IN NZ MARKETS DISCIPLINARY TRIBUNAL
SUMMARY HEARING PROCEDURE **NZMDT 1/14**

UNDER	the NZ Markets Disciplinary Tribunal Rules
IN THE MATTER OF	alleged breach of NZX Main Board Listing Rule 10.1.1
BETWEEN	**NZX LIMITED**
AND	**RAKON LIMITED**
	Respondent

DETERMINATION OF NZ MARKETS DISCIPLINARY TRIBUNAL
24 FEBRUARY 2014

NEW ZEALAND MARKETS
DISCIPLINARY TRIBUNAL

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1. This is a determination of a division of the NZ Markets Disciplinary Tribunal (*the Tribunal*) comprising Don Holborow (division chairman), David Kreider and James Ogden.

2. Capitalised terms that are not defined in this determination have the meanings given to them in the NZX Main Board Listing Rules (*the Rules*).

Procedural Background

3. NZX Limited (*NZX*) served a statement of case on Rakon Limited (*RAK*) on 17 January 2014 in which it alleged that RAK had breached Rule 10.1.1.

4. On 31 January 2014, RAK filed a statement of response in which it denied having breached Rule 10.1.1 and requested that an oral hearing be held. The Tribunal sought confirmation from RAK that it believed an oral hearing was essential to establish all the facts relevant to this matter as required under Tribunal Rule 6.3.2. RAK provided this confirmation to the Tribunal by email dated 4 February 2014.

5. On 5 February 2014, NZX filed a rejoinder to its statement of case.

6. On 7 February 2014, the Tribunal issued a notice of oral hearing notifying the parties of the date, time and venue of the hearing and setting out the intended format for the hearing.

7. On 14 February 2014, an oral hearing of the Tribunal was held. Both parties attended the hearing with RAK having one legal advisor present as permitted by the Tribunal in accordance with Tribunal Rule 6.5.1(b)(ii).

Factual Background

8. RAK directly or indirectly owned 85.4% of the shares in Rakon HK Limited (*RAK HK*). RAK HK owned 100% of the shares in Rakon Crystal (Chengdu) Co., Ltd (*RCC*). RCC owned a manufacturing facility in Chengdu, China. RAK advised that RCC had been performing badly and in early 2013 RAK was considering whether to sell the shares in RCC or to close the Chengdu operation and liquidate the assets of RCC.

9. Between March 2013 and early July 2013, RAK and Zhejiang East Crystal Electronic Co., Ltd (*ECEC*), an entity listed on the Shenzhen Stock Exchange, negotiated a possible joint venture and sale of not less than 80% of RAK HK's shares in RCC to ECEC. RAK and ECEC had an existing relationship, the parties having entered into a confidentiality agreement signed by ECEC on 18 March 2010.

10. The Tribunal received detailed submissions from RAK on the protracted and difficult nature of the negotiations with ECEC regarding the sale of the RCC shares. RAK has stressed to the Tribunal, in both its written and oral submissions, that nothing about the proposal or the negotiations was certain and that RAK was concerned about whether ECEC was committed to the proposal. Accordingly, RAK did not want to be bound to any agreement which would prevent it from pursuing the alternative option of liquidation until it received a deposit from ECEC. RAK considered that a deposit would both demonstrate ECEC's commitment to the deal and provide funds to allow the RCC plant to continue in operation at least until the time that the terms of a formal share transfer agreement could be agreed upon or, if agreement could not be reached, a decision made to liquidate RCC's assets.

11. RAK submitted that its Board was willing to investigate the possible sale of the shares in RCC to ECEC, but that the alternative proposal to close its Chengdu operation and liquidate the assets of RCC remained on the table.

12. The negotiations culminated in a Cooperation Framework Agreement (*the Agreement*) which expressed the "tentative" intention of RAK and ECEC to form a strategic partnership and set out the process the parties would follow in order to enter into a formal share transfer agreement for the sale of at least 80% of RAK HK's RCC shares.

13. On 2 July 2013, the RAK Board unanimously resolved to enter into the Agreement and granted its permission for the Agreement to be signed by the RAK CEO.

14. The parties exchanged emails on the signing of the Agreement and the timing of the announcements to NZX and the Shenzhen Stock Exchange.

15. On 3 July 2013 at 1.08 pm, George Ye (JV partner to RAK and General Manager of RCC) suggested the following schedule in an email to RAK and ECEC:

> *"1. Finalize the two announcements and sign the agreement tomorrow.*
>
> *2. ECEC makes the payment of 0.5 mil USD to Rakon Hongkong Ltd.*
>
> *3. Both parties release the announcement on this Friday.*
>
> *Please review the above timetable and send back your comments."*

16. ECEC sent an email to RAK at 5:21 pm (NZST) on 3 July 2013 in which it stated *"For your information, ECEC will make the announcement this Friday [5 July 2013]. Therefore we need to file all relevant documents to the China Stock Exchange before 12am tomorrow [4 July] (Beijing Time).".*

17. ECEC sent a further email to RAK at 7:56 pm (NZST) on 3 July 2013 suggesting that:

    (a) Before 11 am (NZST) on 4 July 2013 RAK sends ECEC the draft of its announcement, the signed Agreement and the RAK Board's letter of authority authorising its CEO to sign the Agreement.

    (b) Before 3 pm (NZST) on 4 July 2013 ECEC sends RAK the signed Agreement.

    (c) On 5 July 2013 both parties make announcements and ECEC is to pay the US$0.5 million deposit to RAK HK's bank account before 5 pm Beijing time (9 pm NZST).

18. The RAK CEO responded by email to ECEC at 8:57 am (NZST) on Thursday, 4 July 2013 noting that RAK was still drafting its announcement and it would not be ready until later in the day and that in respect of the order of events to complete the Agreement:

"...Rakon will need to sight cleared funds in our RHK USD account before we can announce. It is not until payment is made and received the Frame Work agreement effectuated hence we can't announce before. I'm hoping we can both still announce tomorrow but it will depend on the speed of the Banking system and announcement agreement."

19. The Tribunal was not presented with written evidence to show that ECEC accepted that the announcements should not be made until RAK had sighted cleared funds in RAK HK's bank account. Nor did RAK's written submissions address this point. However, during the course of the Tribunal oral hearing, the RAK CEO stated that ECEC had confirmed to him that it agreed with this position during a telephone call on 4 July 2013. The Tribunal was surprised that this important evidence was not referred to in RAK's statement of response. The Tribunal also considers that the recording of such an important confirmation in writing would have been prudent.

20. At 6 pm (NZST) on 4 July 2013, the RAK CEO sent a copy of the Agreement signed by RAK, RAK's signed Board resolution and RAK's draft market announcement to ECEC.

21. At 9:15 pm (NZST) on 4 July 2013, ECEC sent a copy of the Agreement signed by ECEC to RAK.

22. NZX has advised the Tribunal that following the opening of trading on the Main Board on Friday, 5 July 2013, it observed a significant price rise and increase in trading volume in RAK ordinary shares. By 10:30 am, the price of RAK ordinary shares had risen to NZ$0.25 (an 8.7% rise on the previous day's closing price). Between 10 am and 10:30 am, 495,036 RAK ordinary shares were traded. This is compared to an average daily trading volume over the previous 20 days of 154,373.

23. Initial investigations by NZX found that ECEC had announced the Agreement to the Shenzhen Stock Exchange and that this information was publicly available online via Chinese media outlets as early as 7:42 pm (CST) on 4 July 2013 (being 11:42 pm (NZST) on 4 July 2013). NZX contacted RAK at approximately 11:30 am on 5 July 2013. RAK was not aware the information was publicly available but confirmed the substance of the Chinese website articles was correct. RAK ordinary shares were placed in a trading halt at approximately 11.35 am on 5 July 2013, pending release of an announcement by RAK. At 12:17 pm on 5 July 2013, RAK announced details of the Agreement. Trading in RAK ordinary shares resumed at 12:32 pm on 5 July 2013.

24. No evidence was provided to the Tribunal from RAK to explain why ECEC had released its announcement on the evening of 4 July 2013. Nor was the Tribunal provided with submissions or evidence on what ECEC's obligations to disclose the Agreement were under the rules of the Shenzhen Stock Exchange. RAK advised the Tribunal during the oral hearing that it had not made enquiries as to ECEC's obligations to disclose the Agreement.

25. RAK advised that it sighted a bank confirmation on Monday, 8 July 2013 or thereabouts that confirmed ECEC had made payment of the deposit to RAK HK on 5 July 2013. RAK subsequently provided bank documentation to the Tribunal showing that cleared funds were available in the bank account of RAK HK by 8 July 2013.

The Agreement

26. The Agreement is written in Chinese and English. Clause IV(5) of the Agreement provides that the Chinese version prevails. However, RAK advised the Tribunal that it did not obtain a professional translation of the Agreement. RAK has provided the Tribunal with a certified translation of clause IV(4) during the course of these proceedings.

27. Clause IV(4) of the Agreement provides, in the English, that:

> *The Agreement is in Quadruplication, each party holds two originals. This Agreement takes effect upon signature, seal of both parties and the approval by Party A's* [ECEC] *Board of Directors and Party A paid 0.5 million USD deposit to Party B* [RAK].

28. The certified translated version of clause IV(4) provided to the Tribunal by RAK provides that:

> *This Agreement is drawn up in quadruplicate, two copies for each Party to the Agreement; this Framework Agreement of Intent shall come into force after each Party has affixed their signature and stamp to the agreement, the agreement has been considered and approved by the Board of Directors of Party A, and Party A has paid a deposit of USD500,000 dollars.*

29. RAK has submitted that the effect of clause IV(4) is that there was no binding agreement until the deposit was paid. RAK submitted that this provision was deliberate - it wanted to be sure of ECEC's financial commitment to the transaction before it became contractually bound and before an obligation arose to advise the market. RAK did not want to announce the Agreement before the commitment of ECEC was assured.

30. RAK has submitted that up until payment of the deposit, either party was free to walk away from the proposed transaction or to re-open negotiations. It was only upon payment of the deposit that the Agreement "came into force" such that the parties had legal obligations to each other. In this respect the Agreement was unusual. Generally speaking, once an agreement is signed a purchaser is contractually obliged to pay the deposit because the contract is formed on execution. However, RAK argue that this was not the case here because until the deposit was paid, neither party were legally bound to do anything.

31. The Tribunal notes that the Agreement does not specify what constitutes payment of the deposit or how this was to be done. "Paid" could simply require ECEC to have instructed its bank to make the payment. However, RAK has submitted that the parties understood payment was not made until cleared funds were received in the account of RAK HK. This is supported by the email correspondence, particularly the RAK CEO's email to ECEC at 8:57 am (NZST) on Thursday, 4 July 2013. In addition, RAK advised during the Tribunal oral hearing that this position was agreed by ECEC during a telephone call on 4 July 2013. Depending on how fast the transaction proceeded through the banking system there could be a difference of several days between ECEC instructing its bank to make the payment and cleared funds being available in the bank account of RAK HK. As it transpired, ECEC had instructed its bank to transfer the deposit on Friday, 5 July 2013 and cleared funds were available in the account of RAK HK by Monday, 8 July 2013.

32. NZX submitted that the Agreement contemplated action by the parties "after signing the Agreement", not upon signing and payment of the deposit. Such actions to be completed once the Agreement was signed included: (1) the appointment of accountants to conduct an audit of RCC's assets and issue a report. ECEC was to pay RAK the USD$0.5 million deposit provided the net value of RCC's fixed assets and intangible assets was no less than 240 million CNY (page 6 of the Agreement). RAK advised during the course of the Tribunal oral hearing that this deposit is the same deposit referred to in clause IV(4); (2) the provision of engineers by RAK to ECEC (page 13); and (3) the parties could engage professional agencies to do due diligence (page 14). In response, RAK submitted that as clause IV(4) is the only clause which expressly addresses the issue of when the Agreement takes effect, so on that issue clause IV(4) must prevail.

33. The Agreement is silent as to governing law. RAK advised the Tribunal during the oral hearing that the Agreement is governed by the laws of the People's Republic of China (*PRC*), and not New Zealand law. However, RAK has advised the Tribunal that it did not seek legal advice on when the Agreement became legally binding under PRC law.

34. The Tribunal was not provided with evidence to show that the Agreement had been approved by the ECEC Board as required under clause IV(4), but during the course of the oral hearing RAK advised that this approval had been granted.

Rule 10.1.1(a)

35. Rule 10.1.1(a) provides that:

> *Without limiting any other Rule, every Issuer shall:*
>
> *(a) once it becomes aware of any Material Information concerning it, immediately release that Material Information to NZX, provided that this Rule shall not apply when:*
>
> *(i) a reasonable person would not expect the information to be disclosed; and*
>
> *(ii) the information is confidential and its confidentiality is maintained; and*
>
> *(iii) one or more of the following applies:*
>
> *(A) the release of information would be a breach of law; or*
>
> *(B) the information concerns an incomplete proposal or negotiation; or*
>
> *(C) the information comprises matters of supposition or is insufficiently definite to warrant disclosure; or*
>
> *(D) the information is generated for the internal management purposes of the Issuer; or*

(E) the information is a trade secret.

36. "Material Information" is defined in the Rules as information in relation to the Issuer that a reasonable person would expect, if it were generally available to the market, to have a material effect on the price of Quoted Securities of the Issuer. Footnote 1 to Rule 10.1.1 notes that an acquisition or disposition, by whatever means of assets of any nature (including entering into any agreement or option to do so) where the gross value of those assets, or the consideration paid or received by the Issuer, represents more than 10% of the Average Market Capitalisation of the Issuer is likely to constitute Material Information under the Rules.

37. Rule 10.1.1(a) sets out a number of exceptions which permit Material Information to be withheld if certain "safe harbour" provisions apply. Each of the three limbs must apply, that is (i) a reasonable person would not expect the information to be disclosed; **and** (ii) the information is confidential and its confidentiality is maintained; **and** one or more of the exceptions in sub-clause (iii) must apply. Rule 10.1.1(a)(iii)(B) allows Material Information to be withheld if "the information concerns an incomplete proposal or negotiation".

38. Footnote 3 to Rule 10.1.1 notes that for the purposes of Rule 10.1.1(a)(i) "a reasonable person" would not expect information to be disclosed if the release of the information would:

    (a) unreasonably prejudice the Issuer; or

    (b) provide no benefit to a person who commonly invests in securities.

39. Footnote 4 to Rule 10.1.1 notes that "confidential" has the sense "secret".

40. The Rules do not elaborate on the intended meaning of an "incomplete proposal or negotiation" for the purposes of Rule 10.1.1(a)(iii)(B).

41. NZX issued a guidance note in April 2011 on continuous disclosure (*NZX Guidance Note*). It is intended to set out the expectations of NZX in relation to compliance with the continuous disclosure Rules and to provide guidance to Issuers to assist with decision making about continuous disclosure.

42. The NZX Guidance Note states on page 7 that NZX:

> *"...views the "reasonable person" aspect of the "safe harbour" provisions as being an overarching test when considering whether information should be released – that is, that test must always be satisfied in addition to the other limbs of the test.*
>
> *The first part of this test requires consideration of the prejudice that disclosing information could have to the Issuer and, by extension to investors. This does not mean that Issuers can simply choose to withhold bad financial news from the market. An example of where disclosure of information might unreasonably prejudice the Issuer is where the Issuer is in the middle of confidential negotiations and disclosure may prejudice the negotiations.*

43. In respect of the confidentiality requirement in Rule 10.1.1(a)(ii), the NZX Guidance Note states (at page 7) that:

> *"Whether information is confidential will be a question of fact. It cannot be in the public domain. Where negotiations are in progress, the other party must also keep the fact of, and content of, those negotiations confidential. There is likely (but not always) to be a confidentiality agreement in place."*

44. The NZX Guidance Note states that as well as meeting the reasonable person and confidentiality thresholds, at least one of the matters in Rule 10.1.1(a)(iii) must apply. It goes on to state (at page 8) that:

> *"In particular, we note sub clause (a)(iii)(B) which enables companies to withhold information about incomplete negotiations. NZXMS considers that negotiations can generally be considered to be complete at the point that contracts are signed. Note that signed conditional contracts will not be regarded as incomplete."*

45. Both parties have also referred to the ASX Guidance Note on continuous disclosure in their submissions. While RAK is not ASX listed, the Tribunal agrees that it is useful to consider the ASX Guidance Note in this case given that Rule 10.1.1(a) and the relevant ASX Listing Rule are identically worded and the experience of ASX in its implementation of the ASX Listing Rules is a useful comparison.

46. The ASX Guidance Note is more extensive in its explanation of what "an incomplete proposal or negotiation" means. ASX Guidance Note 8 (issued on 1 May 2013) provides:

> *A proposal involving a listed entity is incomplete unless and until the entity has adopted it and is committed to proceeding with it. Negotiations are incomplete unless and until they result in a legally binding agreement or the entity is otherwise committed to proceeding with the transaction being negotiated.*
>
> *Hence, all other things being equal:*
>
> - *Where a unilateral proposal requires the approval of the board of directors of a listed entity, and nothing more, for the entity to be committed to it (such as a proposal to declare a dividend), it will be complete when the board formally approves the proposal and resolves to proceed with it, and not beforehand. If the proposal is market sensitive, it will need to be announced immediately after the board resolves to proceed with it.*
>
> - *Where a unilateral proposal requires additional steps to be taken over and above the approval of the board of directors of a listed entity for the entity to be committed to it (such as a unilateral proposal to make a takeover bid, which requires a bidder's statement and, in the case of an off market bid an offer document, to be lodged with ASIC), it will be complete only when those steps have been taken, and not beforehand. If the proposal is market sensitive, it will need to be announced immediately after those steps have been completed.*

- *Where a listed entity is negotiating a transaction with another party or parties, those negotiations will be complete only when the parties enter into an agreement to implement or give effect to the transaction, and not beforehand. If the transaction is market sensitive, it will need to be announced immediately after the agreement has been entered into.*

Generally speaking, an agreement is not legally binding until it is signed or formally adopted in some other way. Until that point, any party is free to walk away from the agreement or to re-open negotiations. This fact does afford a degree of flexibility to a listed entity, in terms of when it chooses to sign a market sensitive agreement and to make an announcement about it.

...

It should be noted that the fact that an agreement to implement or give effect to a market sensitive transaction may be subject to conditions precedent to it becoming legally binding, or conditions subsequent that must be satisfied before the transaction proceeds to completion, does not alter the fact that it will usually need to be disclosed at the point of signing. At that point, it is no longer an incomplete proposal or negotiation and so this exception will no longer apply.

Discussion

47. There are two key issues which the Tribunal must consider in this matter:

(a) what is the correct interpretation of Rule 10.1.1(a)(iii)(B)?; and

(b) how do the Rules apply in this instance?

Interpretation of Rules

48. RAK has submitted that the term "incomplete proposal or negotiation" is generally understood to mean a transaction which has been the subject of discussion and negotiation but which has not yet resulted in a binding legal agreement. At the point where a binding agreement is reached, the proposal or negotiation ceases to be "incomplete" and an immediate disclosure obligation is triggered.

49. NZX has submitted that it will not always be necessary to establish that a legally binding agreement exists to establish that a proposal or negotiation is complete. In NZX's view if the Rules had intended that an Issuer would only be obliged to announce an agreement upon signing of a legally binding agreement, the Rules would state that. NZX considers that the language used within the exemption contemplates a broader range of situations where a proposal or negotiation will be complete.

50. The obligation to disclose Material Information to the market immediately is a fundamental obligation placed on Issuers under the Rules. The Rules are intended to ensure that the market is informed of relevant information at all times, that New Zealand's listed capital markets are efficient, transparent and fair, and that there is equality of information in the market.

51. The presumption in the Rules is that Material Information must be immediately released unless an exception applies. Footnote 10 to Rule 10.1.1 notes that "*An Issuer should also be guided by the principle that if in doubt it should disclose the information*".

52. The Rules permit some exceptions to the fundamental obligation to disclose, known as the "safe harbour" provisions. The exception RAK seeks to rely on in this case, that the Agreement was "an incomplete proposal or negotiation", is intended to ensure that parties are not forced to disclose information to the market at a time when it may prejudice ongoing negotiations. RAK also submitted that the Rule ensures that a proposal is not required to be announced prematurely, which could mislead the market or cause uncertainty.

53. In the Tribunal's view, a proposal or negotiation can be complete for the purposes of Rule 10.1.1(a)(iii)(B) before it becomes legally binding.

54. The Rules do not explicitly require a legally binding commitment. The Tribunal agrees with the submission of NZX that the language used within the exception contemplates a broader range of situations where a proposal or negotiation may be complete. Support for this view can also be found in the ASX Guidance Note (as noted above) where ASX take the view that something can be complete even if it is subject to conditions precedent, which must be satisfied before an agreement may become legally binding.

55. The Tribunal can also envisage other circumstances where a proposal may be complete, but not legally binding, for example a non-binding memorandum of understanding or letter of intent entered into by an Issuer.

56. RAK has submitted that if the Rules are not interpreted to require a legally binding agreement before disclosure must be made, then a grey area is created making it difficult for Issuers to comply.

57. The Tribunal agrees that it is important to ensure that the Rules are interpreted with reasonable consistency and predictability and that there is a "clear line" to inform Issuers on when disclosure is required. Generally speaking, this "clear line" is when both parties sign an agreement.

Application of the Rules

58. Both parties agree that the Agreement was Material Information[1]. In this case the divestment of assets was equivalent to 55% of RAK's Average Market Capitalisation at the relevant time, so very material. The divestment also triggered a requirement for RAK shareholder approval under Rule 9.1.1.

59. Both parties agree that as soon as details of the Agreement were made public via Chinese media on 4 July 2013, confidentiality was lost and disclosure of the Agreement by RAK to NZX was required[2].

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[1] See footnote 3 on page 6 of the statement of response.
[2] See paragraph 13 on page 5 of the statement of response.

60. NZX has not sought in its submissions to contend that RAK was not in compliance with the requirement in Rule 10.1.1(a)(i) that a reasonable person would not expect the information to be disclosed. The Tribunal can only surmise from this that NZX considers that RAK satisfied this limb of the safe harbour provisions.

61. Nor has NZX sought in its submissions to contend that RAK was not in compliance with the requirement of confidentiality in Rule 10.1.1(a)(ii) up until the time of the announcement made by ECEC. The Tribunal notes that the parties had a confidentiality agreement in place.

62. The matter on which the parties disagree is whether the Agreement had ceased to be "an incomplete proposal or negotiation" before it was announced by ECEC.

63. To put matters simply, NZX contends that, at the point the Agreement was signed by both RAK and ECEC, it ceased to be "an incomplete proposal or negotiation" and should therefore have been announced. RAK contend that the Agreement was "incomplete" up until the time the deposit was paid because until that time the Agreement was not legally binding.

64. The Tribunal finds that the Agreement was complete at the time of execution by the parties on the evening of 4th July 2013, and was required to be immediately disclosed by RAK at that time – in practice this should have occurred before the market opened in New Zealand on 5 July 2013.

65. RAK has submitted that both parties had the right to re-open negotiations up until the time the deposit was paid, because the Agreement was not legally binding until that point. In essence RAK argued that negotiations which were capable of being re-opened, without legal consequence, should not be regarded as "complete". The Tribunal notes that the Agreement was unusual in this regard. Putting aside the fact that the Agreement was governed by PRC law, and assuming that RAK's characterisation of the legal effect of the Agreement is correct, the Tribunal accepts that the Agreement was not a "conditional contract", as that term is commonly understood in New Zealand.[3]

66. However, the Tribunal considers that the Agreement was complete at the time of execution by both parties. The act of executing a formalised record of the terms of a potential legal relationship, with board approval on both sides, reflects a high degree of certainty and commitment of the parties to those terms, at a moral and commercial (although, in this case, not an immediate legal) level. While the payment by ECEC of the US$0.5 million deposit was required in order for the Agreement to become "legally binding", the Tribunal considers that the Agreement was nevertheless "complete" for the purposes of Rule 10.1.1(a)(iii)(B) at the point it was signed by both parties. There was no indication that negotiations would re-open or continue after this point, and the fact of board approval and formal execution are strong indications to the contrary.

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[3] The position regarding disclosure of "conditional contracts" under the Rules is clear. NZX Guidance Note explicitly states that, "*signed conditional contracts will not be regarded as incomplete*".

67. The Agreement may not have been a "conditional contract" in strict legal terms, but it was similar in nature, requiring only the meeting of one condition (payment of the deposit) to bring it into effect. If such arrangements were not subject to disclosure, there would be a risk that the policy and intent of the Rule 10.1.1 and its exceptions would be defeated by careful legal structuring. There is a difference between a conditional contract and the Agreement, but not one so significant as to justify non-disclosure.

Penalty

68. In determining the appropriate penalty to impose the Tribunal must consider the matters prescribed in Tribunal Rule 11.16.1, including the conduct of RAK over the previous 24 month period, the severity of the matter, any benefit obtained or detriment suffered as a consequence of the breach, the reputational impact of the penalty being imposed and any other mitigating factors.

Conduct of RAK

69. There has been no suggestion that RAK deliberately breached the Rules. RAK considered that, until the deposit was received in cleared funds, no disclosure was required. The Tribunal accepts RAK's submissions that it was mindful of its obligations under the Rules and sought to ensure a co-ordinated release of announcements with ECEC, subject to its receipt of the deposit. The parties had an existing confidentiality agreement in place under which RAK was entitled to assume the confidentiality of the Agreement unless it consented to disclosure.

70. The Tribunal notes that, as soon as RAK was advised by NZX that the Agreement had been announced by ECEC, it took the appropriate steps and released an announcement as required.

71. The Tribunal also notes that this is the first occasion a breach by RAK has been referred to the Tribunal.

72. RAK has submitted that they continued to have significant doubt as to whether ECEC would pay the deposit, even after both parties had signed the Agreement. RAK submitted that this uncertainty meant that announcing the Agreement before the deposit was paid could have misled the market. However, the Tribunal is not convinced of this – an announcement could have been worded appropriately to ensure the market was made aware of the deposit requirement. The Tribunal notes that when the announcement was made by RAK on 5 July 2013 it made no mention of the reliance on receiving the deposit before the Agreement became binding, despite the deposit not having been received yet by RAK HK.

73. The Tribunal also notes that during the oral hearing, RAK advised that the Agreement was governed by PRC law, but that it had not sought any advice in relation to PRC law, including on when the Agreement would become legally effective under that law. It also appears that RAK did not make any enquiries of ECEC as to ECEC's disclosure obligations under the rules of the Shenzhen Stock Exchange.

Severity of the breach

74. Any breach of the continuous disclosure provisions of the Rules is a very serious matter and any such breach should be considered severe. Such a breach falls within penalty band 6 of the Tribunal's Procedures, indicating that a penalty of up to $250,000 for a matter considered under the Summary Hearing Procedure is appropriate.

75. The Tribunal notes that the duration of the breach – around 1.5 hours – was particularly short. However, this was due to NZX having discovered the online Chinese media reports, rather than any precautionary measures taken by RAK to ensure it became aware of any leaks.[4]

76. The Tribunal also notes that the information was particularly "Material", with the sale of the RCC shares constituting a significant transaction which required RAK shareholder approval under the Rules.

Benefit obtained/detriment suffered

77. RAK submitted that any potential detriment to RAK shareholders was small. An increased volume of trading in RAK shares did occur between market open at 10 am on 5 July 2013 and approximately 11:35 am on 5 July 2013 when RAK ordinary shares were placed in trading halt. RAK submitted that the maximum possible loss to selling shareholders was $10,767. The Tribunal notes that this amount only accounts for the trading which occurred between market open and 10:30 am. The Tribunal was not provided with trading information in order to determine the total possible loss, but accepts this amount is unlikely to have been significant.

Reputational Impact

78. While RAK did not make any submissions on the reputational impact on RAK should the Tribunal make an adverse finding, the Tribunal notes that any ruling against an Issuer is likely to be detrimental to its market reputation. The Tribunal takes its responsibilities very seriously and is very mindful of the possible consequences to an Issuer of adverse findings.

Other mitigating factors

79. In addition to the matters already outlined above, RAK submitted that it has and had internal processes in place to ensure compliance with Rule 10.1.1. These include a reporting process which senior staff must follow including having an identified "communications point" person and a process for dealing with announcements which require immediate disclosure.

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[4] In view of the evidence provided by RAK on the circumstances of its protracted and difficult dealings with ECEC, as well as RAK's concern that ECEC could not be relied upon to pay the US$0.5 million deposit specified in the Agreement, the Tribunal considers that precautionary measures to alert RAK of any leak of confidential information would have been prudent – especially after RAK had delivered the signed Agreement to ECEC along with the signed resolution of the RAK Board of Directors.

80. The Tribunal notes that it was clear that RAK's senior management and Board were aware of the need to announce the Agreement and sought to manage the timing of the announcements by RAK and ECEC. However, the email correspondence between RAK and ECEC did seem at cross-purposes, with no clear written agreement between the parties on when the announcements should be made. The Tribunal was not provided with any evidence that RAK sought external legal advice on its disclosure obligations under the Rules when the Agreement was being signed and announcements proposed.

Financial Penalty

81. NZX has sought a penalty of $30,000. NZX appears to have used the last decision by the Tribunal regarding a breach of Rule 10.1.1 (*NZMDT 5/2013 NZX v Energy Mad Ltd*) as a benchmark. A penalty of $30,000 was also imposed in that case.

82. The breach of Rule 10.1.1 in *NZX v Energy Mad Ltd* continued for a considerably longer period of just over one month (although the intervening Christmas period was a contributing factor). The Board of Directors in that case incorrectly considered (based in part on oral legal advice they had received) that the disclosure of information which could affect the company being able to achieve its IPO financial forecast was not required on the basis that any shortfall could be recovered through other potential revenue streams. The Tribunal notes that the parties agreed a settlement in that case. It is the Tribunal's policy that where NZX has negotiated a settlement with a respondent it is a matter for NZX in the first instance to assess an appropriate financial penalty. As a general rule, it is only on rare occasions that the Tribunal would disagree with the financial penalties agreed between the parties.

Summary of Orders

83. The Tribunal considers that a penalty of $30,000 is appropriate in this case when taking all the circumstances into account.

84. It follows that the Tribunal imposes the following penalties:

(a) A public censure in the form of an announcement by the Tribunal to the market that RAK has been found in breach of Rule 10.1.1.

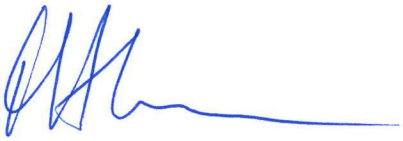
(b) An order that RAK pay to NZX $30,000 by way of penalty within 20 Business Days of the date of an invoice from NZX;

(c) An order that RAK pay the actual costs and expenses incurred by the Tribunal in considering this matter within 20 Business Days of the date of an invoice from NZX; and

(d) An order that RAK pay the actual costs and expenses incurred by NZX in relation to this matter within 20 Business Days of the date of an invoice from NZX.

85. The Tribunal recommends that this decision be released to the market in full under Tribunal Rule 6.6.

DATED 24 FEBRUARY 2014



Don Holborow, Division Chairman, NZ Markets Disciplinary Tribunal

NEW ZEALAND MARKETS
DISCIPLINARY TRIBUNAL

[x] March 2014

ANNOUNCEMENT OF NZ MARKETS DISCIPLINARY TRIBUNAL

PUBLIC CENSURE OF RAKON LIMITED BY THE NZ MARKETS DISCIPLINARY TRINUBAL FOR A BREACH OF NZX MAIN BOARD LISTING RULE 10.1.1

1. In a determination of the NZ Markets Disciplinary Tribunal (*the Tribunal*) dated 24 February 2014, the Tribunal found that Rakon Limited (*RAK*) breached NZX Main Board Listing Rule (*Rule*) 10.1.1.

2. What follows is a high level summary. The facts of this matter and the Tribunal's detailed reasoning are set out in its decision.

Background

3. Between March 2013 and early July 2013, RAK and Zhejiang East Crystal Electronic Co., Ltd (*ECEC*), an entity listed on the Shenzhen Stock Exchange, negotiated a possible joint venture and sale of shares in Rakon Crystal (Chengdu) Co., Ltd (*RCC*) (a company indirectly owned 85.4% by RAK) to ECEC. Details of the negotiations are contained in the Tribunal's decision on this matter.

4. The negotiations culminated in a Cooperation Framework Agreement (*the Agreement*) which expressed the "tentative" intention of RAK and ECEC to form a strategic partnership and set out the process the parties would follow in order to enter into a formal share transfer agreement.

5. Importantly for RAK, the Agreement provided that until ECEC paid a deposit of US$0.5 million, the Agreement was not legally binding. RAK submitted that this provision was deliberate - it wanted to be certain of ECEC's financial commitment to the transaction, given the protracted and difficult negotiations, before it became contractually bound and before an obligation arose to advise the market.

6. On 4 July 2013 both RAK and ECEC signed the Agreement, with the approval of the boards of both companies. The parties exchanged emails on the timing of the announcements to NZX and the Shenzhen Stock Exchange. This correspondence is detailed in the Tribunal's decision on this matter. RAK believed that the announcements would not be made until it had received the deposit from ECEC in its nominated Hong Kong bank account.

7. On 5 July 2013, NZX observed a significant price rise and increase in trading volume in RAK ordinary shares. Initial investigations by NZX found that ECEC had announced the Agreement to the Shenzhen Stock Exchange and that this information was publicly available online via Chinese media from 11:42 pm (NZST) on 4 July 2013. NZX contacted RAK, which was not aware that the announcement had been made in China. RAK ordinary shares were placed in a trading halt at

approximately 11.35 am on 5 July 2013 and at 12:17 pm on 5 July 2013, RAK announced details of the Agreement.

Determination

8. The Tribunal considered two key issues in this case:

   (a) the correct interpretation of Rule 10.1.1(a)(iii)(B); and

   (b) how the Rules applied in this instance.

Interpretation of Rules

9. The obligation to disclose Material Information to the market immediately is a fundamental obligation placed on Issuers under the Rules. The Rules are intended to ensure that the market is informed of relevant information at all times, that New Zealand's listed capital markets are efficient, transparent and fair, and that there is equality of information in the market.

10. The presumption in the Rules is that Material Information must be immediately released unless an exception applies. Footnote 10 to Rule 10.1.1 notes that "*An Issuer should also be guided by the principle that if in doubt it should disclose the information*".

11. The Rules permit some exceptions to the fundamental obligation to disclose, known as the "safe harbour" provisions. The exception in Rule 10.1.1(a)(iii)(B) of "an incomplete negotiation or proposal" is intended to ensure that parties are not forced to disclose information to the market at a time when it may prejudice ongoing negotiations and to ensure that a proposal is not required to be announced prematurely, which could mislead the market or cause uncertainty.

12. In the Tribunal's view, a proposal or negotiation can be complete for the purposes of Rule 10.1.1(a)(iii)(B) before it becomes legally binding.

13. The Rules do not explicitly require a legally binding commitment. The language used within the exception contemplates a broader range of situations where a proposal or negotiation may be complete.

14. The Tribunal notes that it is important to ensure that the Rules are interpreted with reasonable consistency and predictability and that there is a "clear line" to inform Issuers on when disclosure is required. Generally speaking, this "clear line" is when both parties sign an agreement.

Application of the Rules

15. Both parties agreed that the Agreement was Material Information and that, as soon as details of the Agreement were made public via Chinese media on 4 July 2013, confidentiality was lost and disclosure of the Agreement by RAK to NZX was required.

16. The matter on which NZX and RAK disagreed is whether the Agreement had ceased to be "an incomplete proposal or negotiation" before it was announced by ECEC.

17. NZX contended that, at the point the Agreement was signed by both RAK and ECEC, it ceased to be "an incomplete proposal or negotiation" and should therefore have been announced. RAK contended that the Agreement was "incomplete" up until the time the deposit was paid because until that time the Agreement was not legally binding.

18. The Tribunal found that the Agreement was complete at the time of execution by the parties on the evening of 4th July 2013, and was required to be immediately disclosed by RAK at that time – in practice this should have occurred before the market opened in New Zealand on 5 July 2013.

19. The Tribunal noted that the Agreement was unusual (RAK submitted that both parties had the right to re-open negotiations up until the time the deposit was paid). However, the Tribunal considered that the Agreement was complete at the time of execution by both parties. While the payment by ECEC of the deposit was required in order for the Agreement to become "legally binding", the Tribunal considered that the Agreement was nevertheless "complete" for the purposes of Rule 10.1.1(a)(iii)(B), as reflected by the approval of both boards and the execution of the Agreement by both parties.

Penalty

20. In determining the appropriate penalty to impose the Tribunal considered the matters prescribed in Tribunal Rule 11.16.1, including the conduct of RAK over the previous 24 month period, the severity of the matter, any benefit obtained or detriment suffered as a consequence of the breach, the reputational impact of the penalty being imposed and any other mitigating factors.

Conduct of RAK

21. There was no suggestion that RAK deliberately breached the Rules. RAK considered that, until the deposit was received in cleared funds, no disclosure was required. It was mindful of its obligations under the Rules and sought to ensure a co-ordinated release of announcements with ECEC upon its receipt of the deposit. The Tribunal notes that, as soon as RAK was advised by NZX that the Agreement had been announced by ECEC, RAK took the appropriate steps and released an announcement as required. The Tribunal also notes that this is the first occasion a breach by RAK has been referred to the Tribunal.

22. RAK submitted that the uncertainty as to whether ECEC would pay the deposit meant that announcing the Agreement before it was paid could have misled the market. However, the Tribunal considered that an announcement could have been worded appropriately to ensure the market was aware of the deposit requirement.

23. RAK advised the Tribunal that the Agreement was governed by the laws of the People's Republic of China (*PRC*), but that it had not sought any advice in relation to PRC law, including on when the Agreement would become legally effective under that law. It also appears that RAK did not make any enquiries of ECEC as to ECEC's disclosure obligations under the rules of the Shenzhen Stock Exchange.

Severity of the breach

24. Any breach of the continuous disclosure provisions of the Rules is a very serious matter and any such breach should be considered severe. Such a breach falls

within penalty band 6 of the Tribunal's Procedures, indicating that a penalty of up to $250,000 for a matter considered under the Summary Hearing Procedure is appropriate.

25. The Tribunal notes that the duration of the breach – around 1.5 hours – was particularly short. However, this was due to NZX having discovered the online Chinese media reports, rather than any precautionary measures taken by RAK to ensure it became aware of any leaks.

26. The Tribunal also notes that the information was particularly "material", with the sale of the RCC shares constituting a significant transaction which required RAK shareholder approval under the Rules.

Benefit obtained/detriment suffered

27. RAK submitted that any potential detriment to RAK shareholders was small. The Tribunal was not provided with trading information in order to determine the total possible loss, but accepted this amount was unlikely to have been significant.

Reputational Impact

28. The Tribunal notes that any ruling against an Issuer is likely to be detrimental to its market reputation. The Tribunal takes its responsibilities very seriously and is very mindful of the possible consequences to an Issuer of adverse findings.

Other mitigating factors

29. RAK submitted that it has and had internal processes in place to ensure compliance with Rule 10.1.1. The Tribunal noted that it was clear that RAK's senior management and Board were aware of the need to announce the Agreement and sought to manage the timing of the announcements by RAK and ECEC.

Penalties

30. The Tribunal imposed the following penalties:

    (a) A public censure in the form of this announcement;

    (b) An order that RAK pay $30,000;

    (c) An order that RAK pay the actual costs and expenses incurred by the Tribunal; and

    (d) An order that RAK pay the actual costs and expenses incurred by NZX.

The Tribunal

31. The Tribunal is a disciplinary body independent of NZX and its subsidiaries. The Financial Markets Authority approves its members. Under the Tribunal Rules, the Tribunal determines and imposes penalties for referrals made to it by NZX in relation to the conduct of parties regulated by the market rules.