



5 March 2014

## **ANNOUNCEMENT OF NZ MARKETS DISCIPLINARY TRIBUNAL**

### **PUBLIC CENSURE OF RAKON LIMITED BY THE NZ MARKETS DISCIPLINARY TRIBUNAL 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.