

# CLIENT UPDATE

## FSA ENFORCEMENT DECISION INTRODUCES MAJOR INCREASE IN FINES FOR BREACHES OF THE LISTING RULES

### LONDON

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*“Listed companies should have no doubt about the importance the FSA places on them meeting their obligations in order to protect investors interests and to maintain confidence in UK markets” – Tracey McDermott, FSA director of enforcement and financial crime.<sup>1</sup>*

### INTRODUCTION

On 15 March 2013, the FSA<sup>2</sup> published its final notice imposing a fine of £2,428,300 on Lamprell plc for significant failings in its systems and controls resulting in breaches of the Listing Rules. The fine was originally assessed at £3,469,125 but was increased by 10% owing to aggravating factors and discounted by 30% to reflect the fact that Lamprell agreed to settle at an early stage and initiated vigorous remedial action. The level of the fine was calculated by the FSA using a revised method based on a percentage of market capitalisation, which is expected to lead to significantly higher financial penalties for these types of breaches compared with previous enforcement decisions.<sup>3</sup>

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<sup>1</sup> FSA press release 18 March 2013 (FSA/PN/024/2013 “Lamprell plc fined £2,428,300 for systems and controls failings”). FSA Final Notice (Lamprell plc, 15 March 2013).

<sup>2</sup> On 1 April 2013, the majority of the functions of the FSA were assumed by the Financial Conduct Authority (“FCA”).

<sup>3</sup> Nestor Healthcare Group Limited, Final Notice (14 February, 2013) fined £175,000 for breaches of LR9.2.8R and Listing Principles 1 and 2 (no description of methodology for fixing fine level). Exillon Energy plc, Final Notice (26 April, 2012) fined £292,950 for breaches of LR11.1.10R(2) and 11.1.11(3) and Listing Principle 2 (detail of methodology given – seriousness of the breach determined to be “level 3”).

## BRIEF SUMMARY OF THE FACTS OF THE LAMPRELL DECISION

Lamprell's business encompasses construction projects for the offshore oil and gas and renewable energy sectors in the UAE. It had grown rapidly both organically and by an acquisition in July 2011 which had roughly doubled its operational size.

The FSA found that there were serious systems and controls failings at Lamprell, which meant it was unable to adequately monitor the full impact of operational issues on its financial performance for 2012. Lamprell's systems and controls in this respect had not grown and developed in line with its operational growth. It was therefore unable to update the market in a timely manner as to its financial performance.<sup>4</sup>

From early in 2012, Lamprell's financial performance against its budget had been deteriorating due to operational issues. However, Lamprell did not update the market on its deteriorating financial performance until it released a trading update on 16 May 2012. In response to this trading update, Lamprell's share price fell by 57%, demonstrating the importance of that financial information.<sup>5</sup>

The system and controls failings resulted in Lamprell breaching the Listing Principles, the Disclosure and Transparency Rules and also the Model Code on directors' dealings in securities.<sup>6</sup>

## THE FSA'S REVISED METHOD FOR CALCULATING THE QUANTUM OF FINES

The FSA's policy for imposing a financial penalty is set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP"), which is part of the FSA Handbook.<sup>7</sup> The FSA is required to apply a five-step framework to determine the appropriate level of financial penalty.<sup>8</sup>

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<sup>4</sup> See FSA Press Release.

<sup>5</sup> For a full description of the facts and circumstances giving rise to the breaches, see the Final Notice, paragraphs 17 to 51.

<sup>6</sup> For a full analysis of the breaches of the Listing Rules, and Disclosure and Transparency Rules, see the Final Notice, paragraphs 52 to 75.

<sup>7</sup> See FCA Handbook DEPP 6 Penalties.

<sup>8</sup> See Final Notice, paragraphs 76 to 102.

## STEP 1: DISGORGEMENT

The FSA seeks to deprive a firm of the financial benefit derived directly from the breach. Lamprell did not derive any financial benefit directly from its breaches in this case, so the amount was zero.

## STEP 2: THE SERIOUSNESS OF THE BREACH

### Appropriate Indicator of Seriousness of Breach

In this case, the FSA did not consider that the revenue generated by Lamprell was an appropriate indicator as it did not reflect the harm or risk of harm resulting from the Company's breaches.

*"The FSA considers the appropriate indicator is the Company's market capitalisation as it reflects the harm or risk 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."*

### Scale

*"The FSA considers that a scale of 0-0.5% of market capitalisation (applied according to the seriousness of the breach) is appropriate in order that the penalty properly reflects the seriousness of the breach."*

In Lamprell's case, its market capitalisation at the time the breaches took place was assessed at £841m.

### Level of Seriousness

*"This breach is considered by the FSA as a serious breach because Lamprell was unable to comply with certain of its obligations as a listed company for a prolonged period of time. Its systems and controls concerning its ability to keep the market properly informed of its financial position on an on-going basis were inadequate and outdated for a company of its size and complexity. As a result, there was a risk that investors might make decisions based on incomplete information. When the inside information about the Company's financial prospects was released to the market in the May Trading Update, Lamprell's share price fell significantly demonstrating the importance of that inside information."*

*“Even though the breaches did not result from deliberate or reckless behaviour, on the basis of the factors, discussed above, the FSA considers the seriousness of the breach to be level 4. Therefore, the Step 2 figure is 0.365% of £841m.”*

### **STEP 3: MITIGATING AND AGGRAVATING FACTORS**

The FSA may increase or decrease the amount of the financial penalty arrived at after Step 2 (not including any amount to be disgorged as set out in Step 1) to take into account factors which aggravate or mitigate the breach.

*“Having taken into account these aggravating and mitigating factors, the FSA considers that an upward adjustment of 10% is made to the penalty figure at Step 3. Lamprell had previously received a warning letter from the FSA directly relating to its systems and controls failings around the disclosure of inside information to the market. This represents a serious aggravating factor. Had it not been for the relevant mitigating factors, in particular the co-operation of the Company during the FSA investigation, the upward adjustment would have been significantly higher.”*

### **STEP 4: ADJUSTMENT FOR DETERRENCE**

If the FSA considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the FSA may increase the penalty.

*“The FSA considers that the Step 3 figure of £3,469,125 represents a sufficient deterrent to Lamprell and others, and so has not increased the penalty at step 4.”*

### **STEP 5: SETTLEMENT DISCOUNT**

*“If the FSA and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the FSA and the firm reached agreement.....*

*The FSA and Lamprell reached agreement at Stage 1 so a 30% discount applies to the Step 4 figure.”*

The result was a financial penalty of £2,428,300.

## CONCLUSION

The FSA (now FCA) has made clear its intention to pursue breaches of the Listing Rules more actively and that it will use the new market capitalisation method to calculate fines, which is likely to mean a very marked increase in the level of fines imposed. Listed companies and their directors will need to consider carefully the adequacy of their compliance resourcing and procedures with respect to all the continuing obligations under the Listing Rules, including the overall Listing Principle 2 requirement that the listed company “take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.”

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Please feel free to contact us with any questions you may have about the implications of the Lamprell decision.

17 April 2013