

NOVEMBER 2020

# New Zealand Corporate Governance

Trends & insights

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# A time for boardrooms to hold their nerve

The opportunity is out there – created by the havoc of COVID-19, underlined by the impending threat of climate change, and encouraged by the Government and some of our more farsighted business leaders – to ‘build back better’.

But this is going to require effective governance in businesses large and small and, in some of the more exposed sectors, a willingness to work through difficult conditions and to find new business opportunities.

The Supreme Court’s recent judgment in *Debut Homes v Cooper* is unfortunate in this context as it may force salvageable companies into formal insolvency processes where the best interests of the company’s shareholders and creditors would have been served by an informal workout.

We put the decision into perspective as we consider many of the commentaries have been unduly alarmist.

This is a time for boardrooms, and the organisations which serve them, to hold their nerve. The Government acknowledged the challenges to directors of trading in volatile economic conditions through the temporary director duty safe harbour provisions, now expired.

To some extent, the safe harbour intervention was a symbolic statement of support from the Government to prevent boards from becoming immobilised by a perceived exposure to unacceptable risk. The country cannot afford that and as we explain, the risk profile attached to being a director is essentially unchanged, as all of the usual protections and defences remain in place.

Our 2019 governance publication highlighted a debate on contemporary theories relating to whether primacy should be accorded to shareholders or stakeholders.

The COVID-19 crisis provided a working example of this tension as boards grappled with whether they should apply for the Government’s wage subsidy and then – if the business damage was less than anticipated – whether they should return the money, improving the Crown’s balance sheet at the expense of the company, and their shareholders.

Other COVID-19 effects will be more enduring:

- greater use of remote communications technologies (they can have cost and efficiency advantages but do not remove the need for face-to-face engagement where practicable, especially for strategic decision-making), and
- a surge of Millennials into the share market (we think this will reinforce existing pressures on businesses to put the customer first, improve their work culture, reduce their carbon footprint and adopt sustainable business models).



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# Debut homes decision – unhelpful but no cause for alarm

The Supreme Court's decision on directors' duties in *Debut Homes v Cooper* has been a prominent topic of discussion in recent weeks.

The judgment contains a series of broad statements (particularly on sections 135 and 136) that do little to help directors understand their duties. Of particular note, it:

- says that continued trading may result in a breach even where such trading reduces the company's overall deficit. If the company is "unsalvageable", directors must look to insolvency mechanisms under the Act
- says that Courts can take a broad approach to awarding compensation in case of a breach. That may include ordering directors to underwrite the company's entire loss in a liquidation
- wrongly seeks to apply the section 4 solvency test applying to distributions as part of the statutory scheme applying to directors and liquidations
- reinforces the subjective aspect of the section 131 test (although that is well understood in practice), and
- comments on the competing shareholder primacy and stakeholder models, but concludes that it does not need to decide which of those models is correct.

Our view is that *Debut Homes* should not cause unnecessary alarm for thoughtful and prudent directors who can conclude that their company is able to trade on.

The decision is focused on a very narrow context: a property developer who knew that a liquidation with a loss to creditors was inevitable and who adopted a strategy to allocate that loss to the Inland Revenue, for his personal benefit.

The Supreme Court has made some effort to limit the scope of the judgment to "unsalvageable" companies. That includes companies with temporary liquidity issues but not facing inevitable liquidation. Importantly, the judgment does not address attempts to trade out a difficult position in good faith.

We hope that the judgment will be confined to its facts in the future so director-driven workouts can take place without needing to resort to insolvency mechanisms under the Companies Act.

*Debut Homes* shows again that reform of sections 135 and 136 is needed, particularly in the current economic climate, and with the directors' temporary safe harbour having ended.

The Court of Appeal's judgment in *Mainzeal* is expected later this year or early next. Plainly, it will also be of significance to directors, not least for how it treats *Debut Homes*. We will keep you updated on that judgment.





## Mix Zoom-time with room-time

The frequency of meetings is substantially the same as last year, which may seem counter-intuitive given the ongoing disruption created by the COVID-19 pandemic. Not captured by the data, although of interest, is how much the lockdown Zoom habit has persisted.

There are clear time and cost advantages in using Zoom but, ideally, this will be interspersed with face-to-face meetings, particularly to discuss strategic planning, using a looser format to encourage the free flow of ideas.

As the Productivity Commission suggested in its New Zealand boards and frontier firms report, released in August this year:

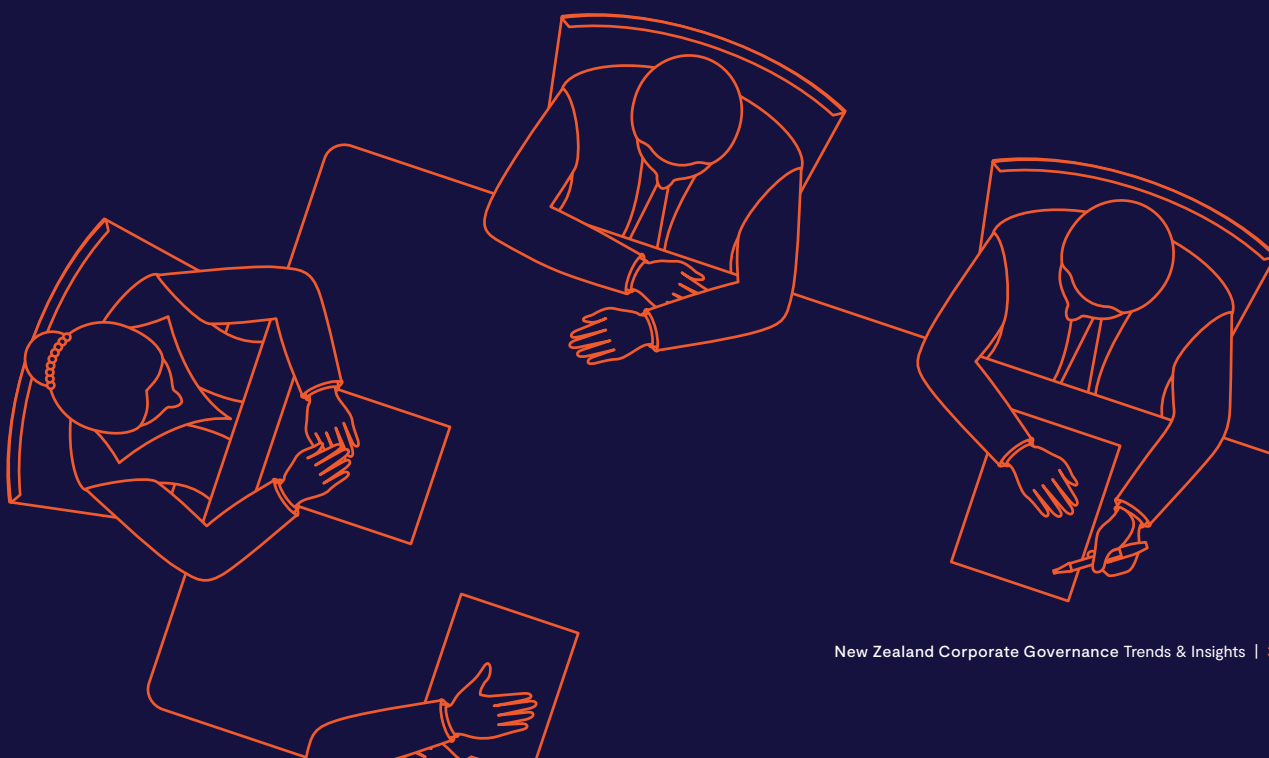
### Take-out

Mix Zoom-time with room-time. They each have benefits to offer.

“

Carve out time for unstructured, forward-looking conversations that advance long-term value creation. Bringing in an external facilitator for a strategy session can help draw out the collective wisdom of the board”.

”



# What Millennials want

Millennials are now in their 20s to 40s and are starting to take over the world. They are already New Zealand's dominant consumer group, are on target to comprise more than half our workforce before the end of this year, and are commanding a stronger political voice. Prime Minister Jacinda Ardern is a Millennial.

These things alone would require boards to sit up and take notice – but there is more. The Millennial Generation is becoming an increasing force on the New Zealand, and global share markets.

Much of this investment will be passive, through their KiwiSaver schemes. KiwiSaver funds at the end of September this year totalled close to \$71b. But Millennials are also fuelling the success of online retail platforms such as Sharesies and InvestNow, each of which now has more than half a billion under management.

Sharesies in particular has added around 75,000 new investors during the second quarter of 2020, possibly a result of the enforced leisure time created by the COVID-19 lockdown. The typical Millennial is a digital native and purpose-driven.

Given these trends – both demographic and behavioural – it is crucial that directors turn their minds to this new wave of Millennial shareholders, what they want and what they bring.

## Surveys have established that:

- the number one thing Millennials want from their employer is good quality workplace culture and behaviour. This includes social activities and flexitime initiatives that enable employees to build their working day around their personal interests. It also includes the option of working remotely
- both as employees and as shareholders, Millennials are willing to jump into opportunities that involve 'good causes' at the local level and are strongly identified with the promotion of sustainable business practices
- Millennials are twice as likely as other investors to put their money into companies or funds that target social or environmental outcomes, with 86% identifying this as a key investment driver, and
- Millennials attach more importance to corporate social responsibility than other generations and are more likely to let it guide their purchase decisions. This came from a US survey, conducted seven years ago. Our sense is that this finding will apply at least as strongly in New Zealand and is likely to have intensified in both countries over the intervening years.

“

I believe millennials bring a “sky's the limit” attitude to boardrooms, encouraging business' to be creative and challenging the status quo. Millennials seem to have a greater passion for inclusivity, sustainability and other important social issues.

”



**Hannah Barrett**  
Director, Me Today



### Implications for directors

Millennial values are already reflected in the NZX reporting requirements under the Listing Rules on Diversity and the recommendations on non-financial disclosure through the NZX Corporate Governance Code.

But pressure around issues of sustainability is likely to increase as the Millennials' influence tips over into dominance. The traditional single bottom line mentality is unlikely to get Millennials enthusiastic about a company, with the rising 'Triple Bottom Line', or 'Quadruple Bottom Line' likely to become more prominent in the future.

To stay ahead of the curve, boards need to seriously consider how they can get Millennial views and perspectives intertwined into their business strategies and decision-making.

An obvious way to do this is to ensure that Millennials are represented at the boardroom table. Few NZX Top 75 companies can currently claim this. Of course, it will happen as a matter of course over time but the Millennial Generation's size and economic clout are arguments for moving now.

Nominations Committees should go beyond the standard practice of looking for potential directors with board experience as a prerequisite. Different channels for talent need to be explored.



**Liam Stoneley**  
Solicitor – Corporate & Commercial  
Liam is a Millennial.



# Absence of fear, not fear of absence

Due to the limitations on overseas travel, the importance of staying home when sick, and the ongoing prospect of lockdown, directors may find themselves often unable to attend board meetings.

This should not be cause for nervousness or shroud waving as absent directors will not be held responsible for decisions in which they were unable to participate. Practice and the law accept that directors may not be present for every meeting.

The duties in the Companies Act to act in good faith and to exercise reasonable care, diligence and skill apply only when the director is actually “exercising” a power or “performing” a duty.

Directors’ obligations under the Health and Safety at Work Act are also manageable, provided the director has done due diligence on the company’s health and safety processes and policies and is satisfied that they are robust.

Many entities will have specific leave of absence provisions in their constitutions but – generally – the rules are simple.

- Advise the board and tender an apology for a one-off absence.
- If you are going to be unavailable for a sustained period, discuss with the Chair whether an alternate should be appointed.

The COVID-19 crisis is throwing up challenges for all businesses, requiring strong leadership from boards and senior management. In these circumstances, board continuity and access to skills and experience can be the difference between success and failure. Directors should feel confident that they will not be put at legal risk because they miss a board meeting or meetings.





# Conduct and culture – the new imperatives

Conduct and culture were identified as a key governance responsibility in the Hayne Royal Commission and the subsequent reports by the Reserve Bank of New Zealand (RBNZ) and the Financial Markets Authority (FMA).

But the new focus on these matters is also driven by rising expectations among employees, consumers and the general public around the sorts of behaviours they want of their employers, their work colleagues, the businesses they engage with, and their public institutions.

## Legislating for good behaviour

The Government's response to the post-Hayne FMA/RBNZ reviews into the banking and insurance sectors is contained in the Financial Markets (Conduct of Institutions) Amendment Bill (COFI) which was reported back with cross-party support in the last Parliament and will be progressed to completion this term.

The COFI law will apply to registered banks, insurers and non-bank deposit takers, with a transitional period of up to three years from enactment. It will require those financial institutions to:

- be licensed by the FMA under the Financial Markets Conduct Act
- comply with a general fair conduct principle that they treat consumers fairly, including by having due regard to consumers' interests, and
- establish, implement and maintain effective fair conduct programmes and comply (and ensure their intermediaries comply) with those programmes.

The fair conduct principle is undefined and subjective so will require guidance notes for implementation. Some details of the conduct regime will also need to be prescribed by regulation (e.g. minimum requirements for fair conduct programmes and incentives).

## Our view

The Government has a responsibility to maintain public faith in the integrity of major players in the economy, essential service providers and those agencies entrusted with the maintenance of law and order. To the extent the COFI law achieves this, it will have a legitimate purpose.

But the COFI law will increase the compliance burden on financial institutions, depending on their size and scale, and these costs will necessarily be passed onto the consumer. So the question becomes whether the consumer benefits created by the new regulation are sufficient to justify the extra cost. This is especially important in the COVID-19 economic environment.

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**Ryan Bridgman**  
Senior Solicitor – Corporate & Commercial



# Climate risk – what do we do now?

Climate change has been identified as a top five risk for boards by the Institute of Directors in each of the last two years. The message is simple: action in response to climate risk is no longer optional – it is expected.

## Why should boards engage on climate risk in 2020?

- Directors' fiduciary duties of due care and diligence require them to think through climate-related financial risk when making decisions. The Chapman Tripp legal opinion published by the Aotearoa Circle in late 2019 confirms that because climate change presents a foreseeable risk of financial harm to many businesses, directors need to factor it into their risk management and strategy. Although the "business judgement" rule provides some protection, this does not excuse a failure to make proper enquiries – and the more material the risk, the greater the expectation that it will be considered.
- New Zealand will require 'comply or explain' climate-related financial risk reporting for listed issuers, and banks, general insurers, asset owners and asset managers with more than \$1b under management (NZ Super Fund and ACC) from FY2022-2023. This reflects trends in the UK, EU and Australia, but puts New Zealand ahead of the curve in making it mandatory.
  - The Taskforce on Climate-related Financial Disclosures (TCFD), appointed by the G20 and led by Michael Bloomberg, recommended in 2017 that listed issuers, banks, insurers, asset owners and asset managers publicly disclose their climate-related financial risks – both transitional and physical.
  - The TCFD disclosure model has been widely adopted around the world, including by 80% of the top 1,100 global companies. It encourages organisations to disclose:
    - their **governance arrangements** around how they will manage climate-related risks and opportunities, and
    - the actual and potential impacts of climate-related risks and opportunities on the organisation's **business, strategy** and **financial planning**, and the **metrics and targets** used to assess and manage them – in each case to the extent such information is material.
- At least 14 shareholder resolutions were filed in Australia last year seeking climate change action from ASX 200 listed issuers, including against major banks, insurers and energy companies. It is reasonable to expect similar shareholder activism in New Zealand.
- Major household names have been taken to court in New Zealand seeking orders to reduce their emissions or cease their operations. The litigation is currently subject to a strike-out application on appeal, to be heard by the Court of Appeal in early 2021.
- Globally, major infrastructure projects are being held up by court rulings that climate change considerations have not been sufficiently taken into account. In 2020, the English Court of Appeal stymied plans for a third runway at Heathrow Airport, finding that the UK Government acted unlawfully in failing to consider its obligations under the Paris Agreement when preparing policy documents. Similarly, a New South Wales court upheld a decision to deny planning permission for a proposed new open-cast coal mine due in part to the projected downstream and offshore greenhouse gas emission effects. And in Poland, courts upheld an activist shareholder challenge against a major new coal-fired power project on the basis that climate change-related financial risks meant the decision to proceed was not in the company's best financial interests.



- Our Government has been put on notice that it has a legal obligation to use COVID-19 recovery funds to help the transition to a low-emissions economy, raising the prospect of judicial review should it not make climate change resilience a core part of its assessment of all post-COVID-19 stimulus spending, including the “shovel ready projects” currently being assessed.
- New Zealand’s Climate Change Commission is working to release national emissions budgets to 2035 by May 2021. In the meantime, Emissions Trading Scheme (ETS) reform is coming down the pipe at pace, with the Government’s flagship changes to the ETS having passed through Parliament in June 2020.

#### What should directors be doing through 2020?

- ✓ Start the TCFD conversation.
- ✓ Identify the top three or four risks to your business: accept that you won’t spot every risk.
- ✓ Assess the top two or three risks for your business, including getting good technical advice if necessary.
- ✓ Consider possible actions your company could take to reduce its exposure to physical, legal and commercial risks on the horizon from climate change.
- ✓ Make sure you have expertise in place – a board sub-committee, responsibility within the senior leadership team, and good internal skills.
- ✓ Ensure reporting is consistent: check that material climate-related financial risks are being disclosed alongside other material risks.
- ✓ Look at what others are doing to get ready for mandatory reporting – see guidance from the World Economic Forum and the TCFD Research Hub.

Chapman Tripp has released a **Tool Kit for Directors** on management of climate risk.



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Changes in climate policies, new technologies and growing physical risks will prompt reassessments of the values of virtually every financial asset. Those that fail to adapt will cease to exist. The longer that meaningful adjustment is delayed, the greater the disruption will be.

”

**Mark Carney**

Former Governor, Bank of England.

“

We are witnessing a step-change in climate-related business risk. Climate change is no longer a mere environmental concern: for many, it presents a material financial risk.

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**Nicola Swan**

Senior Associate – Litigation & Dispute Resolution

# How to avoid a charter ‘own goal’... ...and prevent good intentions putting you on the road to a bad outcome.

**Board charters, although required by the NZX Corporate Governance Code, are often just seen as “guidance” – documents which can contribute to boardroom culture but have no legal significance. This is not a safe assumption.**

A carelessly worded charter can increase directors’ potential liability exposure.

- A charter can be taken as evidence that directors understand their legal duties and what it takes to comply with them. A charter which presents these obligations inaccurately or loosely will not help directors to demonstrate later that they knew, and did, what was required of them. It is particularly important for any health and safety provisions to properly reflect the specifics of the directors’ express “due diligence” duty under the Health and Safety at Work Act (HSWA).
- Aspirational “best practice” statements can, if not carefully worded, be interpreted as defining what the directors thought was required for compliance. Again, health and safety provisions are of particular relevance here. A board charter may, for laudable reasons, set out expectations of directors which go further than their core “due diligence” duty under the HSWA. But those provisions might later be taken by WorkSafe to evidence what the director’s core duty actually required – with the result that what was intended simply as an aspiration could become a source of liability.
- A director is required to exercise the care, diligence and skill a reasonable director would exercise in the same circumstances. Those circumstances include “the position of the director and the nature of the responsibilities undertaken”. The board charter can be relevant to determining these matters – particularly where charter requirements can be construed as the undertaking of additional responsibilities. This may apply especially to charter provisions which set out specific expectations of the chair. The 2003 Australian case *ASIC v Rich* concluded that more may be required for chairs to discharge their duty of care than is required of other directors – especially in relation to the types of matter for which the chair normally has a specific role, such as (in *ASIC v Rich*) prudent financial and organisational leadership. A charter which sets out specific expectations of the chair will increase the prospect of a similar finding.



**Boards should:**

- ✓ ensure that descriptions of legal obligations are accurate
- ✓ be very clear about those parts of the charter which articulate “best practice” beyond what the law requires
- ✓ be very clear that the charter is not intended to increase directors’ obligations
- ✓ monitor board performance against the charter and proactively address any non-compliance, and
- ✓ review the charter every few years to ensure it remains up to date and useful.

“

None of this is reason not to have a charter. On the contrary, their utility in setting conduct expectations and baselines is widely acknowledged. But they should not be taken lightly, or seen as having no legal implications.

”



**Geof Shirtcliffe**  
Partner – Corporate & Commercial



# The Top 75 – board composition, size, diversity and length of service

as at 31 March 2020

This is the fourth year of Chapman Tripp's data series.

## Overview

The top 75 by market capitalisation ranged from Fisher & Paykel Healthcare at \$17.5b to Evolve Education at \$83m – a bigger spread than 2019 (\$10.7b to \$113m).

Big movers in top 75 rankings were AFT Pharmaceuticals (up 21 places), Evolve Education up 19 (from a low base in 2019), Green Cross Health up 12, and Arvida up 10 spots. Last year's riser Vista Group dropped 20 places, Sky TV fell 19 places, and Tourism Holdings, 16 places – reflecting the initial impact of COVID-19 on NZX market capitalisation and the mid-March 2020 market fall.

Hallenstein remains the longest top 75 listing by NZX or predecessor exchanges – for almost 73 years – and Napier Port Holdings the newest, listing last year. The overall average time since first listing on NZX is 20.2 years.

## Average board size

6.54 directors, up from 6.35 in 2019.

## Independence

81.3% of boards had a majority of independent directors, of which 22.6% had only independents (against 73% and 21% in 2019). 84% had an independent chair (2019: 77%) and 32% had the CEO on the board (2019: 38%). This trend reflects the increasing impact of 2019 NZX Listing Rules changes and the updated NZX Corporate Governance Code.

## Length of service

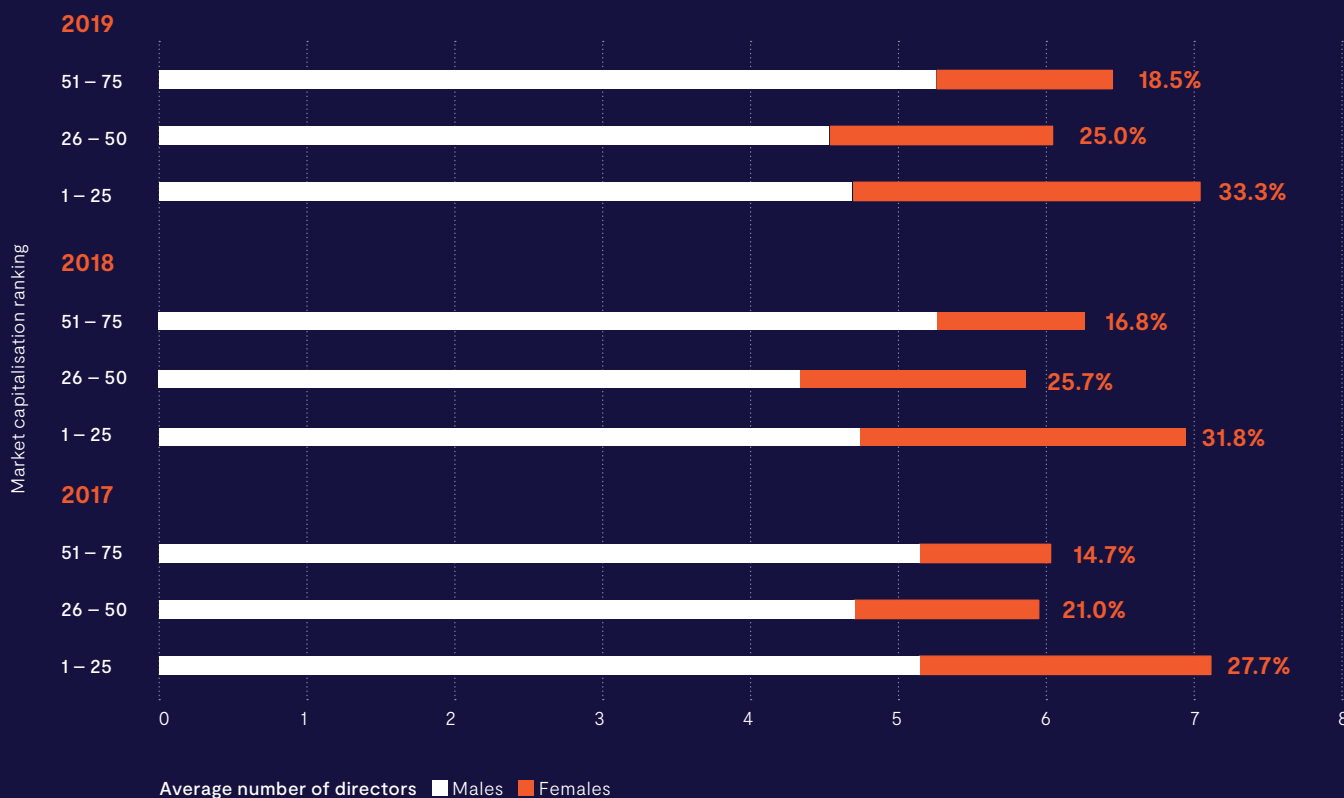
The average length of service across the top 75 fell to 5.8 years (2019: 6.2), with the highest coming in at 19 years (2019: 18 years (same company)).

## Skills matrix

Seven of the top 10 published a director skills matrix in their most recent annual report, and 41 of the top 75 did so.



## Director gender by NZX market capitalisation ranking



### Multiple board roles

Multiple directorships among the top 75 remain comparatively rare. One director has five roles (2019: 1), four directors have four roles (2019: 3), 13 directors have three (2019: 11), and 43 directors have two (2019: 52). The top 75 had 487 directors altogether (2019: 474).

### Gender diversity

13 of the top 75 board chairs, or 17.3%, were females, as were four CEOs (2019: four) and 12 CFOs (17%).

Our analysis continues to show that the top 25 of the top 75 are leading the way on gender diversity.

However the NZX gender diverse board composition significantly lags the public sector, with Minister for Women Julie Genter announcing on 17 September that the Government had reached its 50% women target on state sector boards and committees. This beat the previous record of 45.7% from 2017.

### Geographic diversity

218 of the 487 roles in the top 75, or 44.8%, were filled by directors who recorded their place of residence as Auckland. Other popular locations were Wellington (37), Christchurch (25) and Queenstown/Wanaka (19). 108 roles were filled by directors residing overseas (22.2%). These metrics are all broadly the same as for 2019.

### Average board size

# 6.54

directors, up from 6.35 in 2019

### Gender diversity – board chairs in the top 75

# 17.3%

were women, up from 13% in 2019

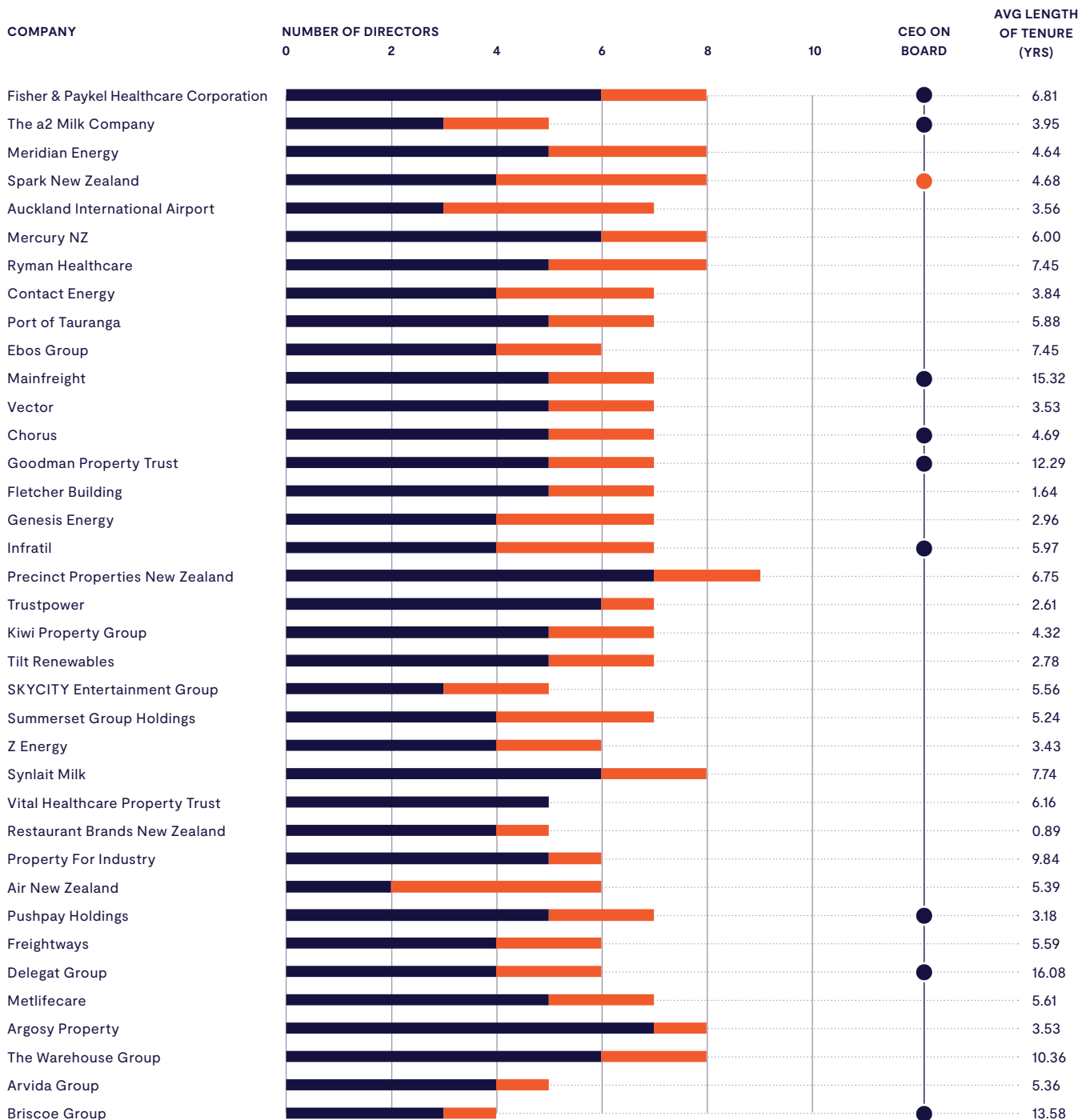
### Geographic diversity – directors in the top 75

# 44.8%

Auckland-based residence

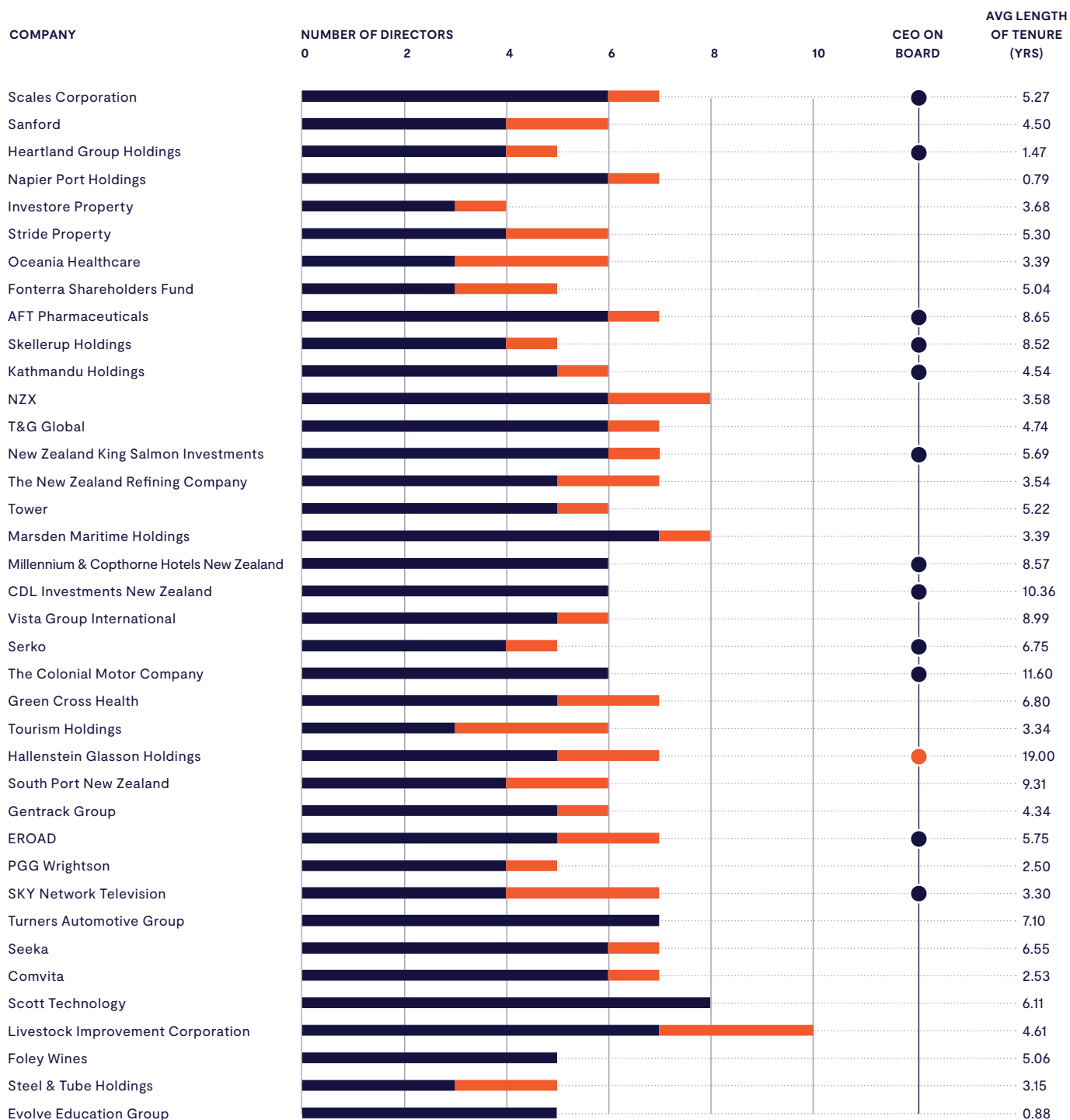
# The Top 75 – board composition, size, diversity and length of service

as at 31 March 2020





Number of male directors
  Number of female directors
  Male CEO on board
  Female CEO on board



# Recent NZX Corporate Governance Code disclosures

## ESG reporting

While an increasing number of issuers are including a section in their annual report devoted to Environmental, Social and Governance Disclosure, the format of reporting remains varied. However, as discussed earlier in this report, adoption of TCFD Climate Change reporting scheduled to commence through 2023 should result in more comparable and in-depth reports.

## CEO Remuneration reporting

All issuers disclosed their CEO base pay, and the basis for determining short term and long term incentives. The level of detail continues to vary significantly.

- Of the Top 25 issuers, (7/25) have adopted (in full or close to) the NZSA template for disclosures.
- Similarly, (7/25) in the Top 25 and (3/50) in the next 50 issuers provided the Median Pay Gap between the CEO remuneration and the median employee remuneration.
- Only (3/75) issuers provided an insight into the following years' proposed remuneration for the CEO.

## Shareholder engagement

When we commenced our 'top-75' analysis in 2017, 'hybrid' shareholder meetings were rare, and 'virtual' shareholder meetings unheard of. But COVID-19 has forced most issuers holding annual meetings following March 2020 to hold 'virtual' shareholder meetings.

Views on whether issuers should continue with a 'virtual' or 'hybrid' format post COVID-19 are mixed. Some of the reasons a 'virtual' meeting may be attractive are:

- more certainty that a meeting may proceed, regardless of what happens with restrictions on gatherings etc. due to unusual situations such as the COVID-19 pandemic
- time and cost efficiency for the issuer and shareholders (travel costs are eliminated for shareholders, and the cost of a venue and set up etc. is reduced)

- potential increased attendance – and greater participation from a shareholders resident in a broader range of geographies, including overseas, than traditional physical meetings, and
- more inclusive for those with disabilities, as participating in a virtual meeting may be easier for those who have visual or hearing impairments, or other disabilities that would make attending in person challenging.

The New Zealand Shareholders' Association perspective is unambiguous. While the virtual meeting process is working satisfactorily, they are making it clear to companies that once the COVID-19 restrictions are lifted, they expect them to have a physical meeting as well as a virtual meeting.

“

Restricting physical attendance at ASMs disenfranchises shareholders and severely limits questioning of the board and management. If questions can only be asked online rather than directly, there is the risk that the meaning can be lost or misinterpreted and there is no guarantee a question will be acknowledged and answered during the meeting.

”

**New Zealand Shareholders' Association**  
Scrip magazine, June 2020



### Takeover protocols

Most of the top 75 issuers now have formal protocols in place for dealing with a takeover, except for situations where a takeover is unlikely – for example the Mixed Ownership Model companies (Meridian, Mercury, Genesis) because their majority Crown ownership positions mean a takeover is not likely (unless a takeover were initiated by the Crown).

Of the policies we have reviewed, however, many are reactive – focusing on the mechanics of takeover ‘response’ once a takeover notice, or scheme proposal, is received or imminent, rather than true takeover ‘preparedness’.

Recent unsolicited takeovers we have assisted target boards with – Fletcher Building’s unsuccessful takeover for Steel & Tube, and the Asia Pacific Villages Group scheme of arrangement for Metlifecare, has reinforced to us the benefit of a board and its advisers having access to a regularly updated internal company valuation and clear-eyed view on a reasonable offer price.

### Audit

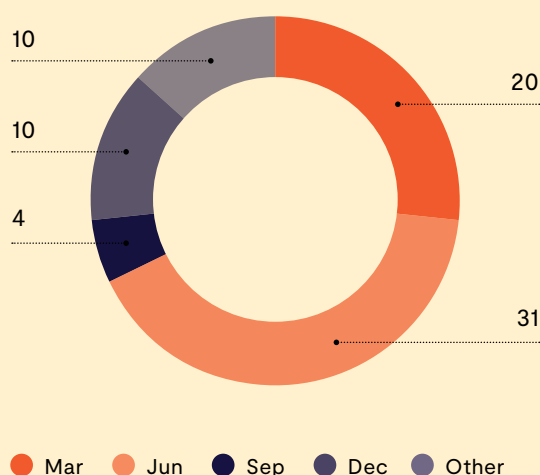
The Key Audit Matter (KAM) regime is now well-established, after the audit reporting standards were lifted three years ago. The most common KAMs pre-COVID this year, continuing the pattern from 2019, related to impairment testing, revenue recognition, and valuation of property, plant and equipment. Post-COVID, there was an increase in material uncertainty disclosures especially for asset valuations. It will be interesting to see if this trend carries through to 2021 reports.

The latest FMA and External Reporting Board (XRB) **Key Audit Matters** report found that only 48% of investors thought audit quality was of a high standard, which the FMA described as ‘not alarmingly low’ but there is clear room for improvement.

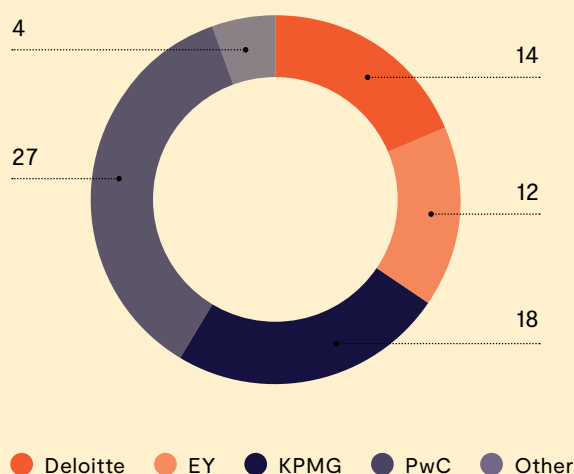
The FMA/XRB survey also found that on average the level of non-audit fees is 15% that of audit and assurance-related fees. Our review of the top 75 showed a wide spread in the ratio of non-audit fees to audit fees – with a number of issuers having nil non-audit fees while, at the other end of the spectrum, some had as high as 90%.

PwC New Zealand has created an **Audit Advisory Board**, comprising three members independent of PwC, to provide guidance and challenge related to audit quality at the firm.

### Most prevalent year-end balance dates



### Audit firms for top 75 listed issuers



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### Arthur Young

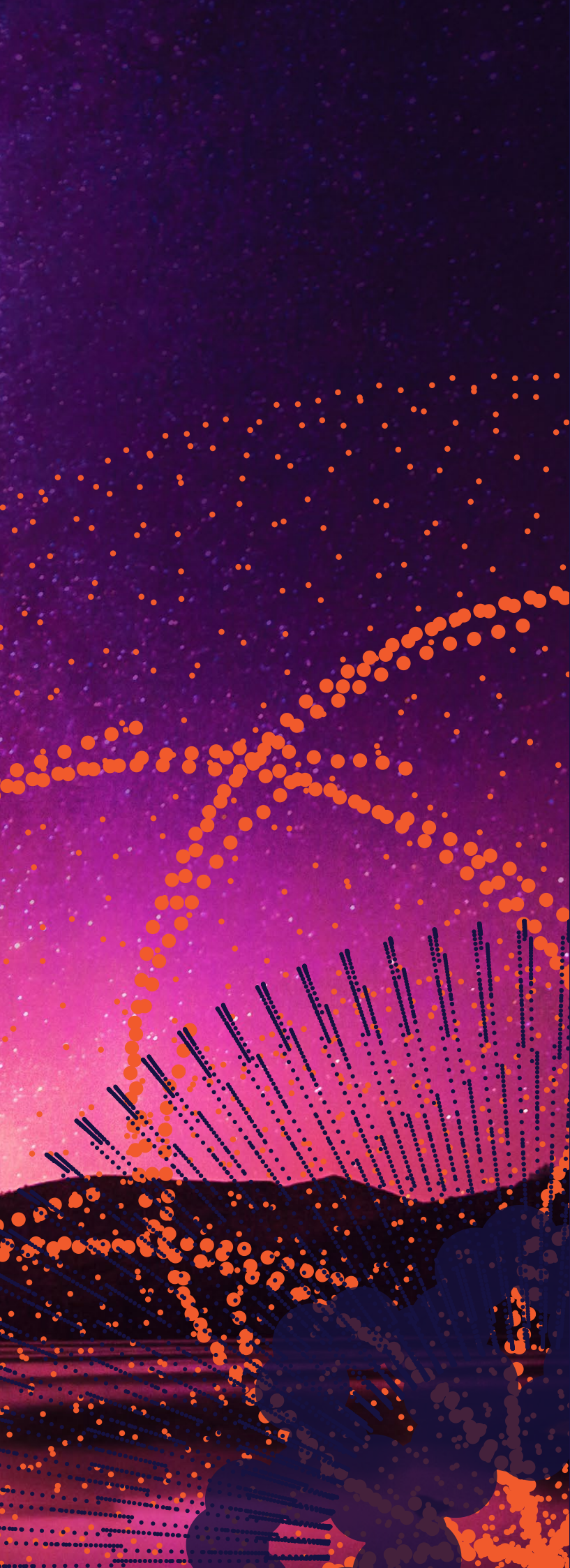
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**This is a time for  
boardrooms, and  
the organisations  
they serve, to hold  
their nerve.**





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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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