



Hong Kong Law

7 February 2014

## EXCHANGE PUBLISHES DECISION ON BREACH OF LISTING RULES IN RELATION TO PRICE SENSITIVE INFORMATION

### Introduction

On 28 January 2014, the Exchange published a press release in relation to the censure of a listed company (**Company**) and its directors for breach of Rule 13.09 of the Listing Rules as previously in force prior to the Listing Rule Amendments consequential on the new statutory regime for price-sensitive information disclosure (**Old Rule 13.09**)<sup>1</sup> and the director's undertaking to the Exchange as set out in Appendix 5 to the Listing Rules (**Undertaking**).

One of the important points to note is that the non-executive director (**NED**) and independent non-executive directors (**INEDs**) of the Company were also publicly censured by the Exchange for breach of their respective undertakings to use best endeavours to procure the Company's compliance with Old Rule 13.09. The Listing Committee was particularly critical of the non-executive directors' failure to proactively monitor the Company's financial performance after being made aware of its deterioration. It also criticized the Company's failure to seek professional advice.

The Listing Committee's decision was based on Old Rule 13.09. However, the decision may shed light on how the Securities and Futures Commission (**SFC**) and the Market Misconduct Tribunal (**MMT**) will implement and interpret the statutory regime for inside information in the future.

### Chronology

The following table briefly sets out the facts on which the Listing Committee's decision was based.

Date	Events
26 Aug 2011	The Company announced its results for the 6 months ended 30 June 2011 (1H2011 and 1H2011 Results respectively). The 1H2011 Results showed a decreasing trend in gross profit margin.
19 Sep 2011	The board of the Company discussed the trend as shown in 1H2011 Results.

<sup>1</sup> Following the statutory regime for disclosure of price sensitive information (known as "inside information" in the new regime) effective on 1 January 2013, Rules 13.09(a) & (c) of the Old Rule 13.09 were deleted in their entirety and "inside information" was defined under section 307A of the Securities and Futures Ordinance (SFO).

15 Nov 2011	The monthly management accounts of the Company (Management Accounts) for October 2011 were circulated to the executive directors, which had recorded a net loss for each of the 3 consecutive months since August 2011.
15 Dec 2011	The Management Accounts for November 2011 were circulated to the executive directors, which had recorded a net loss for each of the 4 consecutive months since August 2011.
29 Dec 2011	The directors of the Company were briefed in respect of the latest decreasing trend in gross profit margin.
12 Jan 2012	The Company finished the first draft impairment test (Impairment Test) for its intangible asset, which suggested that an impairment loss of \$328 million would be expected.
15 Jan 2012	The Management Accounts for December 2011 were circulated to the executive directors, which showed that the Company would record a net loss of about \$237.4 million for the year ended 31 December 2011 (FY2011).
Mid-Jan 2012	The executive directors of the Company discussed the Impairment Test results.
2 Feb 2012	The executive directors of the Company had the first draft of the Company's consolidated Management Accounts for the financial year ended 31 December 2011 (FY2011 Accounts).
Mid-Feb 2012	The NEDs and INEDs of the Company were briefed on the decreasing trend in gross profit margin and the Impairment Test.
27 Feb 2012	The second draft of the FY2011 Accounts was available to the Company.
6 Mar 2012	The Company issued a profit warning announcement (PWA) stating that it expected to record a loss for FY2011 as compared to a profit for FY2010.
28 Mar 2012	The Company announced its FY2011 results which recorded a loss of \$483.3 million for FY2011, including an impairment loss of \$435 million.

## **Breach of Old Rule 13.09 by the Company**

### Reasons for the Listing Committee's findings of breach

#### *Lack of information in the public domain*

The Listing Committee found that the Company did not indicate in its 1H2011 interim report or any other announcements during the second half of 2011 (**2H2011**) to the market that there was a possibility that it would suffer a further and significant deterioration in its financial performance during 2H2011, despite the fact that deterioration signals in the Company's financial performance had already been shown in 1H2011 Results.

#### *Significant further deterioration in the Company's financial performance during 2H2011*

The Listing Committee found that there was significant further deterioration in 2H2011. In particular,

- Revenue dropped 27.3% from 1H2011 to 2H2011;

- A gross loss of \$2.5 million for 2H2011 was recorded, in contrast with the gross profit of \$180.4 million for 1H2011, representing a drop of 101.4%;
- Administrative expense for 2H2011 increased 32.9% from 1H2011;
- An impairment loss of \$435 million was recorded for 2H2011

The Listing Committee ruled that the magnitude of the above deterioration was significant and was not within expectation based on information in the public domain at the material time.

*The Company's failure to disclose the information in relation to the deterioration*

The Listing Committee concluded that timely disclosure of the information in relation to the deterioration was required under Old Rule 13.09, without which the market would reasonably have expected that the Company's financial performance for 2H2011 and hence for FY2011 would not significantly deviate from the 1H2011 Results.

In particular, the Listing Committee concluded that the Company's disclosure obligation arose on the following occasions:

- On 15 November 2011, when the Management Accounts of the Company were circulated to the executive directors;
- On 15 December 2011, when the Management Accounts of the Company were circulated to the executive directors, which further suggested that there had been no improvement since the previous month;
- On 12 January 2012, when the Company finished the Impairment Test and was aware of the estimated impairment loss;
- Mid-January 2012, when the executive directors of the Company were aware of the possible net loss for FY2011 and the impairment loss as shown in the Impairment Test;
- 2 February 2012, when the executive directors of the Company received the first draft of the FY2011 Accounts which showed that the Company's full-year net profit was much less than that of 2010 and would be insufficient to cover the proposed amount of the impairment loss (estimated to be \$328 million at that time);
- Mid-February 2012, when the NEDs and INEDs of the Company were made aware of the deterioration in the Company's financial performance; and
- 27 February 2012, when the second draft of the FY2011 Accounts was available to the Company, which recorded \$75.6 million loss for FY2011 even before taking into account the impairment loss to be determined.

*The information was price-sensitive*

Under Old Rule 13.09, the information:

- a) Was necessary to enable shareholders and the public to appraise the position of the Company; and
- b) Might be reasonably expected to materially to affect market activity in and the price of its securities

On the next trading day after the issue of the PWA, the Company's share price dropped about 7.5% and at close 5.7%. The trading volume increased 1.143 times more than the previous 10-day average.

On the day of the Company's announcement of FY2011 results, the Company's share price dropped 37.6% and at close 16.5%. The trading volume increased 12.6 times more than the past 10-day average.

## Breach of directors' undertaking

As a result of the Company's breach of Old Rule 13.09, the Listing Committee also concluded that the directors of the Company breached the Undertaking given by them to the Exchange.

### Executive directors

The Listing Committee noted that the executive directors received the Company's Management Accounts on the 15<sup>th</sup> day of each month and they were therefore aware of the Company's financial deterioration in 2H2011. The director's undertaking includes an undertaking to use best endeavours to procure that the issuer complies with the Listing Rules. The Listing Committee concluded that in the period from 15 November 2011 (after receipt of the October 2011 Management Accounts) to 6 March 2012, the use of "best endeavours" would have required the executive directors to:

- Bring the financial deterioration for 2H2011 and the first draft Impairment Test results to the attention of the entire board for discussion of the Rule implications and compliance earlier than they did in mid-February 2012;
- Procure the Company to consult external professional advisers or the Exchange as to the Company's Old Rule 13.09 obligations arising from the financial deterioration; and
- Take steps to procure disclosure under Old Rule 13.09 earlier than they did with the publication of the PWA only on 6 March 2012.

### NED and INEDs

Although the NED and INEDs did not receive the Company's Management Accounts for 2H2011, the Listing Committee found that they were nevertheless aware of the decreasing trend in gross profit margin at the board meeting on 26 August 2011 approving the announcement of 1H2011 Results and were updated at the board meetings on 19 September 2011 and 29 December 2011. Further, the NED and INEDs had known for certain about the significant deterioration in the Company's performance for FY2011 by mid-February 2012.

In view of the signs of deterioration which the NED and INEDs were aware of, they should have:

- Proactively asked the management for more detailed financial information of the Company;
- Proactively monitored and kept themselves regularly informed of the Company's financial performance during 2H2011 and sought professional advice if appropriate;
- Ensured that the Company complied with its Rule obligations especially under Old Rule 13.09 in a timely manner; and
- Procured the publication of the PWA as soon as reasonably practicable

In general, the Listing Committee commented that the conduct of the NEDs and INEDs demonstrated a lack of proactivity on their part.

It should be noted that under Appendix 14 "Corporate Governance Code and Corporate Governance Report" to the Listing Rules, NEDs and INEDs are required to demonstrate the same duties of care and skill and fiduciary duties as executive directors. Amongst other things, they are required to:

- Participate in board meetings to bring an independent judgement to bear on issues of strategy, policy, performance, accountability, standards of conduct etc.;

- Scrutinise the Company's performance in achieving agreed corporate goals and monitoring performance reporting;
- Give sufficient time and attention to the Company's affairs;
- Give the board the benefit of their skills, expertise and qualifications through regular attendance and active participation; and
- Make a positive contribution to the development of the Company's strategy and policies through independent, constructive and informed comments.

## Seriousness of the breach

The Listing Committee considered the breaches by the Company and the directors serious for the following reasons:

- The signals indicating deterioration were obvious, significant and discoverable throughout 2H2011 or shortly after the year-end;
- The delay in disclosing the further significant deterioration for 2H2011 by way of the PWA was at least 1 month and 22 days from the date of the Management Accounts for December 2011 (i.e. 15 January 2012);
- Over the delay, there were a number of occasions on which the directors could have taken steps to inform the market;
- At no time did the Company seek professional advice in respect of its Old Rule 13.09 obligations;
- Between the dates when the disclosure obligations arose and when the PWA was published, there was trading in the Company's shares (i.e. there was no suspension of trading); and
- The conduct and lack of action by the directors suggested a serious failure on their part to understand the Company's obligations and the actions required of them personally in due performance of the Undertaking.

## Sanctions

With regard to the seriousness of the breaches as discussed, the Listing Committee:

- Censured the Company for breaching Old Rule 13.09(1)
- Censured the executive directors for breach of their undertaking
- Publicly criticized the NED and the INEDs for breach of their undertaking;
- Directed the Company to appoint an independent Compliance Adviser<sup>2</sup> on an ongoing basis for consultation on compliance with the Listing Rules for 2 years;
- Required each of the Company's directors to attend 24 hours of training on Listing Rule compliance, director's duties and corporate governance matters (including 4 hours on Old Rule 13.09 compliance and the statutory regime for disclosure of inside information); and
- Required the Company to publish an announcement to confirm full compliance with the above directions.

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<sup>2</sup> As defined in Chapter 3A of the Listing Rules, being an entity licensed or registered under the SFO for Type 6 regulated activity

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