

8 July 2005

NZX Regulation Decision  
Tenon Limited  
Application for ruling under NZSX Listing Rule 9.2.4(c)

**Background**

1. Tenon Limited (“TEN”) has entered into an employment agreement (“Agreement”) with a new appointee, Mr Mark Eglinton, for the position of Chief Executive Officer of TEN (“CEO”). The Agreement is conditional upon TEN obtaining appropriate shareholder approval or a waiver from NZX from the requirement to obtain that approval.
2. Mr Eglinton is currently the Chief Operating Officer of TEN and will become CEO under the Agreement. He is, therefore, a Related Party of TEN pursuant to Listing Rule 9.2.3(a).
3. The entry into the Agreement with Mr Eglinton may be a Material Transaction under NZSX Listing Rule (“Listing Rule”) 9.2.2(e) as the total remuneration pursuant to the Agreement including incentive payments (“Package”) may exceed in any given year an amount equal to 0.5% of the Average Market Capitalisation of TEN (which currently equates to approximately NZ\$1.3million).
4. It is noted that the exception in Listing Rule 9.2.1(c) is not available to Mr Eglinton as it is intended that he remain a Director of TEN subsidiaries after his appointment as CEO.
5. The Package is made up of the following components:
  - a. base salary (US\$250,000);
  - b. variable remuneration component (up to US\$125,000 if all targets and objectives attached to that component are met in full); and
  - c. a right to receive (subject to the achievement of certain hurdle rates of TEN’s earnings performance – see paragraph 7) the value of any share price increase on an allocation (“Allocation”) pursuant to TEN’s Senior Executive Incentive Scheme (“Incentive Scheme”) of 700,000 notional shares,

together with entitlements to a range of standard employment related benefits including accommodation, car, telecommunications, travel, tax planning, medical insurance and childcare. The total cost to TEN of these benefits (excluding medical care and travel) is approximately US\$103,000 per annum, reflecting the relative costs of those benefits in the United States.

6. Excluding the Incentive Scheme entitlements, and assuming that Mr Eglinton meets all the targets and objectives associated with the variable remuneration component, the total costs of the Package (including non-salary benefits) to Tenon will be US\$477,800. When this amount is converted back to NZ\$ at current exchange rates, it is considerably less than the NZ\$1.3 million threshold above which shareholder approval is required. However, there are potentially scenarios where the aggregate entitlements of Mr Eglinton under the Incentive Scheme, if exercised in a single year, would result in the total cost to TEN of the Package in any one year exceeding the NZ\$1.3 million threshold.
7. The benefits under the Incentive Scheme will potentially accrue to Mr Eglinton after three years if per annum growth in earnings per share of TEN increases by a compound rate of 10% per annum. In essence, if the increase in earnings per share target is met, Mr Eglinton will have a three year window in which to exercise his entitlement under the Incentive Scheme in respect of the Allocation. If he elects to do so, the payment pursuant to the Incentive Scheme will be the difference in the TEN share price at the time the Allocation is made, escalated at an annual hurdle rate of 10%, compounded quarterly, and the TEN share price at the time the Allocation is exercised.
8. As a matter of prudence, TEN seeks a ruling from NZX Regulation (“NZXR”) that the exception in Listing Rule 9.2.4(c) is applicable to avoid the risk of breaching the Listing Rules.
9. TEN has provided NZXR with copies of the Agreement, the Incentive Scheme, a draft certificate from the Remuneration Committee of TEN, and a copy of an independent report from Woburn International.

## **Application**

10. TEN has applied to NZXR for a ruling that the exception to Listing Rule 9.2.1 in Listing Rule 9.2.4(c) applies to the Package on the basis that it has been set on an arm’s length, commercial basis.
11. In support of its application TEN submits the following:
  - (a) A report prepared by human resource recruitment and consultant firm Woburn International (“the Woburn Report”) was commissioned by the Remuneration Committee of TEN.
  - (b) The Package, which was determined by the Remuneration Committee of TEN (which comprises three non-Executive Directors, two of whom are Independent Directors and the other whose relationship with TEN is not germane to this issue), is largely consistent with the independent recommendations made to TEN in the Woburn Report.
  - (c) Mr Eglinton will be located in the United States and is largely responsible for a United States based organisation (in terms of asset mix and earnings). As a result, the Remuneration Committee of TEN considered that the appropriate comparisons are with the remuneration for an equivalent United States executive.

- (d) The Package is well within the Woburn Report's recommended range for both base salary and total target annual cash payments. However, at this point it is impractical to calculate the value of the Incentive Scheme portion of the Package as it is pegged to TEN's share price three years from the date the Allocation is made and the amount of the Allocation Mr Eglinton wishes to exercise at any one time. It is recognised that there may be scenarios where the exercise of the Allocation may push the total value of the Package above the threshold of 0.5% of Average Market Capitalisation of TEN in any one year.
- (e) Having reviewed the Woburn Report the Remuneration Committee and the Board of Directors of TEN believe that the Package is comparable to the market for the role of CEO.

### **Listing Rule 9.2.1**

- 12. The relevant part of Listing Rule 9.2.1 is aimed at regulating related party transactions in which a person may gain favourable consideration because of their relationship with the Issuer. In addition to these transactions, the rule is intended to capture transactions that may be perceived to be favourable.
- 13. Rule 9.2.1 provides that:

*“An Issuer shall not enter into a Material Transaction if a Related Party is, or is likely to become:*

- (a) a direct or indirect party to the Material Transaction, or to at least one of a related series of transactions of which the Material Transaction forms part...*

*unless:*

*...*

- (e) that Material Transaction is approved by an Ordinary Resolution of the Issuer.”*

### **Listing Rule 9.2.4(c)**

- 14. Listing Rule 9.2.4.(c) provides an exception to Listing Rule 9.2.1, and states that:

*“Rule 9.2.1 shall not apply to:*

- (c) any employment or service contracts which are Material Transactions under Rule [9.2.2(e)] where NZX is satisfied that the terms of the contract have been set out on an arm's length, commercial basis;”*

- 15. Footnote 2 to Listing Rule 9.2.4.(c) provides:

*For purposes of Rule 9.2.4(c), evidence from Independent Directors, audit or remuneration committees (of which a majority of members must be non-Executive Directors) or other committees of the Board comprised entirely of “non-interested” directors or independent experts will be relevant.*

## **Listing Rule 9.2.2**

16. Listing Rule 9.2.2 provides that:

*“For the purposes of Rule 9.2.1, “Material Transaction” means a transaction or a related series of transactions whereby an Issuer:*

*(e) provides or obtains any services (including without limitation the underwriting of Securities or services as an employee) in respect of which the actual gross cost to the Issuer in any financial year (ignoring any returns or benefits in connection with such services) is likely to exceed an amount equal to 0.5% of the Average Market Capitalisation of the Issuer; or”*

17. TEN’s Average Market Capitalisation over the 20 Business Days to 28 June 2005 was approximately NZ\$261,000,000. The 0.5% threshold for TEN’s purposes will thus be approximately \$1,300,000. The CEO’s proposed Package under the Agreement could exceed the 0.5% threshold and will exceed the \$250,000 de minimis threshold in Listing Rule 9.2.1(d). Thus, entering into the Agreement for the Package may be a Material Transaction for the purposes of the Rules.

## **Decision**

18. On the basis that the information provided to NZXR is full and accurate in all material respects, NZXR rules that the exception to Listing Rule 9.2.1 provided by Listing Rule 9.2.4(c) applies to the Package on the condition that the Remuneration Committee of TEN provide confirmation to NZXR that:

- a. They believe the terms of the Package represents fair value to TEN;
- b. The decision to enter the Package has been made on an arm’s length, commercial basis;
- c. The decision to enter the Package was not unduly influenced by, and was made independently from Mr Eglinton; and
- d. The decision to enter the Package is in the best interests of shareholders of TEN.

## **Reasons**

19. In coming to the above decision to approve TEN entering into the Agreement NZXR has considered:

- a. The Woburn Report which includes a recommendation of a market comparable remuneration package for the CEO;
  - b. The Agreement provided by TEN;
  - c. That NZXR will receive from the Remuneration Committee of TEN (comprising three non-Executive Directors, two of whom are Independent Directors and the other whose relationship with TEN is not germane to this issue) a certificate in the form required by the condition in paragraph 18 above.
20. NZXR is satisfied that the terms of the Agreement have been set on an arm's length, commercial basis.

ENDS.