

**IN NZ MARKETS DISCIPLINARY TRIBUNAL  
SUMMARY HEARING PROCEDURE**

**NZMDT 2/12**

**UNDER** the NZ Markets Disciplinary Tribunal Rules

**IN THE MATTER OF** breach of the NZSX Listing Rules 3.3.1(c) and 3.6.2(b)

**BETWEEN** **NZX LIMITED**

**AND** **HERITAGE GOLD NZ LIMITED**  
Respondent

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**DETERMINATION OF NZ MARKETS DISCIPLINARY TRIBUNAL  
26 APRIL 2012**

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1. This is a determination of a division of NZ Markets Disciplinary Tribunal (*the Tribunal*) comprising David Flacks (chairman), Alison Paterson and Phillip Meyer.
2. Capitalised terms that are not defined in this decision have the meanings given to them in the NZSX Listing Rules (*the Rules*).

### **Background**

3. On 16 March 2012, NZX Limited (*NZX*) served a statement of case on Heritage Gold NZ Limited (*HGD*). HGD is a Listed Issuer whose ordinary shares are Quoted on the NZSX and is subject to the Rules.
4. NZX subsequently served a revised statement of case on HGD, dated 19 March 2012.
5. On 28 March 2012, HGD advised the Tribunal that it had entered into settlement negotiations with NZX and requested an extension of time to submit documentation to the Tribunal by 20 April 2012. NZX advised the Tribunal that it supported an extension of time, but only until 13 April 2012.
6. On 30 March 2012, the Tribunal granted an extension, pursuant to NZ Disciplinary Tribunal Rule 6.2.2, giving HGD until 13 April 2012 to file its statement of response or settlement agreement, as the case may be.
7. The parties did not reach a settlement and on 13 April 2012, HGD filed a statement of response.
8. On 18 April 2012, NZX filed a statement of rejoinder.

### **Statement of Case**

9. The statement of case alleged that HGD had breached:
  - a. Rule 3.3.1(c) from 6 April 2011 until 2 August 2011, because its Board did not include at least two Independent Directors (*Breach One*); and
  - b. Rule 3.6.2(b) from 31 March 2007 until 15 November 2011, because its Audit Committee was not comprised of at least three members (*Breach Two*).

#### *Breach One*

10. The statement of case set out the material facts relevant to Breach One as follows:
  - a. Up until 6 April 2011, HGD had five Directors on its Board, including two Independent Directors. On 6 April 2011, Mr Warwick Grigor, an Independent Director, resigned from HGD's Board.
  - b. Following Mr Grigor's resignation, the HGD Board comprised three members with a Disqualifying Relationship and one Independent Director. HGD was therefore in breach of Rule 3.3.1(c) from 6 April 2011, as only one member of its Board was an Independent Director.

- c. On 28 July 2011, NZX received an application from HGD for retrospective waivers from Rules 3.3.1(c) and 3.6.2(c) so that the composition of the HGD Board and Audit Committee complied with the Rules until HGD appointed an Independent Director to replace Mr Grigor.
- d. On 29 July 2011, NZX advised HGD that it was disinclined to grant the waivers sought.
- e. On 2 August 2011, HGD announced to the market that Dr Ian Pringle had been appointed as an Independent Director of HGD. Following the announcement, HGD requested that the waiver application be withdrawn.
- f. On 17 August 2011, HGD wrote to NZX providing further information regarding the resignation of Mr Grigor and the appointment of Dr Pringle in which it advised that:
  - (a) Mr Grigor had difficulty attending Audit and Remuneration Committee meetings and Board meetings in the half year ending 31 March 2011, and in March, indicated that his future workload could preclude him from fulfilling his obligations as a Director;
  - (b) When Mr Grigor resigned, HGD began a search in New Zealand for a replacement Independent Director;
  - (c) The HGD Board identified a suitable candidate and interviewed him. One of HGD's Directors, Mr Atkinson, met with the candidate on three occasions and he was also interviewed by other Board members;
  - (d) The candidate spent approximately seven weeks doing due diligence and finally declined the position on 14 July 2011; and
  - (e) Following this, HGD's Board immediately reviewed their contacts and identified two possible contenders. Mr Atkinson was making inquiries to locate those potential candidates before HGD sought the waivers on 28 July 2011 and Dr Pringle was appointed as an Independent Director on 2 August 2011 with immediate effect.

*Breach Two*

- 11. The statement of case set out the material facts relevant to Breach Two as follows:
  - a. During its investigation of Breach One, NZX became aware of statements in HGD's 2011 Annual Report that its Audit Committee for the year ending 31 March 2011 had only two members, Mr Grigor and Mr McKee (both being Independent Directors). The same statement was contained in HGD's 2010 and 2009 Annual Reports.
  - b. On 12 October 2011, NZX wrote to HGD requesting further information about the composition of HGD's Audit Committee and

for what period HGD's Audit Committee had consisted of only two members.

- c. On 19 October 2011, HGD advised that since the resignation of a former Director on 31 March 2007, and until the resignation of Mr Grigor on 6 April 2011, HGD's Audit Committee consisted of only two members – Mr McKee and Mr Grigor. Following Mr Grigor's resignation, and until the appointment of Dr Pringle on 2 August 2011, HGD's Audit Committee consisted of only Mr McKee. Throughout these periods, the Managing Director (Mr Lash and subsequently Mr Atkinson) were also generally in attendance but were never formally appointed members of the Audit Committee.
- d. HGD accepted that it was technically in breach of Rule 3.6.2(b) but submitted that as it is listed on both the NZSX and the ASX, it had not fully appreciated the difference between the requirements of the ASX (which *recommend* that an Audit Committee be comprised of at least three members) and the Rules (which *require* an Audit Committee to be comprised of at least three members).
- e. On 22 November 2011, HGD advised that the Board would appoint Mr Matthew Hill as an additional member of the Audit Committee effective 15 November 2011.

#### **Statement of Response**

- 12. On 13 April 2012, HGD filed a statement of response. HGD acknowledged that it had breached Rules 3.3.1(c) and 3.6.2(b), but submitted in mitigation that:
  - a. the breaches were unintended and that no investor was misinformed as a result. Both the number of HGD's Independent Directors and the composition of its audit committee were fully disclosed to the market at all times. There has been no suggestion that the breaches resulted in any actual harm to investors.
  - b. it acted in good faith and undertook reasonable endeavours to obtain a replacement Independent Director promptly following Mr Grigor's resignation. The recruitment process simply took longer than anticipated.
  - c. recruitment was challenging, primarily, in HGD's view, because of extraordinary circumstances outside of its control. HGD considers that suitable candidates were deterred from taking on a directorship with the company in light of the Pike River Mine disaster on the West Coast (where the directors and senior management face substantial consequences) and other recent decisions relating to potential liability of directors.
  - d. when the HGD Board identified a suitable candidate, that candidate spent approximately seven weeks undertaking due diligence on the company before finally declining the position.
  - e. HGD understands that the purpose of the Rules relating to Audit Committee composition is to protect investors.

- f. HGD notes that membership of the committee was fully disclosed in its annual reports, and that it had complied with Australian best practice of having two Independent Directors on the committee with the managing director in attendance. As such, in substance there were three directors present at Audit Committee meetings, which is the number required under the Rules.
- g. In HGD's view, the duration of the breach of Rule 3.6.2(b) is unfortunate, but should not be given undue emphasis. Notwithstanding that the Audit Committee composition was fully disclosed, no market regulator brought the non-compliance to HGD's attention for quite some time, and when it was ultimately brought to HGD's attention it acted swiftly to correct its misunderstanding.
- h. HGD emphasises that it is a small company in NZSX terms. As such, the proposed penalties are a substantial figure and represent a significantly larger proportion of market capitalisation than the fines imposed on Skellerup Holdings Limited for what NZX acknowledges to be more egregious breaches of the relevant Rules. The penalties proposed by NZX represent a substantially greater cost per shareholder, which HGD suggests is unwarranted.

#### **Statement of Rejoinder**

- 13. On 18 April 2012, NZX filed a statement of rejoinder in which it noted that:
  - a. the original penalties sought in the statement of case remain appropriate.
  - b. it acknowledges the submission of HGD that its small market capitalisation is a relevant mitigating factor in determining the quantum of penalties, but considers that the penalties sought are still reasonable when considering this additional factor.
  - c. the corporate governance requirements for Issuers are clearly set out in the Rules and it is incumbent on Issuers to have processes in place to ensure that they comply with these requirements.
  - d. With regard to HGD's submission that suitable candidates were deterred from taking on a directorship with HGD following the Pike River Mine disaster and recent decisions relating to potential liability of directors, while HGD operates in the mining industry, this is an issue faced by all Issuers in maintaining appropriately comprised Boards, and is not a factor specific to HGD nor a compelling reason to reduce the penalty for HGD's breach of Rule 3.3.1(c).
  - e. HGD's disclosure of the composition of its Audit Committee in its annual report does not constitute self-reporting the breach of Rule 3.6.2(b). It is an Issuer's obligation to ensure it complies with the Rules. This submission is supported by the requirements of Rule 2.2.2, which requires every Director of an Issuer to acknowledge

that the Issuer is contractually bound to observe the Rules. Accordingly, NZX submits that this is not a compelling reason to reduce the penalty for HGD's breach of Rule 3.6.2(b).

#### **Penalty and plea of mitigation**

14. NZX submitted that the appropriate penalty for HGD is:
  - a. A public censure in the form of an announcement to the market that HGD is found to have breached Rules 3.3.1(c) and 3.6.2(b) and is censured by the Tribunal;
  - b. An order to pay NZX, within 20 days of the date of this decision, \$15,000 by way of penalty, being:
    - (i) \$10,000 for Breach One; and
    - (ii) \$5,000 for Breach Two;
  - c. An order to pay the costs of the Tribunal; and
  - d. An order to pay the costs incurred by NZX.
15. Penalty Band 3 of Procedure 11.3.1 of the NZ Markets Disciplinary Tribunal Procedures (*the Procedures*) provides guidance on the financial penalties to be imposed for breaches of the corporate governance provisions of the Rules. This is the intermediate band for breaches of the Rules by Issuers and merits imposition of financial penalties of up to \$20,000. Both Breach One and Breach Two fall within Penalty Band 3, indicating that a financial penalty of up to \$20,000 may be imposed in respect of each breach.
16. NZX submitted that the following mitigating factors are relevant in considering the appropriate penalty for Breach One:
  - a. the breach arose due to the resignation of Mr Grigor. It is not a situation where a non-compliant board appointment has been wilfully made; and
  - b. HGD submits and NZX has no reason to dispute that following Mr Grigor's resignation, HGD had taken active steps to recruit a suitable Independent Director and that HGD has at all times, been concerned with finding an Independent Director who would add real value to the governance of HGD.
17. NZX submitted that the following aggravating factors are relevant in considering the appropriate penalty for Breach One:
  - a. Mr Grigor's resignation was not completely unexpected. He had forewarned the HGD Board in March that his future workload could preclude him from fulfilling his ongoing obligations as a Director. HGD has not demonstrated that it had undertaken succession planning before Mr Grigor's resignation; and
  - b. HGD did not seek a waiver from Rule 3.3.1(c) until approximately 3.5 months after it first breached the Rule and did not self report its breach of Rule 3.3.1(c) to NZX until that time.

18. In considering the appropriate penalty for Breach Two, NZX submitted that the following mitigating factors are relevant:
  - a. the composition of HGD's Audit Committee was specifically identified to shareholders and the market in the annual reports for the relevant periods;
  - b. HGD's Audit Committee comprised all the Independent Directors of HGD and as such was able to provide independent oversight of the Audit Committee function;
  - c. Mr Atkinson generally participated in Audit Committee deliberations and as such the Audit Committee had appropriate levels of resource to perform its functions; and
  - d. immediate steps were taken to remedy Breach Two upon HGD becoming aware of it.
19. In considering the appropriate penalty for Breach Two, NZX submitted that the following aggravating factors are relevant:
  - a. HGD had been in breach of Rule 3.6.2(b) for approximately four and a half years – from 31 March 2007 until 15 November 2011;
  - b. until NZX alerted HGD of the requirements of Rule 3.6.2(b), HGD appears to have been unaware of them;
  - c. following the resignation of Mr Grigor on 6 April 2011 and until the appointment of Dr Pringle on 2 August 2011, Mr McKee was the sole member of HGD's Audit Committee. During this period the robustness of debate and decision making at Audit Committee meetings was compromised; and
  - d. although Mr Atkinson participated in Audit Committee deliberations he was not a formal member of that Committee and was unable to vote on resolutions tasked for Audit Committee approval.
20. HGD submitted in its statement of response that a more appropriate financial penalty for Breach One is \$7,500 and Breach Two is \$3,750.
21. HGD did not make submissions regarding NZX's recommendation that it be publicly censured by the Tribunal.

**Costs**

22. As at the date of the statement of case, NZX had incurred costs of \$6,158 in bringing this matter to the Tribunal.
23. HGD made submissions in its statement of response on costs and requested that NZX's costs be capped at \$5,000. In this regard, HGD noted that:
  - a. its own legal fees accrued to date in responding to this matter were \$2,700; and
  - b. there was a gap of some months between the initial correspondence from NZX on the relevant breaches and the ultimate statement of case, suggesting that NZX's costs may be

higher than they would otherwise have been had the matter been pursued on a more rapid timeframe.

24. NZX acknowledged HGD's submission on costs in its statement of rejoinder, but submitted that its costs are not unreasonable in the circumstances and for the documentation prepared for this matter and are proportional to other recent matters before the Tribunal. NZX noted that it has accrued a further 2.5 hours of time in liaising with HGD since 19 March 2012 and in preparing its rejoinder.

### **Relevant Rules**

25. Rule 3.3.1(c) provides that:

*"The composition of the Board shall include the following:*

*(c) the minimum number of Independent Directors shall be two or, if there are eight or more Directors, three or one-third (rounded down to the nearest whole number of Directors) of the total number of Directors whichever is greater."*

26. Rule 3.6.2 provides that:

*"The Audit Committee shall:*

- (a) be comprised solely of Directors of the Issuer; and*
- (b) have a minimum of three members; and*
- (c) have a majority of members that are Independent Directors; and*
- (d) have at least one member with an accounting or financial background."*

### **Determination of NZ Markets Disciplinary Tribunal**

27. The Tribunal finds that HGD acted in breach of Rule 3.3.1(c) and Rule 3.6.2(b).
28. The breach of Rule 3.3.1(c) occurred from 16 April 2011 until 2 August 2011 and the breach of Rule 3.6.2(b) occurred from 31 March 2007 until 15 November 2011.
29. The Tribunal notes that HGD does not dispute its breach of these Rules.

### **Orders**

30. The Tribunal imposes the following penalties:
- a. A public censure of HGD in the form attached to this determination;
  - b. An order to pay to NZX \$15,000 within 20 Business Days of the date of this determination, being \$10,000 in respect of the breach of Rule 3.3.1(c) and \$5,000 in respect of the breach of Rule 3.6.2(b);
  - c. An order to pay to NZX a sum equal to the costs incurred by the Tribunal and NZX (plus GST, if any) in bringing this proceeding, within 20 business days of the date of an invoice for these amounts from NZX.



### ***Precedent***

31. In *NZMDT 03/11 NZX v Skellerup Holdings Limited (SKL)*, the Tribunal found SKL had breached, and remained in breach of, Rules 3.3.1(c), 3.6.2(b) and 3.6.2(c). The Tribunal considered that the breach of the Rules by SKL warranted the imposition of a financial penalty at the upper end of the scale for an offence of this nature given the number of aggravating factors.
32. The penalties imposed by the Tribunal included public censure and an order to pay to NZX the sum of \$25,000, being \$15,000 for the breach of Rule 3.3.1(c), \$5,000 for the breach of Rule 3.6.2(b) and \$5,000 for the breach of Rule 3.6.2(c).
33. In its decision, the Tribunal noted that in determining the level of penalty, it had taken into account the cumulative effect of the amounts imposed. Accordingly, the lesser amounts imposed with regards to the breaches of Rules 3.6.2(b) and 3.6.2(c) are not an indication that the Rules regarding the composition of an Issuer's Audit Committee are any less serious than the breach of Rule 3.3.1(c). Rather, they reflect that the Tribunal considered the offence by SKL as a whole.

### ***Reasons for Decision***

34. The Tribunal takes the breach of Rules 3.3.1(c) and 3.6.2(b) by HGD very seriously. The corporate governance provisions of the Rules are of vital importance to the integrity of the market and to give investor's confidence in the directors who are appointed to represent their interests. In addition, an appropriately comprised audit committee is critical in ensuring that an Issuer maintains a robust audit process.
35. The Tribunal accepts that HGD has not disputed the fact of the breaches and that it took active steps to rectify them prior to the case being brought before the Tribunal.
36. However, with respect to Breach One, HGD had only the minimum number of Independent Directors on its Board making it imperative that the company have a succession plan in place should one of these members resign.
37. Further, the Tribunal is not satisfied with the argument put forward by HGD that the significant length of time it remained without an Independent Director – some four months – was due to circumstances outside its control. The matters cited by HGD – the Pike River Mine disaster and other recent decisions relating to potential liability of directors – are all the more reason to ensure that the Board has the requisite number of Independent Directors at all times. On HGD's own evidence, once its first candidate turned down the position, it was able to appoint Dr Pringle within a matter of weeks.
38. HGD did seek a waiver from Rule 3.3.1(c), but the Tribunal gives little weight to this, as the waiver was sought several months after the breach had first occurred.
39. However, the Tribunal does not consider the present case to be more serious than SKL. Accordingly, the Tribunal considers a sum of \$10,000 for Breach One to be an appropriate financial penalty in the circumstances of this case.

40. With respect to Breach Two, the Tribunal is very concerned about the significant period of time – approximately four and a half years – that HGD was in breach of Rule 3.6.2(b). It is fortunate in this case that the HGD Audit Committee has remained in compliance with Rule 3.6.2(c) – having a majority of members who are Independent Directors - and that the Managing Director was generally in attendance.
41. However, being unaware of the Rules is not a satisfactory reason for non-compliance for such a significant length of time. It is beholden on all Issuers and their Directors to understand the obligations the Rules impose and to ensure compliance with them.
42. Accordingly, the Tribunal considers the sum of \$5,000 for Breach Two to be an appropriate financial penalty in the circumstances of this case.
43. The Tribunal has considered the submissions made by HGD regarding the costs of NZX. However, the Tribunal considers the costs incurred by NZX in bringing this case to be reasonable and so awards them.

**Publication of this decision**

44. The Tribunal recommends that this decision be released to the market in full.

**Summary Hearing Procedure**

45. Under Rule 6.1.1 NZX has the discretion to refer a matter, which is not frivolous but is not sufficiently serious to require determination under the Full Hearing Procedure, to the Tribunal for hearing and determination by way of the Summary Hearing Procedure.
46. NZX advised the Tribunal that it considered this matter appropriate for the Summary Hearing Procedure because the issues involved were not complex and HGD was clearly in breach of the Rules.
47. The Tribunal agrees that a Summary Hearing was the appropriate forum for this matter.

DATED 26 APRIL 2012

A handwritten signature in blue ink that reads "D. M. Flacks". The signature is written in a cursive, flowing style.

David Flacks, Division Chairman, NZ Markets Disciplinary Tribunal