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FSA FINES LAMPRELL PLC FOR LISTING RULES BREACHES

The Final Notice issued to Lamprell plc on 15 March 2013 by the Financial Services Authority ("FSA") provides a timely reminder to listed companies of the consequences of non-compliance with their obligations under the Listing Rules. The size of the financial penalty imposed on Lamprell (£2,428,300) dwarfs those previously imposed in similar cases. Whilst the facts, as presented in the Final Notice, may be clear, there are important lessons to be learned by all listed companies and those who advise them.

Background

On 16 May 2012 Lamprell issued a profits warning. The announcement informed the market that, due to various operational issues, expected revenue and profit for the year would be substantially lower than the Board's original expectations. Lamprell's share price fell 57% as a result of the announcement.

The deterioration in Lamprell's financial performance in the early part of 2012 was caused by various operational issues. However, the FSA found that inadequacies in Lamprell's systems and controls meant that the company could not monitor the full impact of these operational issues on its financial performance for the year and Lamprell failed to inform the market of its deteriorating financial position in a timely way.

Specifically, the FSA identified a number of shortcomings in Lamprell's systems and controls:

- The information in the monthly board reports failed to consider properly the impact on the company's budget for the financial year of variances in project performance. The board reports showed project information as against each project's individual budget but did not focus on the financial performance of the project against the company's overall performance for the financial year. There was therefore a "serious disconnect".

- Similarly, there was no system in place which calculated the impact on the company's budget when an anticipated project was either not awarded within the expected timeframe or not awarded at all.

- There was no detailed assessment of staff utilisation rates to enable Lamprell to assess the impact that under-utilisation was having on financial performance.

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- Finally, in the first quarter of 2012, some financial reports were produced later than usual.

At the end of April 2012, the financial report for March was produced. In this report, year-to-date revenue was stated to be 31% behind budget and gross profit margin was 4.3% against a budgeted 10%. Senior management did not consider that this was "reflective of a problem…in meeting its overall budget for the year" for two reasons. First, the accounting methodology used by the company ("cost-to-complete") tended to produce "lumpy" results with large shifts in revenue and profit from month to month and second, the board reports did not indicate any unexpected operational or financial issues in major projects.

On 29 April 2012, a Q1 Re-forecast was circulated to certain members of senior management. Initially, this was considered to be unreliable because it was based on a new model and further work was carried out to verify the figures. This process resulted in the issue of the profits warning on 16 May 2012.

Breaches

Against this background, the FSA concluded that Lamprell had breached Listing Principle 2 (*A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations*). It also found that Lamprell had breached:

a. DTR 1.3.4R (*An issuer must take all reasonable care to ensure that any information it notifies to a RIS is not misleading, false or deceptive and does not omit anything likely to affect the import of the information*). Lamprell had made a number of announcements prior to the May profits warning which gave the market the impression that it was performing well operationally. However, as a result of the systems and controls failings, these announcements failed to inform the market of the Company's deteriorating financial position and performance. The breach of DTR 1.3.4R was therefore a "consequential breach" arising from the systems and control failings.

b. DTR 2.2.1R (*An issuer must notify a RIS as soon as possible of any inside information which directly concerns the issuer unless DTR 2.5.1R applies*). The FSA found that the information in the financial reports for January to March 2012 and the Q1 Re-forecast which had been received by senior management by 29 April 2012 was inside information. Lamprell breached DTR 2.2.1R by failing to release the inside information as soon as possible. It should, at least, have issued a holding announcement putting the market on notice of a potential change to its expected financial performance soon after that date.

c. LR Annex 1(R) paragraph 8 of the Model Code on directors' dealings in securities (the "Model Code") (*A restricted person must not be given clearance to deal in any securities of the company (a) during a prohibited period … A prohibited period includes any period when there exists any matter which constitutes inside information in relation to the company*). The existence of the inside information on 29 April 2012 meant that Lamprell was in a prohibited period for the purposes of the Model Code. However, clearance was given to persons discharging managerial responsibilities (PDMRs) in April and on 1 May and the PDMRs had continued to deal in Lamprell's shares including on 2 May. The Final Notice expressly states that no culpability attaches to the PDMRs.

Sanction

The FSA imposed a financial penalty of £2,428,300 on Lamprell which agreed to settle the enforcement proceedings at stage 1 and thus benefit from the 30% discount; otherwise, the financial penalty would have been £3,469,125.

Comments

Sanctions

This is the first Listing Rules case since the FSA introduced its 5 step framework for calculating financial penalties in 2010. The penalty was calculated as a percentage of Lamprell's market capitalisation "as it reflects the harm or risk of harm resulting from the breaches. The higher the shareholder value, the more investor money is at stake and the impact of a breach (and/or the risk arising from a breach) on shareholders and the overall market is greater." The possibility of using market capitalisation as a basis for calculating a financial penalty was signalled by the FSA at the time that the new framework was introduced.[1]

In determining the level of seriousness and thus the appropriate percentage to be used, the FSA considered Lamprell's breaches to be at the serious end of the spectrum because the breaches took place over a prolonged period, there was a risk of investors making decisions without accurate information and Lamprell had issued a series of announcements which had mis-informed the market. The FSA determined that, on a scale of 1 to 5, this was a level 4 case and the percentage to be applied was 0.375%.

An upward adjustment of 10% was then applied to the resulting figure to reflect the aggravating and mitigating factors. A serious aggravating factor was the fact that Lamprell had received a warning letter from the FSA highlighting concerns around its systems and controls for dealing with the release of inside information. This was only partially offset by the Company's "great degree of pro-active co-operation throughout the investigation" (which included paying for flights for individuals to attend interviews and providing the FSA with full access to its lawyers' investigation work) and other steps taken by the Company to remedy the problems.

In a stark warning, the FSA states that the "methodology sets a precedent going forward for similar breaches by listed companies and is expected to increase the level of financial penalties for these types of breaches".

Inside Information

In considering whether the information in the financial reports for January to March 2012 andQ1 Re-forecast was inside information, the FSA continued with its controversial approach to the interpretation of the definition of inside information.

Under the Financial Services and Markets Act 2000 ("FSMA"), for information to be inside information it must be

- precise;
- not generally available; and
- if it were generally available, it must be such as would be likely to have a significant effect on the price of the relevant investment (the "significant effect test").

The FSA's approach is to consider that the significant effect test is satisfied if the information is of a kind which a reasonable investor would be likely to use as part of the basis of an investment decision. The language of the Lamprell Final Notice makes this clear – "It was likely that, if generally available, the information would have had a significant effect on Lamprell's share price …in that it was information of a kind which a reasonable investor would

1 Policy Statement 10/04 "Enforcement financial penalties Feedback on CP09/19".

be likely to use as part of the basis of his investment decisions" (emphasis added).[2]

This interpretation contrasts with the approach which has been widely adopted by company directors and market professionals who have considered the likely effect on price to determine whether disclosure obligations have been triggered. Whilst in all likelihood it would have made no difference on the facts of the Lamprell case, the FSA's interpretation lowers the bar on what constitutes inside information and, if correct, it is likely to mean that companies should be making more announcements than is currently the case. The Lamprell case is a stark reminder of the costs of failing to make announcements of inside information in a timely manner.

Lessons of the past – holding announcements

The FSA suggests that, soon after the receipt of the Q1 Re-forecast on 29 April 2012, a holding announcement putting the market on notice of a potential material change to its expected financial performance should have been issued. Instead, an announcement was delayed to enable work to be done to confirm the accuracy of the Q1 Re-forecast and the underlying model. This finding has echoes in the Final Notice issued to Marconi plc[3] where an announcement was delayed for a much shorter period (two days) to enable a director to be consulted. The FSA concluded: "Marconi placed undue importance on the repeated refinement of the figures and language contained in the trading statement, at the expense of its obligations to the market".

Lessons of the past – outdated systems

The FSA observes that Lamprell's systems and controls had not grown and developed in line with the Company's operational growth and that much of the financial information was compiled manually and based on Excel spreadsheets. There were also difficulties in integrating the systems of an acquisition, MIS, and that, as a result of these difficulties, the finance department had insufficient resources to produce the monthly financial reports on time. Again, these findings have echoes in previous enforcement action. For example, the Final Notice issued to SFI Group plc[4] notes that the accounting systems had suffered as a consequence of a failure to devote sufficient resource to the financial management of the company at a time when the business was rapidly expanding.

It is worth noting that the FSA has power[5] to require a listed company to appoint a sponsor where it appears to the FSA that there is, or may be, a breach of the Listing Rules or DTRs. The sponsor may be required, for example, to review the company's systems and controls relating to the disclosure of inside information and to report to the FSA.

Individual liability

Whilst there is no suggestion of individual liability in the Lamprell Final Notice, under s91(2) of the FSMA, the FSA may take enforcement action against a director who is "knowingly concerned" in a breach by a company of the Listing Rules[6]. In a submission to the Parliamentary Commission on Banking Standards in September 2012, the FSA expressed the view that this was "too narrow" a test and "positively disincentives directors from making enquiries to discover whether the listing rules are being complied with". It has proposed that it should be able to take action where a director "knew, or should have known" of the contravention. Whether or not this change comes into effect, given the FSA's current focus on individual liability, it is likely that, in future Listing Rules cases, the actions of individual directors will be scrutinised.

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2 Similar wording is used in the Final Notice issued to Greenlight Capital Inc (15 February 2012) and the Decision Notice issued to Ian Hannam (27 February 2012).

3 11 April 2003.

4 11 December 2003.

5 LR 8.2.1 R (5)

6 Most recently, the FSA found the former finance director of Cattles plc, James Corr, had been knowingly concerned in breaches by Cattles plc of the Listing Rules and Listing Principles (see Final Notice dated 28 March 2012).

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