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LISTING RULE 3.1.1 - INCORPORATION BY REFERENCE TO LISTING RULES

- 1 We have reviewed the New Zealand Shareholders Association Inc ("NZSA") email which alleges that the incorporation by reference option in Listing Rule 3.1.1(a) will "lead the company into a breach of the statutory requirements in sections 32,104,105,106 and 117 of the Companies Act".
- 2 We disagree with the New Zealand Shareholders Association Inc conclusion which proceeds on a narrow reading of Part V of the Companies Act. We think:
 - 2.1 a company will not be in breach of the Companies Act simply because it includes in its constitution an "incorporate by reference" provision. Such a provision, properly inserted by special resolution, will validly incorporate into the constitution the specific rules referred to in Appendix 6 of the Listing Rules;

2.2 it would not be difficult for a court to conclude, in this context, that any amendments to the Rules in Appendix 6 will also be validly incorporated if the relevant constitutional provision expressly provides that such amendments are deemed to be incorporated.

3 We note the provision objected to by the New Zealand Shareholders Association is one of a number of provisions in Listing Rule 3.1.1 which deal with the relationship between the Rules and the constitution, with the remaining provisions effectively providing, and requiring issuers constitutions to provide, that the Rules will have primacy in certain circumstances over the constitution e.g:

3.1 the constitution must provide that an Issuer comply with the Rules (Rule 3.1(c)).

3.2 if the constitution is inconsistent with the Rules the Rules will prevail (see Listing Rule 3.1.1(e)); and

3.3 if the NZX grants a Ruling on an act or an omission, which in the absence of the Ruling would be in contravention of the constitution, then the constitution shall be deemed to have authorised that act (Rule 3.1.1(d)).

While the "incorporate by reference" option is a relatively recent flexibility introduced into the rules the other provisions in Listing Rule 3.1.1 which deal with the primacy of the Rules over the constitution have been in constitutions for many years, and have been recognised by the New Zealand courts.

4 The Rules provide additional protections to those set out in the Companies Act. The Rules are publicly available documents. Any amendments to the Rules are subject to a consultation process and review by the Securities Commission as part of the process of assisting the Minister of Commerce in deciding whether to exercise the Minister's statutory veto right over any amendments.

5 Inclusion of the Listing Rules in Appendix 6 in a company's constitution is intended to achieve two broad objectives, namely:

5.1 where the rules are a modification of a matter permitted by the Companies Act, those rules need to be included in the constitution otherwise the Companies Act default provisions would apply. We note in this context that the modifications generally increase the

protections that would otherwise be available under the Companies Act default provisions;

- 5.2 to provide shareholders with additional enforcement rights (for example injunctive relief under the Companies Act) and directors with greater responsibilities (breach of a listing rule could result in a breach of a director's duty).
- 6 In short inclusion of the Appendix 6 Rules in the constitution is designed to provide benefits to shareholders. It is not designed to allow companies to pick and choose which Rules they wish to comply with (see Rule 3.1.1(d)). This approach would undermine the listed market objective of standardisation. Standardisation advances market integrity and efficiency. It means that shareholders have the confidence that regardless of which listed company they invest in the same protections apply and it also reduces the transactional costs involved in inquiring whether, and how, a particular listed company might depart from the norm.
- 7 It is settled law that a special resolution can validly "incorporate by reference" the rules (as they then stand) into a constitution. The courts have previously recognised that a previous constitution can ensure that the rules are not only incorporated, but prevail "whatever the constitution might say" (*Xylem Fund v Fletcher Challenge Forests Ltd*).
- 8 Nor do we think it difficult for a court to conclude that a reference to rules as amended from time to time, in this context at least, does not constitute an alteration of the constitution. That is, shareholders have agreed to an "alteration" which provides for further amendments to be made by the NZX.
- 9 Constitutions commonly refer to legislation (including the Companies Act itself) and particularly to definitions. The same is true of contracts and statutes. Legislative sources change from time to time. Depending on the language of incorporation used, the reference are often interpreted as being to the law for the time being in force. Similarly, contracts commonly incorporate standard terms or rules (eg shipping rules, rules of arbitration). Such provisions are often interpreted as referring to the most recent edition of such terms or rules, again depending on the language of incorporation used.
- 10 We do not think such an interpretation is a fetter on shareholders rights. To the extent that any authority is being surrendered by shareholders it is more than compensated by the benefit and protections in a regulated listed market. The courts have recognised that listing may require the "surrender" of some shareholder autonomy (*Xylem*).

- 11 In addition shareholders retain the backstop of section 174 of the Act. If a subsequent Rule amendment was prejudicial to shareholders (an unlikely event, given the Minister in determining whether to exercise a veto right over any amendments to the Listing Rules must be satisfied that the amendment is in the public interest) then the shareholder has the protection of a range of court ordered remedies.

- 12 There will be boundary issues between the Companies Act and the Listing Rules-it is inevitable where you have two, relatively extensive, co existing regulatory regimes. We do not think it justifiable that the NZX should have to seek a declaratory judgment (as proposed by the NZSA) for the issues that will arise around these boundaries. Rather we think, particularly in this context, that the NZX can rely on the legal arguments above we have provided, and the history of the New Zealand courts willingness to give effect to the co-existence of the two regulatory regimes.

- 13 If you require any further elaboration on the above please contact the writer.

Yours faithfully

Frank McLaughlin
Partner