “devoid of any capacity to conduct its own affairs” and was being run essentially as a “division” of the parent. Steel & Tube was invoiced for and paid the rent and rates on the lease and decided to renew it for another 21-year term without Stube obtaining independent legal advice on the decision. The Court acknowledged that it is common practice for a parent company to be involved in the management of a subsidiary, including appointing high-level managers to the subsidiary’s board. However, in this case, the involvement had been so large as to compromise the subsidiary’s independence.

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Remuneration and other benefits

We expect more transparency in both executive and directors’ remuneration.

Executive remuneration

There is clearly public interest in shedding more light on executive pay packets – a gap the New Zealand Herald has tried to fill with its annual executive pay survey. However, the Herald finds itself in the catch-22 situation of being dependent for the quality of its data on the quality of disclosure available in company annual reports, and the reporting of executive remuneration in New Zealand has been light compared to other jurisdictions.

But the new NZX Corporate Governance Code has put the acid on by providing in Recommendation 5.3 that:

An issuer should disclose the remuneration arrangements in place for the CEO in its annual report. This should include disclosure of the base salary, short-term incentives and long-term incentives and the performance criteria used to determine performance-based payments.

Another important initiative is the reporting framework produced by the NZSA last year, which goes further than the NZX Code. Early adopters are Chorus and Mercury, but we expect others will follow until a critical mass is achieved and it becomes the benchmark. This will bring New Zealand more in line with international standards.

NZSA remuneration template – elements to be disclosed are:

- **Base salary and fees**
- **Taxable benefits**
- **Short and long term incentives**

To make remuneration decision-making more transparent, and to provide a basis for assessing the reasonableness of board decisions, the template provides for five year summaries of:

- CEO remuneration paid each year, including the proportion of incentives received against the maximum available, and
- total shareholder returns for the company against the NZX 50 average.

A copy of the NZSA template is available here.
**Director remuneration**

The Institute of Directors (IoD) has just released a new guide to disclosing director remuneration in annual reports with the aim of improving the transparency and consistency of reporting.

In some ways, it can be seen as a sister document to the executive remuneration template.

Elements identified by IoD are:

- the total fee pool approved by shareholders
- details and explanations about any increases or other changes in fees

- total fees paid to the board
- all remuneration received by directors individually, including
  - a breakout of committee fees
  - any shares or other benefits
  - any other payments – e.g. for consultancy services
- appropriate context and explanation about any changes or anomalies in fees paid.

A copy of the IoD template is available [here](#).

**D&O insurance developments**

The Financial Markets Conduct Act and related financial reporting reforms make the company itself primarily liable for disclosure defects. Previous law focused liability on directors.

The practical effects of these changes are significant given that plaintiffs will generally prefer to chase the company than the directors. “Side C” insurance cover will assume additional significance in conjunction with traditional director and officer policies. Even where the directors are targets, the company is exposed to investigation, litigation and defence costs.
2016 chair and base director fees

Our analysis of director remuneration disclosure among the top 75 identified a wide variance in director and chair base fees. A small number of issuers also pay separate board committee fees, particularly to the chair of the audit committee. For international comparison, a recent survey by remuneration consultants Strategic Pay found that New Zealand directors are paid 38.5% less than their Australian counterparts and chairs about 36% less.
**NZX Corporate Governance Code reform**

In May 2017, the NZX finalised an updated Corporate Governance Code, after 18 months of consultation.

Reporting against the new Code is required from 31 December 2017 balance dates, although issuers can choose to report earlier. We expect most significant June issuers will at least indicate major areas of alignment with the new standards.

The NZX conducted two consultation rounds – the first in November 2015 on the initial discussion document and the second from August 2016 on a consultation paper outlining its preliminary conclusions. The feedback showed a large measure of agreement but also – not surprisingly – some fault lines. Chief among these were the extent to which the NZX should push change in the areas of:

- board independence
- remuneration disclosure, and
- ESG (environmental, social and governance) reporting.

To get an understanding of the range of opinion offered, we looked closely at the second round submissions of:

- the Corporate Governance Forum (the Forum) and the New Zealand Superannuation Fund (NZSF), representing institutional investors
- the New Zealand Shareholders’ Association (NZSA), representing retail investors
- the Listed Companies Association (LCA), representing issuers, and
- the Institute of Directors (IoD).

The NZX Corporate Governance Code is available [here](#).
Board independence

The Listing Rules currently require a minimum of two independent directors unless the board has eight or more members, in which case the threshold rises to one-third of the total. NZX floated the idea of recommending that boards should have a majority of independent directors and/or an independent chair.

Support for this was strongest from the Forum, the NZSF and the NZSA, all of which wanted it introduced on a 'comply or explain' basis.

The IoD and the LCA took a softer stance, both advocating that, in the New Zealand market, it would be more practical to settle for a majority of non-executive (as opposed to independent) directors and an independent chair.

Chapman Tripp also advocated in our submission for this position, which is in line with the Financial Market Authority's Governance Guidelines.

Remuneration disclosure

The main point of divergence here was over the level of detail which should be disclosed in relation to CEO and senior executive pay.

Again, the most emphatic responses were from the Forum and the NZSF, both of which argued for annual disclosure of how remuneration levels and components were determined and why they were deemed appropriate when reconciled with the company's performance. They also submitted that share-based reward schemes should require shareholder approval before implementation.

The NZSA took the opportunity to promote its reporting format (discussed above), adding that it – or some iteration of it – would likely become a voluntary standard if the NZX "introduced a general requirement that sought the middle ground".

Chapman Tripp submitted that the proportions of base pay and pay at risk should be reported across directors and senior managers as a group, rather than individually, and as an average or a range. We consider that the detail required by the Australian Corporations Act is excessive and that there are solid commercial reasons for keeping individual remuneration details confidential.

NZX Independence Rule

NZX has decided to leave the status quo in place pending a wider review of its Listing Rules.

NZX CEO Remuneration Recommendation

The final code focuses on disclosure of CEO base salary, short term and long term incentives and performance criteria to determine incentive payments.
ESG reporting

The question here was whether NZX should introduce any additional recommendations or best practice commentary in relation to non-financial reporting matters, including ESG disclosures.

Everyone agreed that this was an area for improvement and that there was a value in ESG reporting. The NZSF, in particular, pointed out that poor management of ESG can have significant repercussions for companies and the business environment in which they operate, including regulatory response, as the recent workplace health and safety reforms demonstrate.

However, there was a consensus that the way to move the issue forward is through voluntary guidance or reference materials rather than through prescription or coercion. The IoD, the NZSA and the LCA stressed the need for flexibility to allow reporting only on those issues that were relevant to the business to prevent imposing too big a burden on smaller issuers and to avoid a tick box approach.

Chapman Tripp’s view is that the solution lies in the market. Investors can make their own decisions about the importance of ESG matters and can choose not to invest in issuers that do not satisfy these expectations. The fact that the Companies Act allows a single shareholder to raise a proposal, no matter how small the shareholding, also provides a platform for shareholders to promote ESG concerns directly with the board.

NZX ESG Reporting Recommendation

The final code recommends issuers provide annual non-financial disclosure, including material exposure to environmental, economic and social sustainability risks and other key risks. It also recommends explanations of plans to manage risks and how operational or other non-financial targets are measured.

Chapman Tripp’s submission and our fuller overview of the new Code can be accessed on our website www.chapmantripp.com

Investors can make their own decisions about the importance of ESG matters and can choose not to invest in issuers that do not satisfy these expectations.
Promoting investor confidence through the application of good governance principles.

Our leading team of senior corporate lawyers specialising in corporate governance advise a number of New Zealand’s largest listed companies – and government-owned companies and agencies – on governance and strategic advice, relevant Financial Markets Authority guidance, and market practice and trends.

Our work includes advising on:

- directors’ duties and liabilities, delegations and conflict of interest management
- best practice corporate governance policies and procedures
- market disclosure, insider trading compliance and appropriate procedures and systems
- director and senior executive remuneration structuring and disclosure, including employee share plans and incentive arrangements, and director contracts
- board and sub-committees composition, including charters and best practice, and
- annual reports and preparation for meetings of shareholders.

A number of our partners and consultants are independent directors of NZX listed companies, crown agencies, and other large business entities. We are the primary national legal partner for the Institute of Directors in New Zealand. Our partners regularly provide media comment on topical governance issues, and are active contributors to governance law and policy reform initiatives of government, NZX, the Financial Markets Authority and the Takeovers Panel.

We have worked with a number of directors and boards on a range of complex issues, including:

- advising on appropriate decision-making processes, management of conflict of interests, and resolution of deadlocks
- acting as a sounding-board for difficult, or strategic, decision-making
- advising on delegation, reasonable reliance on others and required ongoing monitoring and oversight of delegates
- providing external, independent advice to the chair or individual directors, including advising on issues of board composition and refreshment
- advising on market disclosure of listed issuers, financial reporting and assurance requirements, and other statutory disclosure obligations
- advising on director and senior manager remuneration policies, appropriate STI and LTI incentives, and other benefits
- advising on director and officer insurance and indemnification
- advising on the NZX Corporate Governance Code
- preparing corporate governance policies and charters that meet best practice and the requirements of the Listing Rules, Companies Act and other legislation
- assisting with reporting against corporate governance policies in annual reports, or via websites, and comparison with the NZX, FMA and other third party best practice governance codes and recommendations, and
- attending meetings of shareholders and advising on meeting practice and procedure.

“They are a cohesive unit and appear to discuss current issues and problem-solve to reach solutions – as a client you really feel like you are getting their best advice.”

Band 1, Corporate and Commercial, Chambers Asia Pacific 2017
Corporate governance: Initial contacts

ROGER WALLIS – PARTNER
AUCKLAND
T: +64 9 357 9077 | M: +64 27 478 3192
E: roger.wallis@chapmantripp.com

GEOF SHIRTCLIFFE – PARTNER
WELLINGTON
T: +64 4 498 6322 | M: +64 27 481 1699
E: geof.shirtcliffe@chapmantripp.com

ALISTER MCDONALD – PARTNER
CHRISTCHURCH
T: +64 3 353 0392 | M: +64 21 477 935
E: alister.mcdonald@chapmantripp.com

Other corporate governance partners

FIONA BENNETT – PARTNER
CHRISTCHURCH
T: +64 3 353 0341 | M: +64 27 209 5871
E: fiona.bennett@chapmantripp.com

JOSH BLACKMORE – PARTNER
WELLINGTON
T: +64 4 498 4904 | M: +64 21 828 814
E: josh.blackmore@chapmantripp.com

RACHEL DUNNE – PARTNER
AUCKLAND
T: +64 9 357 9626 | M: +64 27 553 4924
E: rachel.dunne@chapmantripp.com

PIP ENGLAND – PARTNER
AUCKLAND
T: +64 9 357 9069 | M: +64 27 434 8854
E: pip.england@chapmantripp.com

JOHN STROWGER – PARTNER
AUCKLAND
T: +64 9 357 9081 | M: +64 27 478 1854
E: john.strowger@chapmantripp.com

TIM TUBMAN – PARTNER
AUCKLAND
T: +64 9 357 9076 | M: +64 27 344 2178
E: tim.tubman@chapmantripp.com

ARTHUR YOUNG – SENIOR PARTNER
AUCKLAND
T: +64 9 357 9001 | M: +64 21 680 067
E: arthur.young@chapmantripp.com
Our thanks to Asha Trotter, Hugo Van Dyke, Tom Jemson and Tony Davis for helping with research for this publication.

If you would prefer to receive this publication by email, please send us an email at subscriptions@chapmantripp.com.

Every effort has been made to ensure accuracy in this publication. However, the items are necessarily generalised and readers are urged to seek specific advice on particular matters and not rely solely on this text.

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