

CONSULTATION PAPER
Proposed NZX Discipline Rule Amendments

June 2008



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I. INTRODUCTION

A. PURPOSE

NZX Discipline ("**NZXD**") has been in operation for four years. While the operation of NZXD over that period has been successful, NZX Regulation ("**NZXR**") considers improvements could be made to the NZX Discipline Rules ("**Rules**"). NZXR has also considered matters raised by the Securities Commission when conducting this review. Accordingly, NZXR has decided to conduct a review of those Rules, targeted at areas to improve the efficiency and operation of NZXD.

The proposals contained in the paper have been prepared in consultation with NZXD.

NZXR encourages interested persons to consider the proposed amendments detailed in this consultation paper. NZXR has not made any determinations on any of the proposals detailed herein and whether they should be adopted. The purpose of this consultation paper is to provide you with an opportunity to comment on the proposals under consideration. NZXR welcomes submissions on any or all of the proposals set out in this paper. As set out in section III of this consultation paper, submissions are due by 25 July 2008.

NZXR reserves the right to publish submissions received. If you do not wish your submissions to be made public, please indicate this in your submission. NZXR would prefer submissions to be provided in electronic format. Submissions should be addressed to:

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Those responding to this consultation paper are asked, as part of their response, to identify specifically the section, rule and paragraph number on which they are commenting.

B. STRUCTURE OF THIS CONSULTATION PAPER

This consultation paper is divided into the following sections:

- (i) Introduction;
- (ii) Proposed Amendments; and
- (iii) Timetable.

II. PROPOSED AMENDMENTS

NZXD: Renaming

NZX considers that the current name of the Discipline body does not adequately represent its independence from NZX and, accordingly, creates confusion. NZX proposes that NZX Discipline be renamed as NZ Markets Disciplinary Tribunal (NZMDT). Amendments will need to be made throughout the Rules to reflect this.

Ancillary Powers

Rule 4.1 sets out the powers NZXD has under the Rules but makes no specific reference to NZXD being able to determine its own processes and procedures to the extent that such matters are not set out in the Rules. NZX considers that this power should be explicitly included in the Rules so as to ensure that NZXD retains maximum flexibility to deal with situations not explicitly envisaged under the Rules. Rule 4.1 should be amended as follows:

At the end of Rule 4.1 the following shall be inserted:

and shall have all necessary or desirable ancillary powers to give full effect to the specific powers set out in this NZX Discipline Rule 4 *including the power for NZX Discipline to determine its own processes and procedures to the extent that such processes and procedures are not set out in these NZX Discipline Rules.*

It would also be beneficial for the NZXD Panel to be able to provide **guidance** or **practice notes**. Most Tribunals or Courts in New Zealand have the ability to issue practice notes, mainly with regard to procedure. NZX Regulation also produces guidance notes to assist in interpretation of the Listing Rules or Participant Rules. This approach has two advantages: 1. it is a formal method of determining practice and procedure where such practice and procedure is not set out in the Rules; and 2. it provides guidance to parties bringing/responding to NZXD matters.

Accordingly, it is proposed that Rule 4.1 should also be amended as follows:

After Rule 4.1(h) the following shall be inserted:

- (i) consider issuing Practice Notes addressing the process, procedure, and approach of NZX Discipline in accordance with Rule 4.1 and may publish those Practice Notes on NZX's website (www.nzx.com) in conjunction with a summary of the practice note that may be released to Market Participants and Listed Issuers via NZX's market announcement platform.

Service

Service is provided for by Rule 5.5. There is no particular form of service of documents required under the Rules. The Rules do not contain a substituted or deemed service provision. NZXD has determined that a respondent must actually receive a statement of case before a Hearing can proceed. This can cause difficulty where a respondent seeks to avoid service or has left New Zealand and can not be located.

There are several ways that Rule 5.5¹ could be improved:

- i. The Rules could be amended to create an explicit right to apply for ex parte directions as to substituted service;
- ii. NZX could make it mandatory that all parties governed by the Listing Rules or Participant Rules (whichever is applicable) acquire and maintain an official email address (or other appropriate electronic system) for the purposes of receiving such notices and immediately advise NZX of any update or change to that address; or
- iii. The Rules could be amended to include a deemed service provision.

Certainty and speed of resolution should be the chief priority in the context of service. This makes option i). with its required application to NZXD undesirable. Although option ii). would require an amendment to the Listing Rules or Participant Rules before it could be introduced, the speed and ease of use that e-mailing disciplinary documents to effect service make it an attractive alternative. However, e-mail addresses are not permanent and are invariably changed. Option iii). would provide similar benefits of speed and simplicity as option ii). but without the need to amend the Listing Rules or Participant Rules. Moreover the use of deemed service provisions such as option iii). has been successfully adopted by the New York Stock Exchange in its discipline rules.

The obvious objection to the creation of a deemed service provision is that there is a risk that it could cause injustice. Where, for example, a Respondent returns from being out of the country only to find that a default determination has been entered in his or her absence, the Respondent would feel that he or she had been unjustly treated. In order to prevent such situations arising, a safety valve has been included under sub-clause (c) of the proposed default determination provision (set out on page 10). That sub-clause allows such a Respondent to apply to NZXD to set aside the determination. If the Respondent could show good reason and NZXD considered that it was reasonable to do so, the determination would be set aside. Accordingly, NZX considers option iii). to be the most acceptable amendment.

Proposal

It is proposed that the following rule be introduced to give effect to option iii).:

5.18 Service: Service shall be deemed effective by personal service of the statement of case, or by leaving the same either at the respondent's last office address advised to NZX during business hours or the Respondent's last place of residence as reflected in NZX records, or upon mailing the same to the Respondent at the aforesaid office address or place of residence. Following such service, NZX Discipline shall then have jurisdiction upon receipt of the statement of case.

Filing of Statement of Case and Statement of Response

The time frames for the exchange of statements of case and response are provided for by Rules 5.6 and 6.4. There are two concerns with the Rules as presently drafted. First, a Respondent must file a statement of response for Full Hearing, and second, the time frames for response are unduly short as is reflected by the extensions often granted by NZXD to respondents to file a statement of response.

The first issue is purely a drafting error and is easily corrected. A statement of response in a Summary Hearing *may* be filed, whereas for a Full Hearing, the Respondent *must* file its statement of response. It is

¹ Rules 5.5-5.12 apply to full hearings and summary hearings except as stated otherwise under Rule 6.4.

also arguable that it is a correct interpretation of the Rules that there is no ability for NZXD to extend the time period for the filing of a statement of response in a Full Hearing.

The default time frames for filing statements of response in Summary and Full hearings have been a cause of concern for those involved in the discipline process. For a Summary Hearing 3 Business Days are allowed and for Full Hearings it is 5 Business Days. On their face, the time frames for both proceedings are short given the amount of work required to prepare a statement of response. As a direct result of the brief period allowed for filing statements of response, NZXD has received many requests for extensions of time, and those have been duly granted by NZXD. It is proposed that these default time frames be extended to remove the need for these routine applications for extensions.

It is proposed that the default time frames for filing statements of response for Summary Hearings be extended to 10 Business Days, and for Full Hearings to 20 Business Days. These time frames reflect NZXD's experience with the length of extensions usually sought. It is also proposed that the Chairperson or Deputy may shorten the default time frames where urgency requires it.

Rules 5.6 and 6.4(a) should be amended as follows:

5.6 The Respondent may, within 10 Business Days of receipt of a statement of case provided under NZX Discipline Rule 5.5 or such other period as directed by the Chairperson (or in his or her absence the Deputy Chairperson) on the request of that Respondent submit to NZX and NZX Discipline a statement in response setting out:

...[all requirements remain the same except for]

- (e) copies of all documents...; or
- (f) file a notice requesting more time to file a statement of response with NZX Discipline within 8 Business Days setting out why additional time is required.

6.4 NZX Discipline Rules for Full Hearing: NZX Discipline Rule 5.5 to 5.17 relating to a Summary Hearing shall, with appropriate modifications, apply to a Full Hearing, except that:

- (a) **NZX Discipline Rule 5.6** shall be amended such that the Respondent must provide its statement of response to NZX no later than 20 Business Days after receipt of a statement of case from NZX or such other period as directed by the Chairperson (or in his or her absence, the Deputy Chairperson);

NZX Right of Response following Receipt of Statement of Response

By not expressly permitting re-pleading, the Rules rely on NZXD determining the appropriate procedure and therefore may not facilitate the clarification of issues as best they could.

The function of statements of case and response is to clarify the issues in dispute for determination by NZXD. Therefore, the efficiency of the disciplinary process depends on having thoroughly and properly

prepared statements of case and response. Accordingly, it is submitted that the Rules should be amended to permit the filing of amended statements by both parties.

Proposal

The proposed rule below is designed to give parties an opportunity to re-plead their statement of case or response with the leave of NZXD:

5.6A Amendment to Statement of Case or Statement of Response

- (a) Filing of an amended statement:
- (i) Any party may at any time before a hearing seek leave from NZX Discipline to file an amended statement of case or response with NZX Discipline and serve a copy thereof on the other party.
 - (ii) An amended statement may introduce a fresh claim whether or not that claim has arisen since the filing of the statement of case, or a fresh ground of defence, whether as an alternative or not.
 - (iii) Where an amended statement introduces a fresh claim, if the other party wishes to file and serve a defence thereto, it must be done within 3 Business Days after the day on which the amended statement is served on him, or within such other time as directed by NZX Discipline.
 - (iv) Where an amended statement does not introduce a fresh claim, the other party (if he or she so wishes) may, within 2 Business Days after the day on which the amended pleading is served on him, or within such other period as directed by NZX Discipline file and serve an amended response thereto.

Evidence

Currently, NZXD has a broad power to receive documentary and oral evidence that may, in the opinion of NZXD or an Appeal Panel, assist it to deal effectively with any matter before it, whether or not it would be admissible in a court of law. This basic power is largely congruent with that available to other disciplinary tribunals. This consultation paper raises two principal concerns with the Rules as they relate to evidence at present. First, the potential scope of documents that can be required to be produced is unnecessarily wide. Second, the power of NZXD to penalise failure to produce documents requires improvement.

The first concern relates to the scope of documents of which NZXD can compel production. As the Rules are presently drafted, NZXD may compel the production of all books, records and tapes amongst other information from a wide variety of people, so long as it *relates* to the subject matter of any hearing. It is submitted that the scope of documents to be provided be narrowed from those that 'relate' to the hearing to those that are 'relevant'.

Finally, to ensure compliance with orders for the production of documents, it is submitted that NZXD should be able to penalise respondents for failure to do so.

Proposal

The following amendments are proposed:

4.2

- (c) Delete “relating” in the second to last line and replace with “that are relevant”.

The following rule is proposed to provide NZXD with the power to penalise parties for not complying with orders to produce documents and could be introduced to section 11 (Penalties):

11.x Penalties for failure to comply with requirement to provide information or document:

- (a) A person who receives notice under Rule 4.2, must comply with the requirement stated in the notice in the manner within the period (being not less than 4 Business Days or such other period advised by NZX Discipline after the notice is given to the person) specified in the notice.
- (b) Every person is liable to a fine of not exceeding \$10,000, who, when required to comply with a notice given under Rule 4.2:
 - (i) refuses or fails without reasonable excuse to comply with the notice; or
 - (ii) knowingly or recklessly provides information that is false or misleading in any material particular.

Time frame for delivery of NZXD's determinations

Under the Rules as they are currently drafted, the time frames for the delivery of determinations by NZXD are unclear.

Presently, a Summary Hearing on the papers must be conducted and a determination issued within 3 Business Days of the receipt by NZXD of all documents (NZXD Rule 5.8). There is no time frame, however, for the determination of oral Summary Hearings.

Proposal

The following amendment to Rule 5.9 is proposed:

5.9 Oral Hearing: If a party notifies NZX Discipline that it believes an oral Summary Hearing of a matter is essential to establish all the facts relevant to the matter in accordance with NZX Discipline Rule 5.6(c) or 5.7:

- (a) that matter shall be heard by way of oral Summary Hearing within 10 Business Days of such notice or such other period as determined by NZX Discipline; and
- (b) NZX Discipline shall deliver its Summary Hearing determination within 10 Business Days of the date of the oral summary Hearing.

Rule 6.4(b) amends Rule 5.8 for the purposes of Full Hearings and currently reads:

6.4 NZX Discipline Rules for Full Hearing: NZX Discipline Rule 5.5 to 5.17

...

(b) a Full Hearing on consideration of the documents shall occur not more than 15 Business Days after receipt by NZX of a statement in response in respect of a matter.

The time frame for the delivery of a Full Hearing determination is unclear as a result of a drafting error in Rule 6.4(b). What was intended was that NZXD issue its determination within 15 days of receiving the documents. However, given the complexities of issues considered at a Full Hearing and the need to convene the Panel, NZX considers 30 Business Days to be more viable. Therefore it is proposed that Rule 6.4(b) should read as follows:

6.4 NZX Discipline Rules for Full Hearing: NZX Discipline Rule 5.5 to 5.17

...

(b) NZX Discipline Rule 5.8 shall be amended such that a Full Hearing must be convened to consider the matter and a determination must be issued within 30 Business Days after receipt by NZX Discipline of a statement of response or within such other period as determined by the Chairperson of the Division, or by process set out in a NZX Discipline practice note.

As with Summary Hearings, the Rules do not specify how long NZXD has to hear and make a determination of a Full Hearing conducted orally. A new Rule, Rule 6.4(bb) should be inserted to provide for timeframes for these determinations as follows:

6.4 NZX Discipline Rules for Full Hearing: NZX Discipline Rule 5.5 to 5.17

...

(bb) NZX Discipline Rule 5.8 shall be amended such that NZX Discipline's determination under an oral hearing under the Full Hearing Procedure shall occur within 15 Business Days of such hearing or within such other period as determined by the Chairperson of the Division.

Default determination

If NZXD does not receive the statement of response within the time frame set out in the Rules or following an application for extension of time, it is submitted that NZXD should be able, on application, to enter a default determination. The introduction of a default determination procedure will give NZXD the power to quickly dispose of matters where a party is refusing to participate. Sub-clause (c) has been included as a safety valve to give NZXD a broad power to set aside default determinations where to enforce them would be unfair in the circumstances. Circumstances where this power would be exercised include instances where NZX has served the statement of case on the basis of incorrect address details, or where for some other bona fide reason the Respondent has not received the statement of case or a motion for default determination and as a result a default determination has been entered without the Respondent having the opportunity to defend itself.

Proposal

The following rule is proposed to allow enable NZXD to enter default determinations:

4.16 Default Determination

- (a) If the Respondent has failed to file a statement of response within the time frame permitted under these NZX Discipline Rules or that advised by NZX Discipline at pre-hearing review or otherwise after receiving an application for extension, NZX by application accompanied by proof of service may request a determination of breach by default, and may recommend a penalty to be imposed. NZX must also immediately deliver or post a copy of that application to the Respondent.
- (b) If the Respondent opposes the application, NZX Discipline, on a determination that the Respondent had adequate reason to fail to file a statement of response, may adjourn the hearing of the default application and direct the Respondent to promptly file a statement of response. If the default application is unopposed, or the Respondent did not have adequate reason to fail to file a statement of response, or the Respondent failed to file a statement of response after being given an opportunity to do so, NZX Discipline, on a determination that the Respondent has had notice of the statement of case and application for default determination and that NZX Discipline has jurisdiction in the matter, may make a determination and determine penalty.
- (c) If a Respondent did not receive the statement of case or application for default determination, and a determination has been entered in the absence of any statement of response or application opposing a default determination being filed by the Respondent, the Respondent may apply to NZX Discipline to have the determination set aside if the Respondent can produce evidence that he did not receive the statement of case or the motion for default determination, or otherwise can show good reason for the determination to be set aside, NZX Discipline may set aside the determination if it considers that it fair and reasonable in the circumstances to do so.

Statement of Findings

Currently there is an overlap between the provisions of the Penalties section (section 11) and the Statement of Findings section. Under the Penalties section, NZXD already makes a determination as to whether the Participant or Issuer is issued with a private or public reprimand. This decision is then essentially replicated in the current Statement of Findings (Rule 5.17(a)).

Proposal

The following amendment to Rule 5.17(a) is proposed to confirm that the decision as to naming is made once, when NZXD makes its determination.

5.17 Statement of Findings

Each Division of NZX Discipline constituted to hear and determine a matter shall provide a written statement of its reasons for any decision it makes in determining a matter and its choice of any penalty imposed. That Division shall forward to NZX that written statement of reasons.

NZX shall prepare a statement of the circumstances giving rise to the hearing of that matter which shall identify the Respondent by name, (unless no findings adverse to that Respondent have been made, or the Division constituted to hear and determine the matter *has*, at its discretion, decided not to identify that Respondent). The statement of reasons provided by the Division and the statement of circumstances prepared by NZX may be published by NZX at NZX's discretion.

Appeal and Review

There have been some issues about the scope of the right of appeal and review available under the Rules.

NZXD is aware of a concern amongst Market Participants that the naming of the individuals and/or firms involved in an NZXD hearing following publication of findings may have more damaging effects than the conduct in question dealt with in the findings. Accordingly, this paper proposes an amendment to the appeal procedure clause to allow either party to a hearing the right to appeal their identification in publications of NZXD. This amendment will bring the Rules (and as a result the NZXD hearing procedures) in line with other professional disciplinary bodies such as the Law Society, Dentists Disciplinary Tribunal and Medical Council/Health and Disability Commission which only identify parties when the conduct warrants it.

The following amendment adds a new Rule 8.1(c) to expressly allow for an appeal against decisions to issue public statements naming parties to the disciplinary process.

8. FULL APPEAL PROCEDURE

8.1 Limitation on right to appeal a Full Hearing determination: Subject to Rule 8.1A, either party may appeal a determination of NZX Discipline that relates to a matter that was referred to a Full Hearing in accordance with NZX Discipline Rule 6.1 or 5.3 only where that determination included:

- (a) a penalty in the amount of:
 - (i) \$100,000 or more in the case of a non-natural person; or
 - (ii) \$50,000 or more in the case of a natural person, or
- (b) the suspension or revocation of a Market Participant's designation under NZX Discipline Rule 4.3, the suspension of quotation of trading of an Issuer's Quoted Securities or class of Quoted Securities under NZX Discipline Rule 4.5, or suspension or revocation of a Futures and Options Participant's designation under NZX Discipline Rule 4.8.
- (c) any decision of NZXD to publish the name and/or identity of any party to a Full Hearing.

Other than as set out in this NZX Discipline Rule 8.1, a party shall have no right of appeal from a determination made by NZX Discipline at a Full Hearing.

The second concern relates to the meaning of 'review' in Rule 4.12. As presently drafted, the meaning of Rule 4.12 is ambiguous. It has been interpreted to mean a "second look" at the substance of the decision made by NZX (e.g. in the Oyster Bay decision) in respect of a waiver or ruling application, primarily on the basis of material before NZX. Presently NZXD has the power to receive further evidence in exceptional

circumstances. NZX wishes to narrow the scope of Rule 4.12 to reflect its intended purpose as a mechanism to facilitate review of the process of decision making. Making this amendment will overturn the Oyster Bay decision of NZXD that determined that NZXD could review decisions of NZX on the merits, substitute its view for that of NZXR, and examine new evidence.

There is good reason for the proposed change to the meaning of Rule 4.12. NZXR is the arbiter of waivers and rulings under the Listing Rules, Participant Rules, Futures and Options Rules and any other rules and regulations of NZX. It is therefore inappropriate to allow NZXD to take a “second look” at decisions that are wholly within the scope of NZXR’s authority, especially if such a “second look” involves NZXD receiving new evidence not available to NZX at the time NZX made its decision. NZXD should only have the power to review the process of decision making and not the merits of the decision itself. The following amendment is proposed to bring these changes about:

4.12 Review of NZX Action by NZX Discipline: An applicant for a waiver or ruling under the Conduct Rules, the Futures and Options Rules or any other rules and regulations of NZX from time to time may, apply to NZX Discipline for review of the decision made by NZX in respect of that waiver or ruling application (**Referral**).

- (a) A Referral shall be sought only on the basis that the decision:
- (i) was unreasonable having regard to the evidence available to NZX and the circumstances at the time NZX made the decision; or
 - (ii) made in circumstances when NZX has refused to consider information submitted by an applicant for waiver or ruling,

and shall be confined to a review of the process of the decision made by NZX. Any Referral under this rule shall be a review of NZX’s decision making process with respect to the application, rather than a review of the merits of the decision itself and in light of any precedent that the applicant can present. NZX Discipline can not look to the merits of NZX’s decision or consider new evidence.

- (b) New Evidence shall not be received on a Referral.
- (c) A Referral shall be made in writing to the Chairperson stating the grounds for the Referral. The Chairperson (and in his or her absence the Deputy Chairperson) may:
- (i) reasonably refuse to consider a Referral. Where the Chairperson (and in his or her absence the Deputy Chairperson) refuses to consider a Referral it shall provide the applicant of that Referral with written reasons for such refusal; or
 - (ii) determine that the Referral be dealt with by NZX Discipline in accordance with the procedures set out in NZX Discipline Rule 5, with any modifications to those Summary Hearing Procedures as the Division of NZX Discipline constituted to hear and determine that matter considers appropriate; or
 - (iii) determine that the Referral be referred back to NZX for NZX to reconsider the application for waiver or ruling afresh.

Penalties

There are three objections to the penalties section of the Rules. First, the Rules do not provide for

adequate penalties given the scale of possible offending. Second, the Rules do not provide an appropriate deterrent to prevent intentional breaches of NZX's rules. Thirdly, the Rules do not contain a provision to censure directors or former directors of Listed Issuers for differing levels of misconduct.

Presently, the maximum penalty for an individual under the Rules is \$250,000. The potential scale of damage that can be caused by a breach of the NZX Participant or Listing Rules by a natural person is limited only by the will of the individual. \$250,000 is an inadequate penalty in situations considering the scale of possible offending.

While increasing the maximum fine will improve the ability to NZXD to impose a penalty to match the scale of offending, it will not deter intentional breaches of the NZX rules. A simple fine is at risk of becoming effectively a transaction cost which can be factored in to a decision to breach any of the NZX rules by a potential offender. However, by linking the fine for breach to a multiple of the profit made by the offender, no matter how much profit the offender stands to make from breaching the rules, he or she will still be appropriately deterred from breach by the link between amount of profit and quantum of penalty.

Such a mechanism does have its drawbacks. First, it may involve a greater degree of subjectivity in the fine set by NZXD and second, it will require a greater amount of evidence to be presented to determine exactly what profit the offender has received. It is submitted that if deterrence is the objective of the Rules, then the extra cost of having such a penalty is justified.

With regard to censuring directors or former directors of Listed Issuers, NZXD only has the penalty in Rule 11.5(f) available to it. The threshold in Rule 11.5(f) is high and is in contrast to the standards applicable to Market Participants (who are also individuals). Accordingly, this paper proposes to amend the penalties in Rules 11.5(b), (c) and (d) to extend them to apply to directors and former directors of Listed Issuers

Proposal

It is proposed that in line with the (recently changed) insider trading regime in part I of the Securities Markets Act, that the maximum fine payable should be the greater of:

- (1) The maximum fine for an individual (which we consider ought to be increased from \$250,000 to \$500,000).
- (2) Where the individual has profited from the breach, an additional fine may be imposed that is equal to the profit derived from the breach multiplied by 3.
- (3) Proposition (2) also be introduced for non-natural persons by amending sections 11.3(g); 11.4(b); 11.9(g) and 11.10(b) in the same manner as follows:

<p>11.3 (g) order that Market Participant to pay NZX within a specified time, a sum by way of penalty not exceeding \$500,000, and where the party has profited from the breach, to pay to NZX an additional fine equal to the profit derived from the breach multiplied by 3 notwithstanding that the total fine imposed may exceed \$500,000 (plus GST or any other applicable tax); and/or</p>
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<p>11.4 (b) order that Market Participant to pay to NZX within a specified time, a sum by way of penalty</p>

not exceeding \$500,000, and where the party has profited from the breach, to pay to NZX an additional fine equal to the profit derived from the breach multiplied by 3 notwithstanding that the total fine imposed may exceed \$500,000 (plus GST or any other applicable tax).

11.9 (g) order that Futures and Options Participants to pay to NZX within a specified time, a sum by way of penalty not exceeding \$500,000, and where the party has profited from the breach, to pay to NZX an additional fine equal to the profit derived from the breach multiplied by 3 notwithstanding that the total fine imposed may exceed \$500,000 (plus GST or any other applicable tax); and/or

11.10 (b) order that Futures and Options Participant to pay to NZX within a specified time, a sum by way of penalty not exceeding \$500,000, and where the party has profited from the breach, to pay to NZX an additional fine equal to the profit derived from the breach multiplied by 3 notwithstanding that the total fine imposed may exceed \$500,000 (plus GST or any other applicable tax).

The amendments to the Rules to enable NZXD to censure directors and former directors of Listed Issuers are as follows:

11.5 (b) issue a public statement that that Issuer *or director or former director of that Issuer* has acted in breach of the Listing Rules and:

- (i) state that no further action will be taken; and/or
- (ii) criticise the conduct of that Issuer *or director or former director of that Issuer*; and/or
- (iii) make an announcement to the market that that Issuer *or director or former director of that Issuer* is found to have acted in breach of the Listing Rules and is censured by NZX Discipline or the Appeal Panel (as the case may be); and/or

Costs

NZXD's power to order costs is limited to those arising out of, or incidental to, the hearing/appeal conducted by NZXD and those reasonable travelling expenses incurred by persons giving evidence (other than officers or employees of NZX a Respondent or any other person who gives evidence on behalf of NZX or a Respondent).

An award of costs can be made at the discretion of NZXD against any party to the hearing. However, an order for costs does not include costs incurred in preparation or presentation of the case by NZX. It is appropriate that NZXD be able to order that NZX's costs and expenses incurred in the preparation and presentation of cases be recovered from the Respondent.

Proposal

The following rule should be introduced as 12A.1 with an equivalent Rule change for 12A.3 (replacing references to 'NZX Discipline' with 'Appeal Panel').

12A.1 NZX Discipline Costs and Expenses Awards: NZX Discipline may of its own initiative order any party to pay such reasonable costs as it thinks fit, regardless of any finding or the outcome of the case, after conducting a hearing under these NZX Discipline Rules. Such costs may include the remuneration and expenses of members of NZX Discipline, and any costs incurred by NZX in

the preparation and presentation of its case. Such order, which may be made at the same time as the determination, or following the determination, will be made after the parties have been heard on costs.

Such an order may include:

- (a) The costs and expenses of a hearing, including, the fees and expenses of and incidental to NZX Discipline conducting the hearing, and any other expenses related to the hearing (including any amount payable under NZX Discipline Rule 12.A.2) shall be as fixed and allocated by NZX Discipline in its determination.
- (b) Where the order is made in favour of NZX, the costs and expenses incurred by NZX in the preparation and presentation of its case

12A.1A In the absence of such an award as outlined in the above clause 12A.1 fixing and allocating the costs and expenses of the hearing, each party shall be responsible for the legal and other expenses of that party and for an equal share of the fees and expenses of NZX Discipline and any other expenses relating to that hearing, including any expert's costs, and costs of any counsel assisting NZXD.

12A.1B Any order for costs made by NZX Discipline, in terms of Rule 12A.1, shall be paid within 30 days of receipt of the notification in writing of the amount payable.

Set-off

The Rules are presently silent as to whether a party may set-off any monies owed to it by NZX against any fine or costs order imposed by NZXD. It is submitted that the Rules should be amended to prohibit a party from setting-off fines or costs orders imposed by NZXD against other monies owed to it by NZX.

There are good reasons for this amendment. First, to allow set-off would be to invite disagreement as to the quantum of debt to be set-off in addition to producing an inevitable delay to resolve the dispute. Second, by prohibiting set-off the simplicity and speed of the disciplinary process will be preserved. Third, any fines or costs imposed by NZXD against a party are independent from any monies owed by NZX to the party. Fines and costs orders do not go to NZX, but are deposited into the Discipline Fund (see Rule 11.13).

Proposal

Accordingly, the following rule should be introduced as 11.14:

11.14 No set-off: Fines orders imposed on Market Participants, Issuers or Futures and Options Participants under these NZX Discipline Rules can not be set-off against any other monies owed by NZX to the party against whom the penalty has been imposed.

The following provision should be added to the amended cost provision set out in the above "Costs" section:

- (h) Any order for costs imposed on Market Participants, Issuers or Futures and Options Participants under this Rule can not be set-off against any other monies owed by NZX to the party against whom the costs order has been imposed.

Composition of Divisions

There is insufficient flexibility under Rule 3.3 to enable the Chairperson to replace those members of Divisions who are unable to attend.

Proposal

This issue can be remedied by giving the Chairperson the power to appoint any person whom he or she considers appropriate. The following introduction of a new Rule 3.4 is proposed to build greater flexibility into the operation of NZXD Divisions:

3.4 Appointing of Temporary Member: The Chairperson, or the Deputy Chairperson in his or her absence, may appoint to an NZX Discipline Division any person whom he or she considers appropriate to replace any member who is unable to act or attend. Any such appointment only extends to such time as the determination of the relevant Division is finalised.

Annual Regulatory Report

Rule 12.1 provides the minimum requirements for the annual regulatory report that NZXD must create. There are two principal concerns with 12.1 as it presently appears. First, NZXD must compile the report using information that is generated by NZX. Second, the rule does not provide any time frame within which the report must be produced.

Proposal

It is proposed that Rule 12.1 be deleted and the following rule be inserted in its place:

12.1 Content of report: Following the end of each calendar year NZX shall collate the following information for that year and provide it to NZX Discipline as a report by the end of April of the following year:

- (a) breaches of the Conduct Rules, Futures and Options Rules or any other rules or regulations of NZX from time to time identified by NZX; and
- (b) complaints received by NZX in respect of Market Participants, Issuers and Futures and Options Participants; and
- (c) the use of the proceeds of the Disciplinary Fund.

NZX Discipline shall create and provide an annual regulatory report to the public by the end of June of the following year using as a minimum the information from the report in respect of each year provided to NZX Discipline by NZX above, and that collated by itself listed below:

- (d) the number of statements of case issued by NZX and the type of matters addressed in those statements of case; and
- (e) the findings of NZX Discipline and the Appeal Panel in respect of each statement of case issued by NZX where to do so would not be in breach of NZX Discipline's confidentiality obligations; and
- (f) any penalties imposed by NZX Discipline and the Appeal Panel; and
- (g) a statement from NZX Discipline and the Appeal Panel whether or not it believes that adequate resources have been made available to it to undertake its role under these NZX Discipline Rules.

Change to Status of NZXD Appointees

The Rules in their current form are not clear as to what occurs if the status of a member of NZXD changes during the course of his or her appointment. For example, if a member is appointed as an Issuer Appointee, and during the course of his or her appointment, the company de-lists, does the de-listing affect the status of the Issuer Appointee? It is unclear from the Rules whether appointment would come to an end, or whether it would continue.

Proposal

The following new Rule 2.13 is proposed to clarify the position of members of NZXD who, for whatever reason, no longer fall within their original class of appointment:

2.13 Change of Status: Where the status of a member of NZX Discipline has changed such that he or she no longer comes within the class of his or her original appointment under NZX Discipline Rule 2.1, he or she shall be deemed to be no longer a member of NZX Discipline once all Hearings with which that member is involved are concluded, unless:

- (a) he or shee is also eligible for appointment as another class of appointee under NZX Discipline Rule 2.1; and
- (b) NZX consents to the change of class of appointment; and
- (c) the composition of NZX Discipline satisfies the requirements of NZX Discipline Rule 2.1 after the change of appointment date; then
- (d) the member may continue as a new class of appointee to NZX Discipline.

Remuneration of NZXD Members

The Securities Commission recommended in its oversight report for 2005 that NZX should establish a periodic review of NZXD members' remuneration/fees. NZX has agreed with the Securities Commission to do so.

Proposal

NZX proposes that a new clause be inserted into the rules providing for a 2 yearly review of the remuneration of NZXD members. The current Rule 14 will become Rule 14.1. This rule will expressly provide that the remuneration for NZXD members will not be reduced as a result of the review.

14.2 Remuneration Review: The remuneration of NZX Discipline Members shall be reviewed every two years from 30 June 2008. The remuneration review committee will consist of the Head of Market Supervision at NZX, the Chairperson of NZX Discipline and the Director of Market Supervision at the Securities Commission. That committee shall make a recommendation to the NZX Board. The NZX Board shall determine the rate of remuneration payable to members and may accept, reject or alter that recommendation, provided that the NZX Board may not reduce the rate of remuneration payable to members without prior approval of the Securities Commission.

Further Term

The current Rule 2.6 contains a typographical error, whereby it refers to "future term or terms". This should be replaced by "further term or terms".

NZX Appointees to NZXD

The procedures for the appointment and removal of members of NZXD are central to its independence and its credibility. Presently, NZX appoints the members of NZXD, subject to confirmation by the Securities Commission. Save for certain excluded individuals, up to a quarter of NZXD may also be NZX staff members.

From a practical perspective NZXD has now been in operation for four years. During this time, at least four matters have required an NZX Appointee for a division (under the NZXD Rule 3.3 an NZX Appointee is required for any Full Hearing). In addition currently NZX only has 2 NZX Appointees on NZXD.

This structure can create a perception that NZX possesses the potential to influence NZXD. To remove this perception, NZX proposes to amend the NZXD Rules.

Proposal

It is proposed to remove from the NZXD Rules the requirement for NZX Appointees to be appointed to NZXD. NZX initially desired to appoint members to NZXD so that NZXD could benefit from their knowledge of the workings of NZX, especially at a technical level (e.g., FASTER system, etc). Four years on it is clear that NZXD has not required this expertise to date and if required in future it could be achieved by any of the below methods which would be made allowable under the Rules:

2.1 (c) - *Delete*

2.2 - *Delete*

New clause:

2.2 NZX Quorum: In considering any matter brought to NZX Discipline, the Chairperson, Deputy Chairperson or the chairperson of the relevant Division may in order to obtain advice and guidance on practical market operational matters consult with any NZX staff members considered appropriate to provide the requisite advice or guidance.

NZXD Chairperson

The NZXD Chairperson is not currently required to have a legal background. Given the judicial nature of NZXD determinations, NZX considers that the Chairperson should be a barrister or solicitor with at least 7 years experience and, accordingly, should be selected from those members appointed under Rule 2.1(a). Accordingly, Rule 2.11 would be amended to provide that the members of NZX Discipline shall select the Chairperson only from those appointments made pursuant to Rule 2.1(a)

Consultation on Rule Changes: Requirement that NZX consult with NZXD

It has been NZX's practice to consult with NZX Discipline before instituting any rule changes to the Discipline Rules. However, this requirement is not codified in the existing rule set and, for the avoidance of doubt and for the sake of clarity, NZX proposes inserting a new Rule 1.3 that expressly stipulates that no amendment to the Discipline Rules can occur until NZX has consulted with NZXD.

1.3 Consultation Required Before Any Change To Discipline Rules: NZX must consult with NZX Discipline before making any changes to the NZX Discipline Rules.

Rule Format

Currently, the NZX Discipline Rules form part of the other elements of the NZX Conduct Rules, in particular NZX Participant Rules. NZX is in the process of reviewing these Rules to separate the Advising, Trading, and Clearing and Settlement aspects of these Rules. This re-organisation is required to accommodate NZX's proposed central counterparty clearing system and proposed changes to Advisor legislation. As part of these changes NZX proposes to separate the NZX Discipline Rules into a separate rule book, in a consistent format and style. These changes will be reflected in the exposure draft of the Rules to be released following this consultation.

III. TIMETABLE

Consultation Paper Released	27 June
Submissions Due	25 July
NZX to Release an Exposure Draft Taking Into Account Submissions Received	29 August
Submissions Due on Exposure Draft	26 September
NZX Submission of amended rules to Minister Of Commerce (in accordance with s.36KJ of The Securities Markets Act 1988)	10 October
Expiry of Disallowance period	5 December