IN NZ MARKETS DISCIPLINARY TRIBUNAL
SUMMARY HEARING PROCEDURE **NZMDT 09/2013**

UNDER	the NZ Markets Disciplinary Tribunal Rules
IN THE MATTER OF	breach of NZSX Listing Rule 10.5.1
BETWEEN	**NZX LIMITED**
AND	**VETILOT LIMITED** Respondent

DETERMINATION OF NZ MARKETS DISCIPLINARY TRIBUNAL
17 JANUARY 2014

NEW ZEALAND MARKETS DISCIPLINARY TRIBUNAL

Stephen Layburn
Executive Counsel
NZ Markets Disciplinary Tribunal
Email:
stephen@stephenlayburn.co.nz

1. This is a determination of a division of the NZ Markets Disciplinary Tribunal (*the Tribunal*) comprising Andrew Beck (division chairman), Susan Peterson and Christopher Swasbrook.

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

Background

3. Vetilot Limited (*VET*) is an Issuer Listed on the NZAX and is bound by the Rules.

4. Rule 10.5.1 requires an Issuer listed on the NZAX Market to release its annual report to the market within four months of its financial year end. VET's 2013 financial year ended on 31 March 2013. VET was therefore required to release its annual report by 31 July 2013.

5. VET released its annual report to the market on 15 August 2013, in breach of Rule 10.5.1.

6. On 1 August 2013, NZX Regulation (*NZXR*) advised that, in accordance with the policy set out in Footnote 2 of Rule 5.4.3, that if VET did not issue its annual report within 7 Business Days of the due date (being market close on 7 August 2013), quotation of VET's securities would be suspended effective from the commencement of trading on 8 August 2013 until the Issuer had issued its annual report.

7. On 8 August 2013, NZXR suspended trading in VET's securities in accordance with footnote 2(b) of Rule 5.4.3.

8. On 13 August 2013, NZX wrote to VET noting that it was imperative that VET provide the annual report to the market as soon as possible, and asking VET to explain why there had been a delay in providing the annual report. No response was received to that letter, despite NZX following up with VET on multiple occasions, both by e-mail and telephone.

9. On 15 August 2013, VET released its annual report to the market. Shortly thereafter, the suspension in trading VET's securities was lifted and trading in VET's ordinary shares resumed the same day.

10. On 26 September 2013, NZX sent a second letter to VET. That letter recorded that NZX had not received a response to its letter of 13 August 2013, and sought an explanation as to why there had been a delay in providing the annual report.

11. On 19 October 2013, NZX received a response from VET explaining that the company had disposed of its operating assets and placed a number of its subsidiaries in liquidation during the course of the financial year and that, during the completion of the annual report, some issues arose that required additional work. According to VET, this work could not be completed by due date. It was also noted that there was no change in the principal financial statements from the disclosure made in VET's preliminary announcement on 14 June 2013.

12. On 17 October 2013, NZX wrote to VET notifying the company that NZX had determined to refer the breach of rule 10.5.1 to the Tribunal. That letter asked VET to provide any additional information it considered would be

helpful for NZX to consider. To date, no response has been received by NZX to that letter.

13. NZX served a statement of case on VET on 6 December 2013 relating to the alleged breach of Rule 10.5.1.

Rule 10.5.1

14. Rule 10.5.1 provides that:

> "Subject to Rule 10.5.2 each NZAX Issuer shall within four months of the end of each Issuer's financial years:
>
> (a) Deliver to NZX electronically, in the format specified by NZX from time to time; and
>
> (b) Make available to each Quoted Security holder in accordance with Rule 10.5.3,
>
> an annual report. That annual report shall be delivered to NZX before or at the same time as it is made available to Quoted Security holders in accordance with Rule 10.5.3, and shall contain all information:
>
> (c) required by law;
>
> (d) required in a preliminary announcement by Rule 10.4.2; and
>
> (e) required by Rules 10.5.4. and 10.5.7.
>
> The financial statements in that annual report shall be audited and shall be accompanied by an audit report in accordance with the requirements of the Financial Reporting Act 1993."

15. There is no dispute that VET has breached Rule 10.5.1. The only issue for the Tribunal is the appropriate penalty to be imposed on VET as a result.

Submissions

16. In its statement of case, NZX submitted that VET's conduct is with the middle range of the spectrum of conduct falling within Penalty Band 6 and that, in considering the appropriate penalty for the breach of Rule 10.5.1, a mitigating factor was that the breach only continued for approximately 2 weeks.

17. NZX's statement of case also submitted that VET's offending was aggravated by:

    a. the delay in releasing the annual report with the result that the market was uninformed for approximately 2 weeks, and trading in VET's securities was suspended for approximately one week;

    b. VET failing to provide an update or explanation to the market concerning the delay in finalising the annual report;

    c. the inadequacy of VETs explanation for the delay in meeting its periodic reporting obligations;

    d. the absence of any response to NZX's letter of 13 August 2013 despite NZX following up with VET on multiple occasions; and

e. the fact that VET (or Investment Research Group Limited as it then was called) has previously been the subject of disciplinary action by the Tribunal for failure to meet its periodic reporting obligations in 2010.

18. Having regard to previous decisions of the Tribunal, NZX sought an order censuring VET, a fine of $30,000 and an order that VET pay the costs of both NZX and the Tribunal.

Discussion

19. As this Division has noted in a number of recent decisions including:

    a. *NZX* v *Cynotech Holdings Limited* (9 February 2011*);*

    b. *NZX v Investment Research Group Limited* (7 March 2011);

    c. *NZX* v Insured Group *Limited* (1 March 2013*)*; and

    d. *NZX* v RIS Group Limited (1 March 2013*)*,

    the Tribunal has repeatedly stressed the vital importance of compliance with periodic reporting requirements, and Rule 10.5.1 in particular. These rules ensure that relevant and reliable financial information is made available to the market soon after the end of each listed issuer's financial year. It also mitigates the risks posed by information imbalance, where those "inside" an Issuer are in possession of better information about its financial position than the wider market.

20. In addition, any trading halt - particularly one which lasts for weeks - arising from uncertainty surrounding an issuer's financial position damages the market's integrity. The primary purpose of an exchange is to provide facilities for investors in listed issuers to trade their securities. Trading halts undermine the fundamental purpose of the exchange and deny securityholders one of the key benefits that investing in a listed issuer otherwise provides. In the present case, investors were "trapped" into retaining their VET shares (albeit for approximately 2 weeks) because of the company's failure to comply with the Rules.

21. It follows that breaches of (especially) Rule 10.5.1 are always serious, particularly where they result in the suspension of trading in an issuer's securities.

22. NZX submitted that VET's offending falls in the middle range of the spectrum for breaches of this Rule. This case falls within Penalty Band 6 of Procedure 11.3.1 of the *NZ Markets Disciplinary Tribunal Rules Procedures,* which means that on a summary hearing the maximum fine the Tribunal can impose is $250,000.

23. The Tribunal has imposed heavy fines for breaches of the rule in recent years, with fines of up to $65,000 for breaches of Rule 10.5.1. Cases where fines have exceeded $40,000 have tended to be accompanied by aggravating factors (including, in some cases, an ongoing failure to file an annual report, even many months later when the Tribunal came to consider the case).

24. For straightforward breaches of periodic reporting requirements which have later been remedied, the fines imposed by the Tribunal have ranged from $7,500 to $25,000. Obviously, no two cases are the same, and penalties cannot be calculated mathematically. The Tribunal's task is to make a broad assessment of the seriousness of the offending and the context in which it arose, and to impose a penalty which reflects this.

25. The smallest fine for a breach of Rule 10.5.1 was imposed in the Property Finance Group Limited (*PFG*) case in 2009. PFG's annual report was due on 31 July 2008, but was not provided until 8 September 2008. There were a number of critical mitigating factors. NZX accepted that PFG was having substantial difficulty sourcing data from the trustee for its mortgage securitisation trusts, notwithstanding its best efforts to obtain this information. The Tribunal accepted that this was the primary cause of the breach, and approved a settlement in which PFG was fined $7,500.

26. In 2010, PFG was before the Tribunal again. It admitted that in 2009 it committed a virtually identical breach to the one it committed in 2008. On the second occasion, its preliminary announcement was outstanding for 6-7 weeks, and its annual report remained outstanding for around $2_{1/2}$ months. PFG had sought a waiver, and kept its shareholders and the wider market informed throughout. The Tribunal accepted that these were important mitigating factors – along with the fact that the breaches were, again, primarily caused by the "actions (or inactions) of two trustees with whom [PFG] was dealing". The Tribunal accepted that the initial breaches were largely outside PFG's control, though it agreed that PFG had demonstrated a lack of urgency in remedying the breaches once they occurred. Consequently, it fined PFG $12,500, censured it and ordered it to pay costs. It regarded the offending as comparable to the 2008 breaches, with a $5,000 increase in the fine to reflect the fact that this was the second time in two years that PFG had breached the periodic reporting rules.

27. In the Cooks Food Group Limited (*CFG) case* in 2009, the company's breach of Rule 10.5.1 ran from 1 August to 6 November 2009. The Tribunal found that CFG showed a lack of urgency in remedying its breach, a factor which was particularly important as the annual report, when it was filed, showed material differences between the company's position as disclosed in its preliminary announcement on 16 June 2009, and that disclosed in the audited financial statements. In that determination, the Tribunal reaffirmed that a prolonged trading halt in response to a breach of periodic reporting rules always damages the market's integrity. It also held that CFG's breach was aggravated by its failure to communicate with the market following its initial advice that the report would be available in the week commencing 17 August 2009. As a result, CFG was censured, ordered to pay costs, and fined $25,000.

28. The next case was that relating to Cynotech Holdings Limited (*CYT*) in 2011 in which the Tribunal fined the company $15,000 for a straightforward breach of Rule 10.5.1 which lasted approximately four weeks, with a trading halt of around three weeks. There was no breach of Rule 10.4.1. That case had few serious aggravating factors, but there were some mitigating factors in the company's favour. The Tribunal took account of the size of the company and the relative brevity of the breach, but concluded that a breach which was largely the

result of poor planning and organisation, and which resulted in a 2-3 week trading halt, needed to be marked with a meaningful sanction. The $15,000 fine was designed both to stress the importance of compliance with these rules, and to ensure that companies do not form the view that periodic reporting requirements can be overlooked with any measure of impunity.

29. NZX has submitted that the most relevant determinations are the previous IRG determination and the two determinations from 2013:

    a. *NZX v Investment Research Group Limited* (*IRG*) (7 March 2011) – in which IRG was found to have breached NZAX Listing Rules 10.4.1 and 10.5.1 by failing to provide its preliminary and annual reports by the required time. IRG was ordered to pay the NZX Discipline Fund $25,000 as a penalty for the breach of 10.4.1 and 10.5.1.

    b. *NZX Limited v Insured Group Limited* (*INS*) (1 March 2013) – in which INS was found to have breached NZSX Listing Rule 10.5.1 by failing to provide its 2012 annual report within three months of its financial year-end. INS was ordered to pay the NZX Discipline Fund $45,000 as a penalty for the breach of 10.5.1.

    c. *NZX Limited v RIS Group Limited* (*RIS*) (1 March 2013) – in which RIS was found to have breached NZAX Listing Rule 10.5.1 by failing to provide its 2013 annual report within four months of its financial year-end. RIS was ordered to pay the NZX Discipline Fund $40,000 as a penalty for the breach of 10.5.1.

The present case

30. As noted above, the only mitigating factor in favour of VET is that the breach continued for approximately two weeks. By contrast, NZX in its submissions, suggested that the following aggravating factors are relevant:

    a. The annual report was due to be released by 31 July 2013 but was released to the market on 15 August 2013. Accordingly the market was uninformed for approximately two weeks, and trading in VET was suspended for approximately one week.

    b. VET did not provide an update or explanation to the market concerning the delay in finalising the annual report. The Tribunal has previously noted that it expects Issuers who are going to miss a financial reporting deadline, to notify NZX and the market of a likely delay as soon as it becomes apparent.

    c. VET's explanation is that the delay was a result of VET disposing of its operating assets and placing a number of its subsidiaries into liquidation in the financial year ended 31 March 2013. NZX does not consider this to be a sufficient explanation for VET failing to meet its periodic reporting obligations.

    d. NZX first wrote to VET in respect of the Annual Report on 13 August 2013. VET did not provide a response to that letter, despite NZX following up with VET on multiple occasions (via both email and phone).

e. VET (or IRG as it then was) has already been the subject of disciplinary action by the Tribunal for breaches of obligations under the Rules with respect to periodic reporting.

31. It appears to be a recurring theme in NZXR's dealing with VET (and IRG, as it then was) that both during the period of its default and subsequently, there has been very little provided by the company by way of detailed information which might allow investors, NZX or the Tribunal to gain a clear picture of why the company breached its periodic reporting obligations under the Rules, or when those breaches might be resolved. In the present case, all that was provided, after much prompting from NZX and long after the event, was a short (one-paragraph) statement that the company had disposed of its operating assets and placed a number of its subsidiaries in liquidation during the course of the financial year and that, during the completion of the annual report, some issues arose that required additional work. According to VET, this work could not be completed by due date. There was, for example, no explanation why it was unable to address these issues at any point in the four months between the end of the financial year and the final date for the release of its annual report (or at least signal to NZX and the market that these issues had arisen and provide some form of best estimate when they might be resolved).

32. In the absence of a compelling explanation for these breaches, the repeat nature of the breaches and the expectation of the Tribunal that the current board members of VET should have knowledge of the obligations of an Issuer, leads the Tribunal to the conclusion that VET should be even more alert to the possibility of a breach of the Rules, and of the need to respond accordingly.

33. In the March 2011 determination, the Tribunal concluded that the company was entitled to credit for the fact that it made a number of announcements to the market while it was in breach of the rules (although that credit was tempered by the fact that in each case the company was unable to meet the assurances it gave about compliance). Consequently, the Tribunal repeats its earlier warnings that it is critical, if companies do fall into breach, that they inform the market in an open and frank way of the difficulties they are encountering.

34. As was the case in the March 2011 determination, VET has offered no explanation for its failure, prior to or during its breach. The Tribunal finds that failure difficult to understand. As previously noted, the Rules provide a clear mechanism for companies which are encountering difficulties in meeting their reporting obligations to bring these to the attention of NZX, and to seek, in a transparent fashion, more time to comply. And even an unsuccessful waiver application, if made in a timely fashion, will be regarded as a mitigating factor if the company is later charged. Given that it had been before the Tribunal for a similar breach a little over 18 months ago, VET's failure to seek a waiver is difficult to understand.

35. As has been stated in a number of the determinations referred to above, it is of particular importance that a listed Issuer's reporting deadlines are met. Delays in the provision of material information, or audited financial statements, are likely to unnerve investors and damage confidence both in the Issuer's securities and in the market's

integrity. This loss of confidence will be severely exacerbated where the absence of information is accompanied by a trading halt which lasts for any extended period.

36. In light of all of these factors, and particularly because of the facts that:

    a. the company is a repeat offender; and

    b. there is an apparent pattern of failing to notify NZX in advance of a likely episode of non-compliance and a complete absence of any meaningful explanation while that default continues,

    the Tribunal agrees with NZX's assessment that the present breach fall in middle range of the spectrum of conduct falling within Penalty Band 6. However, the Tribunal disagrees that a $5,000 increment for a repeat offence is adequate. The only mitigating factor is the relatively short time during which the breach continued. Consequently, the Tribunal regards VET's offending as more serious. It is important that any repeat breach of the periodic reporting obligations in the Rules which results in a trading halt be addressed in a manner that signals very clearly to both the Issuer concerned and the market generally, that repeat offending is viewed most unfavourably.

37. It is unusual, although not unheard of, for the Tribunal to impose a penalty greater than that sought by NZX. The Tribunal has given this matter careful consideration, but is convinced that the $30,000 sought by NZX would not adequately reflect the seriousness of VET's offending, particularly when regard is had to both other recent Tribunal decisions and the aggravating factors referred to above. As noted above, larger fines have been imposed where the default continued for much longer periods. However, the aggravating factors (particularly that this is a second offence of the same type and the repeat pattern of a lack of any update or explanation) make VET's offending significantly more serious than just a two-week delay.

38. The Tribunal also repeats its comments made when the company was previously before the Tribunal (in the IRG determination in March 2011) referring to *NZX v Dominion Finance Holdings Ltd* (26 September 2008) are relevant:

> "[The Tribunal] notes that these rules are fundamental to the integrity of the market and to achieving fairness and equity for all investors. The deadlines provided in the Rules exist in part to compel issuers to confront adverse circumstances efficiently. In the present case that was not done. The penalty to be imposed must, therefore, reflect the seriousness of the breach."

39. Also, for completeness, the Tribunal notes that it has considered the point that was raised in submissions by (then) IRG in March 2011 that markets expect occasional hiccups from small public companies and make allowances for their circumstance. As noted in the IRG determination in March 2011, it is impossible to determine whether VET was a victim of circumstances in this case (and therefore should be allowed any indulgence on the basis of its small size and relative lack of

resources), given the almost total absence of any information which might allow NZX or the Tribunal to understand the reasons for the delay in compliance. Instead, the Tribunal notes that the Rules serve a critical purpose, which includes ensuring a regular and transparent flow of accurate information to shareholders and potential investors. The periodic reporting requirements are essential to maintaining investor confidence and with it the integrity of the market. It would bring the market into disrepute if NZX or the Tribunal signalled that they were prepared to excuse, or minimise, breaches of provisions as fundamental as these.

Appropriate penalty

40. Having regard to the range of penalties imposed in other cases, its assessment of the seriousness of the breach and the size of VET, the Tribunal has determined that the appropriate starting point for a fine for a breach of Rule 10.5.1 is now $30,000.

41. In the present case a $30,000 fine is regarded by the Tribunal as lenient when the aggravating factors affecting VET's conduct are considered. Whilst some other cases have involved much longer trading halts, such as those noted in paragraph 29 above, the Tribunal considers that the aggravating factors, particularly those of repeat offending, the absence of market updates or explanations and the failure to respond to NZX enquiries in this case make it broadly comparable with those where larger fines were imposed.

42. In this case, the fact that the breach continued for approximately two weeks (when compared with continuing breaches of several months) and VET's relatively small size are the only factors that stand in the way of imposing a fine that would have been higher.

43. The Tribunal is also troubled by VET's lack of response to NZX's statement of case and the apparent parallels with the standard of responding by the (then) IRG determination in March 2011.

44. As a result, the Tribunal imposes the following penalties:

    a. A **public censure** in the form of an announcement by the Tribunal to the market that VET has breached Rule 10.5.1 and is censured by the Tribunal accordingly;

    b. An order that VET pay to NZX Discipline Fund, within 20 Business Days of the date of this decision, the **sum of $40,000** by way of penalty;

    c. An **order** that VET, within 20 Business Days of the date of an invoice from NZX, the actual costs and expenses incurred by the Tribunal (plus GST) in considering this matter; and

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

Publication of Decision

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

Conclusion

46. The Tribunal has previously noted that there have been too many periodic reporting failures coming before the Tribunal. Penalty Band 6 of Procedure 11.3.1 of the *NZ Markets Disciplinary Tribunal Rules Procedures* enables a maximum fine of $250,000 on a summary hearing. The Tribunal has imposed fines of up to $65,000 for breaches of Rule 10.5.1 alone. The Tribunal is concerned that, notwithstanding the escalating trend in the penalties being imposed, they appear to be proving insufficient to deter this sort of offending, and are contrary to the interests of the market and the public. Consequently, it must again note that future offenders should expect that their conduct will be viewed by the Tribunal with displeasure and that they should not expect leniency.

Default Determination

47. Under Tribunal 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.

48. In its statement of case, NZX advised the Tribunal that it considered this matter appropriate for the Summary Hearing Procedure because the issues involved were not complex and VET was clearly in breach of the Rules.

49. However, on 13 January 2014, the Tribunal received a further application from NZX to the effect that because VET had not provided a statement of response or applied for an extension of time to file a statement of response, the matter should be dealt with by way of a default determination under Tribunal Rule 4.7.

50. The Tribunal agrees that a default determination is the appropriate manner for dealing with this matter.

Question for NZX

51. Finally, as a separate issue and not as a part of the determination the Tribunal asks whether the facts of this matter raise an issue for NZX to consider a policy as to its response to serial offending involving similar facts by the same Issuer. The Tribunal recommends that NZX should consider whether such a pattern of conduct is a matter that triggers a need for further remedial action, either by way of direct dialogue with the board of directors of the Issuer or by way of review of the listing of the Issuer and the quotation of its securities. The Tribunal also suggests that the drivers for taking such a proactive approach are, if anything, amplified in the case of "shell" companies. Specifically, it is important that need for compliance must be actively encouraged not only to ensure market integrity but also to maintain another mechanism for businesses to list without the cost of an IPO.

DATED 17 January 2014

Andrew Beck, Division Chairman, NZ Markets Disciplinary Tribunal