



RiskMetrics Group

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## 2008 New Zealand Voting Guidelines

1 September 2008

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The following guidelines apply to NZX-listed issuers only, for meetings  
on or after 1 September 2008.

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## Introduction

The principle underpinning all RiskMetrics' recommendations is that shareholders are the owners of listed companies.<sup>1</sup> As such, they are entitled to assess every resolution which seeks their approval in terms of how it affects their interests as the owners of the company.

## Disclosure

Shareholders in listed companies are entitled to clear and meaningful disclosure of company finances, the names, roles and experience of directors and senior management and the remuneration paid to directors, auditors and executives, as well as any other transactions between the company and associates of its management.

In addition, shareholders as owners should receive information on the internal and external governance mechanisms of a company, including the details of membership of board committees, attendance at board and committee meetings by directors, and disclosure of committee charters and/or responsibilities. Adequate disclosure on governance mechanisms includes the disclosure of the number of votes cast FOR, AGAINST and to ABSTAIN on particular resolutions at company meetings.

In the absence of such disclosures, shareholders will lack sufficient information to assess how their interests as owners are being safeguarded. In cases where disclosure is generally inadequate, RiskMetrics will consider on a case-by-case basis recommending AGAINST resolutions such as the election of directors, especially the chairperson; the acceptance of financial statements and where necessary and appropriate, any other resolution.

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<sup>1</sup> The same principles will be applied to listed entities that are not 'pure' companies, such as trusts and stapled securities.

## Board of Directors

In assessing resolutions concerning directors, RiskMetrics will consider the following:

- Directors are the stewards of the shareholders' company.
- As such, directors should act in the interests of the company.
- Directors are best placed to provide oversight of the management and operations of a company.
- Directors should be responsive to the wishes of the shareholders whose interests they serve.

As a general principle, RiskMetrics supports boards having a majority of independent non-executive directors with an independent chairperson. However, RiskMetrics acknowledges there will be cases where it is in the best interests of the company for a board not to comprise a majority of independent directors, and will assess all resolutions concerning the election of directors on a case-by-case basis.

### Director Age Limits

RiskMetrics Recommendation: Generally, AGAINST

There is no requirement in the NZ Companies Act for directors to retire at a certain age. RiskMetrics supports resolutions seeking to remove age limitations from company constitutions.

RiskMetrics considers age should not be the sole factor in determining a director's value to a company. Rather, each director's performance should be evaluated on the basis of their individual contribution and experience. As long as directors are able to fulfill their fiduciary responsibility to shareholders, we do not believe they should be disqualified from remaining in office.

### Alteration of the Number of Directors

RiskMetrics Recommendation: CASE-BY-CASE

The NZX Listing Rules require a minimum of three directors for public companies. There is no maximum limit, although company constitutions may set a maximum limit. RiskMetrics considers these proposals on a case-by-case basis, but is generally supportive of resolutions that set a maximum limit on board size. RiskMetrics will generally recommend AGAINST resolutions that seek to remove any maximum limit on board size.

All proposals to alter board size during a proxy fight or other possible contests for control should be opposed. Allowing directors to alter the terms of a contest while it is underway is not in shareholders' interests, as this tactic could be used to thwart a takeover that is in shareholders' interests.

## Classification of Directors

Directors are classified as (i) executive, (ii) non-independent non-executive, or (iii) independent non-executive.

The RiskMetrics definition of an independent director uses the ASX Corporate Governance Council's definition as its core. The ASX Council definition is used because many NZ companies are listed on the ASX and in turn a substantial part of the NZX 50 consists of ASX-listed companies. The ASX definition is similar to the definition adopted by the NZX Listing Rules of an independent director but is more specific and in some cases more stringent. It defines an independent director as a non-executive director who:

- Is not a substantial shareholder (or an executive or associate of a substantial shareholder) of the company.
- Has not within the last three years been employed by the company in an executive capacity, or been a director after ceasing to hold any such employment.
- Has not within the last three years been a principal or employee of a material professional adviser or material consultant to the corporate group.
- Is not a material supplier/customer of the corporate group (or an executive or associate of a material supplier/customer).
- Does not have a material contractual relationship with the corporate group.
- Has not served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.
- Is free from any other interest and any business or other relationship with the corporate group.

RiskMetrics interprets this definition as follows:

### Substantial shareholders

- A 'substantial' shareholder is a shareholder controlling 5 percent or more of the voting rights in the company. This is in accordance with the NZ Securities Markets Act.
- Where a person is a *non-executive* director of a substantial shareholder, he/she is classified as independent (unless a separate reason exists for classifying as non-independent). However, if the person is specifically designated as a representative of the substantial shareholder, he/she is classified as non-independent.

- A company founder is classified as non-independent even if no longer a substantial shareholder.
- A relative of a substantial shareholder is also classified as non-independent.

### Former executives

- The 3-year rule is treated as a 'cooling off' period. Therefore, where an executive joins the board (as a non-executive) on retirement from executive office, or stays on the board (as a non-executive) after retiring from executive office, he/she is classified as non-independent for so long as they remain on the board.
- A relative of a current or former executive is also considered to be non-independent.

### Advisers, suppliers, customers

- Where a person is a *non-executive* director of a material adviser/supplier/ customer, and not a major shareholder (or partner) in the material adviser/supplier/customer, he/she is classified as independent (unless a separate reason exists for classifying them as non-independent).
- The materiality threshold for transactions is NZ\$250,000 per annum for large advisers/suppliers/customers and NZ\$25,000 per annum for small advisers/suppliers /customers. 'Large' advisers include all major law, accounting and investment banking firms. These thresholds are assessed by looking at transactions during the two most recent financial years.

### Tenure

- RiskMetrics classifies a non-executive director who has served 20 or more years as non-independent.

### Miscellaneous

- If the company's annual report classifies a director as non-independent without further information, he/she is classified as non-independent under the 'residual' category.

## Election of Directors

RiskMetrics looks at the overall composition of the board, and the audit, remuneration and nomination committees and at directors' attendance records (where provided) in assessing whether or not to support the election of board-endorsed directors. In doing so, RiskMetrics will bear in mind prevailing NZ board structures although as a general principle RiskMetrics supports audit, remuneration and nomination committees that have a majority of independent non-executive directors.

RiskMetrics will also consider the history of a particular director when deciding whether to recommend in favour of their re/election. Examples of circumstances where RiskMetrics will consider recommending AGAINST a director's election, regardless of board composition, is when a director has had a significant involvement with a failed company or where a director has in the past acted against the interests of all shareholders.

Where there is a majority-independent board (i.e. >50 percent) RiskMetrics will recommend FOR the re/election of a board-nominated director unless:

- He/she is executive and chairperson, and there is no independent deputy chairperson or 'lead independent director' or other accountability mechanism (recommend AGAINST; but if he/she is the company founder and integral to the company: recommend FOR).
- He/she is executive (but not the CEO) and is on the audit committee (recommend AGAINST).
- He/she is non-independent due to being a former partner or employee of the company's auditor, and is on audit committee (recommend AGAINST).
- He/she has attended less than 75 percent of board and committee meetings over the most recent two years, without a satisfactory explanation (recommend AGAINST).
- He/she sits on more than five other listed company boards (counting chairing a company as equivalent to two board positions), or is an executive director and holds more than one non-executive directorship at unrelated listed companies (recommend AGAINST).

Where there is not a majority-independent board (i.e. ≤50 percent):

- Generally recommend AGAINST executive directors (except the CEO and/or a company founder who is integral to the company) because executives do not need to sit on the board for directors to access their expertise. It is common in New Zealand for senior executives to be invited to board meetings to make presentations and answer questions.
- Recommend AGAINST any director who is non-independent due to being a former partner or employee of the company's auditor, and is on audit committee.
- Recommend AGAINST any director who has attended less than 75 percent of board and committee meetings over the most recent two years, without a satisfactory explanation.
- Recommend AGAINST any director who sits on more than five other listed company boards (counting chairing a company as equivalent to two board positions), or is an

executive director and holds more than one non-executive directorship at unrelated listed companies.

- Recommend AGAINST a representative of a substantial shareholder on a board where independent directors constitute a minority of the board due to a preponderance of executive directors and substantial shareholder affiliates. In these cases, RiskMetrics will recommend against only one representative of the substantial shareholder.

Recommend AGAINST shareholder-nominated candidates who lack board endorsement, unless they demonstrate a clear ability to contribute positively to board deliberations.

## Removal of directors

RiskMetrics Recommendation: CASE-BY-CASE

The major factors in considering such resolutions are:

- Company performance relative to its peers.
- Strategy of the incumbents versus the dissidents.
- Independence of directors/nominees.
- Experience and skills of board candidates.
- Governance profile of the company.
- Evidence of management entrenchment.
- Responsiveness to shareholders.
- Level of disclosure by company to shareholders.

## General

### **Company Name Change**

RiskMetrics Recommendation: Generally FOR

RiskMetrics views decisions about the company name as best left to management. Typically, name changes are proposed to align the company name more closely with its primary businesses activities and/or to simplify the company name. Such changes are usually made without detracting from market recognition of the company's identity and activities.

### **Significant Change in Activities**

RiskMetrics Recommendation: Generally FOR

RiskMetrics will generally recommend FOR resolutions to change the nature or scale of business activities (NZX Listing Rule 9.1.1) so long as the notice of meeting and explanatory statement provides a sound business case for the proposed change.

## Capital Structure

### Multiple Voting Rights

RiskMetrics Recommendation: Generally, AGAINST

Recommend AGAINST proposals to create a new class of shares with superior voting rights.

Shareholders are better off opposing dual-class proposal on the grounds that they contribute to the entrenchment of management and allow for the possibility of management acquiring superior voting shares in the future. Empirical evidence also suggests that companies with simple capital structures also tend towards higher valuation because they are easier for investors to understand.

### Non-Voting Shares

RiskMetrics Recommendation for introduction: CASE-BY-CASE

RiskMetrics Recommendation for cancellation: Generally, FOR

Recommend FOR proposals to create a new class of non-voting or sub-voting shares only if:

- It is intended for financing purposes with minimal or no dilution to current shareholders.
- It is not designed to preserve the voting power of an insider or significant shareholder.

## Mergers and Demergers

### RiskMetrics Recommendation: CASE-BY-CASE

In evaluating mergers and demergers for which shareholder approval in a meeting is being sought, RiskMetrics will evaluate the terms of the offer principally on the basis of the returns such an offer provides for shareholders. However, governance issues around the merger or demerger offer will be considered relevant if they have the potential to materially affect shareholders' rights.

Areas where such issues will be considered relevant include:

- Whether a merger is being conducted via the NZ Takeovers Code or via a Companies Act amalgamation.
- Where a merger or demerger agreement includes significant penalties that will be triggered should shareholders not approve it ('break fees').

Even where there are potential governance shortcomings in a proposed merger or demerger, RiskMetrics may still recommend FOR the transaction on a 'lesser of two evils' basis, but may consider the conduct of the directors' involved when assessing them as candidates for election to other boards.

As a general rule, however RiskMetrics will recommend FOR mergers and acquisitions, including those by Companies Act amalgamation, and demergers/spin-offs, unless:

- The impact on earnings or voting rights for one class of shareholders is disproportionate to the relative contributions of the group.
- The company's structure following the acquisition or merger does not reflect good corporate governance.
- Concerns exist that the negotiation process may have had an adverse impact on the valuation of the terms of the offer.

Recommend AGAINST if the company does not provide sufficient information upon request to make an informed voting decision.

## Share Capital

### **Reduction of Share Capital: Absorption of Losses**

RiskMetrics Recommendation: Generally, FOR

These types of capital reduction do not involve any funds being returned to shareholders. A company may take this action if its net assets are in danger of falling below the aggregate of its liabilities and its stated capital. RiskMetrics usually supports such proposals as they are considered to be routine accounting measures.

### **Issue of Shares (Placement): Advance Approval**

RiskMetrics Recommendation: CASE-BY-CASE

The NZX Listing Rules contain a general cap on non-pro-rata share issues of 15 percent of total equity over a rolling 12-month period. Listing Rule 7.3.1(a) allows shareholders to vote to carve out from the '15 percent in 12 months' cap a particular, proposed issue of shares. If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15 percent in 12 months cap for the company.

Recommend CASE-BY-CASE on all requests taking into consideration:

- Dilution to shareholders: In some cases, companies may need the ability to raise funds for routine business contingencies without the expense of carrying out a rights issue. Such contingencies could include the servicing of option plans, small acquisitions, or payment for services. When companies make issuance requests without preemptive rights, shareholders not participating in the placement will suffer dilution. RiskMetrics routinely recommends FOR issuance requests without preemptive rights for up to 20 percent of a company's outstanding capital.
- The discount/premium in purchase price to the investor.
- The intended use of the proceeds.
- Any fairness opinion provided by the company.
- The impact of the issue on control of the company.
- The financing or strategic alternatives explored by the company.
- If the negotiations surrounding the placement were conducted at arm's-length.
- The conversion rates on convertible equity (if applicable).

## **Issue of Shares (Placement): Retrospective Approval**

RiskMetrics Recommendation: CASE-BY-CASE

Listing Rule 7.3.5(b)(iii) allows shareholders to vote to carve out from the '15 percent in 12 months' cap an issue of shares made some time in the previous 12 months. If shareholders vote to approve this type of resolution, then the share allotments in question will not be counted in calculating the 15 percent in 12 months cap for the company.

It is RiskMetrics policy to approve such proposals unless the prior issue does not conform to RiskMetrics guidelines on share issuance in terms of dilution.

## Remuneration

In assessing executive and director remuneration, RiskMetrics' over-riding consideration is how remuneration relates to shareholders' interests, specifically:

- That remuneration for non-executive directors is sufficient to attract and retain high calibre board members, but is not structured in such a way as to compromise their ability to oversee the company.
- That remuneration for executive directors and executives is sufficient to attract and retain talented individuals but is not excessive compared to appropriate market standards.
- That a reasonable proportion of executive remuneration is linked to company performance, and a substantial portion of performance linked remuneration be linked to company performance over the medium- to long-term.
- That all remuneration paid to directors and senior executives is clearly disclosed, and enables shareholders to assess how this remuneration relates to company performance.

### **Remuneration of Non-executive Directors – Increase in Aggregate Fee Cap**

RiskMetrics Recommendation: CASE-BY-CASE

This type of resolution seeks shareholder approval for an increase in the maximum aggregate level of fees able to be paid to a company's non-executive directors. It is a requirement of the NZX Listing Rules that companies must obtain shareholder approval for any increase in the fee cap or alternatively individual remuneration paid to non-executive directors.

RiskMetrics takes into account the size of the proposed increase, the level of fees compared to those at peer companies and the explanation the board has given for the proposed increase.

RiskMetrics will also generally recommend FOR any resolution that enables directors to receive part or all of their fees in shares. The NZX Corporate Governance Code and investor governance guidelines world-wide support such schemes as increasing the alignment of interests between directors and shareholders.

### **Remuneration of Non-executive Directors – Issue of options**

RiskMetrics Recommendation: Generally, AGAINST

This type of resolution seeks shareholder approval for the issue of options, or similar performance-linked securities, to non-executive directors. The NZX Code encourages such schemes. However RiskMetrics' will generally recommend AGAINST the issue of options to non-executive directors because issuing performance-linked equity incentives to directors may impair their ability to exercise independent judgment on behalf of investors. Investor governance standards such as the UK Combined Code and Australian codes oppose the issue of options to non-executive directors.

## Transparency of CEO incentives

It is common in NZX-listed companies for the CEO not to be a member of the board of directors. NZ-registered companies are only required to disclose the individual remuneration of directors, and shareholders are only able to vote on proposals concerning the issue of options to directors. It is reasonable for shareholders to be able to assess the remuneration of the most senior member of management, and to be able to vote on any equity incentives that they may be offered.

On this basis, in circumstances where the CEO's remuneration is not subject to any shareholder approval or scrutiny, RiskMetrics may consider recommending AGAINST the re-election of directors of a company who serve on the remuneration committee. This will only be done in cases where it appears that the CEO has been granted a substantial quantity of equity incentives.

This will be assessed on a case-by-case basis, and will only be considered in cases where there appears to be no credible alternate explanation for a CEO not being a member of the board. RiskMetrics acknowledges there are circumstances in which it may be appropriate for a CEO not to be a director and will take into account all relevant circumstances of a particular company before making such a recommendation.

## Remuneration of Executives: Options and Other Long-Term Incentives

RiskMetrics Recommendation: CASE-BY-CASE

Under the NZX Listing Rules, companies must seek shareholder approval for any grant of options or shares to a director, and are able to issue securities to employees without shareholder approval so long as such issues do not exceed 3 percent of issued capital per annum.

RiskMetrics reviews long-term incentive plans and share option plans (and proposed grants of options and shares to particular directors) according to the following criteria:

### Exercise price

- The exercise price for options should not be at a discount to market price at grant date (in the absence of demanding performance hurdles).
- Plans should not allow for the alteration of the terms of worthless options.

### Vesting period

- There should be appropriate time restrictions before options can be exercised (if 50 percent or more of securities can vest in two years or less, this is generally considered too short).

## Performance hurdles

- Generally, hurdles that relate to total shareholder return (TSR) (share price movement plus dividends and capital returns) are preferable to hurdles that specify an absolute share price target or an accounting measure of performance (such as earnings per share: EPS).
- Where a relative hurdle is used (comparing the company's performance against a group of peers or against an index), no vesting should occur for sub-median performance. RiskMetrics will consider the availability of an appropriate peer group for NZ based companies as a material factor in assessing relative benchmarks.
- The use of 'indexed options' - where the exercise price of an option is increased by the movement in a suitable index of peer companies (such as the NZX40 or NZX50) is generally considered a sufficiently demanding hurdle.
- A sliding-scale hurdle - under which the percentage of options/rights that vest increases according to a sliding scale of performance (whether absolute or relative) - is generally preferable to a hurdle under which 100 percent of options vest once a single target is achieved.
- In the absence of relative performance hurdles, absolute share price hurdles may be appropriate so long as they are sufficiently stretching. Where an absolute share-price target is used, executives can be rewarded by a rising market even if their company does relatively poorly. In addition, even if a share price hurdle is set at a significantly higher level than the prevailing share price, if the option has a long life then the hurdle may not be particularly stretching.
- In considering whether an absolute share price target is sufficiently stretching, RiskMetrics will consider a company's explanation of how the target share price has been calculated. RiskMetrics will be more likely to consider an absolute share price target as sufficiently stretching when the target price is reflected in the option exercise price.
- The issue of options with no performance conditions other than continued service and the exercise price (set as being equal to the share price on date of issue) is not generally considered to be a sufficiently demanding hurdle.
- RiskMetrics will support incentive schemes with accounting-based hurdles if they are sufficiently demanding. An accounting-based hurdle does not necessarily require that shareholder value be improved before the incentive vests. In other words, with an accounting-performance hurdle, it is possible for incentives to vest - and executives to be rewarded - without any medium to long-term improvement in shareholder return having been delivered. Growth in EPS may, but does not always, translate into a material increase in share price and dividends over the medium to long-term.
- Hurdles which relate option vesting to share price performance against a company's cost of capital may be considered acceptable if the exercise price is adjusted to reflect the cost of capital over the vesting period. Shareholders must also be given sufficient information to determine if the cost of capital will be calculated or reviewed independently of management.

- Two different types of options should be distinguished: (1) grants of market-exercise-price options (traditional options), and (2) performance rights (also called conditional awards, performance shares, and performance award rights). Traditional options have an in-built share price appreciation hurdle, because the share price must increase above its level at grant date for the executive to have an incentive to exercise. Performance rights have no exercise price; the executive pays nothing to the company on exercising the rights. An EPS hurdle can lead to executive reward without any increase in shareholder return if the instruments are performance rights, but not if they are traditional options. Therefore, an EPS hurdle can more readily be supported if traditional options, rather than performance rights, are being granted.
- For an EPS target to be sufficiently stretching, where a single target is used (with 100 percent of options/rights vesting on the target being achieved), the target should generally specify a challenging target that is at least in line with analyst and management earnings forecasts. For targets which see rewards vest based on a sliding scale, vesting should start at a level below consensus forecasts only if a substantial portion of the award vests for performance above consensus forecasts.

### Retesting

- RiskMetrics does not support excessive retesting of options grants against performance hurdles. However, many NZ companies use performance hurdles such as cost of capital relative to share price that allow for continual retesting. In addition, the issue of retesting against performance hurdles does not appear to have been raised with NZ companies in the past. As such, it is not appropriate for RiskMetrics to recommend AGAINST a particular options grant on the basis of excessive retesting. However, RiskMetrics will continue to review NZ companies' practices in this area with a view to considering the frequency of retesting in assessing grants sometime in the future.
- RiskMetrics will however generally recommend AGAINST incentive schemes that provide for retesting against performance hurdles on a rolling-basis. For retesting to be acceptable, at a minimum it should assess performance against the hurdle from the inception date to the date of vesting.

### Transparency

- The methodology for determining exercise price of options should be disclosed.
- Shareholders should be presented with sufficient information to determine whether an incentive scheme will reward superior future performance.
- The proposed volume of securities which may be issued under an incentive scheme should be disclosed to enable shareholders to assess dilution.
- Time restrictions before options can be exercised should be disclosed, as should the expiry date of the options. Any restrictions on disposing of shares received on the exercise of options should be disclosed.
- If a value has been assigned to the options, the method used to calculate cost of options should be disclosed.
- The method of purchase or issue of shares on exercise of options should be disclosed.

### Dilution of existing shareholders' equity

- The aggregate number of shares and options issued under all employee and executive incentive schemes should not exceed 10 percent of issued capital.

### Level of reward

- The value of options granted (assuming performance hurdles are met) should be consistent with comparable schemes operating in similar companies.

### Who can participate in the scheme?

- The scheme should be open to all key executives.
- The scheme should not be open to non-executive directors.

### Other

- Incentive plans should include reasonable change-in-control provisions (i.e. pro-rata vesting time and size of awards).
- Incentive plans should include 'good' leaver/'bad' leaver provisions to minimize excessive and unearned payouts.

In summary, RiskMetrics will generally recommend AGAINST plans and proposed grants under plans, if any of the following apply:

- The company failed to disclose adequate information regarding any element of the scheme.
- The performance hurdles are not sufficiently demanding.
- The plan permits retesting of grants based on rolling performance.
- The plan allows for excessive dilution.

## **Remuneration: Shareholder resolutions**

RiskMetrics will generally recommend FOR appropriately-structured shareholder resolutions calling for increased disclosure of executive remuneration and/or the introduction of a non-binding shareholder vote on a company's remuneration policy. The NZ Companies Act and the NZX Listing Rules do not presently require the disclosure of senior executives' remuneration - beyond disclosure of the number of executives earning above NZ\$100,000 per annum in bands of NZ\$10,000 - or what part of executives' remuneration is linked to performance.

Executives are employees of shareholders, and it is therefore appropriate for shareholders to be informed as to the level of executive remuneration, and how it is determined. It is also appropriate for shareholders to be given a non-binding vote on a company's general approach to executive remuneration, and a number of jurisdictions, including the UK, Australia, Sweden and the

Netherlands, have adopted such non-binding votes. These votes can be a valuable and relatively inexpensive way for shareholders to communicate concerns over remuneration to a company.

## Miscellaneous

### **Constitution Amendment**

RiskMetrics Recommendation: CASE-BY-CASE

Proposals to amend the company's constitution are required to be approved by a special resolution (75 percent majority of votes cast).

Proposals range from a general updating of various clauses to reflect changes in corporate law and NZX Listing Rules, to complete replacement of an existing constitution with a new 'plain language', and updated, version.

RiskMetrics will pay particular attention to the likely impact of any proposed amendment on the rights of shareholders, and will generally recommend **AGAINST** any amendment that reduces shareholder rights without adequate justification.