
FINAL NOTICE

To: **Entertainment Rights plc**
Of: **Colet Court**
100 Hammersmith Road
London
W6 7JP

Date: **19 January 2009**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the "FSA") gives you final notice about a requirement to pay a financial penalty:

1. THE PENALTY

- 1.1 The FSA gave Entertainment Rights plc ("Entertainment Rights") a Decision Notice dated 15 January 2009 which notified it that for the reasons listed below and pursuant to section 91(1) of the Financial Services and Markets Act 2000 (the "Act"), the FSA had decided to impose a financial penalty of £245,000 on Entertainment Rights, in relation to breaches of Disclosure and Transparency Rule 2.2.1 and Listing Principle 4, namely the obligation to disclose inside information to the market as soon as possible and to avoid the creation or continuation of a false market in listed securities.
- 1.2 Entertainment Rights has not referred the matter to the Financial Services and Markets Tribunal.
- 1.3 Entertainment Rights agreed to settle at an early stage of the FSA's investigation and qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount FSA would have imposed a financial penalty of £350,000.

2. REASONS FOR THE PENALTY

Summary

- 2.1 The FSA decided to impose a penalty as a result of the delay of 78 days by Entertainment Rights in disclosing a significant variation to the terms of a major distribution agreement and its impact on Entertainment Rights' profits and net debt levels.
- 2.2 On 29 December 2006 Entertainment Rights with its subsidiary Gold Key Home Video Inc ("Gold Key") entered into an agreement (the "Agreement") with Genius Products LLC ("Genius") for the distribution of DVDs in the United States. A variation to the Agreement was agreed, which came into effect on 10 July 2008 (the "Variation") but was not announced to the market until 26 September 2008 (the "Announcement").
- 2.3 The Variation amended payment terms resulting in lower royalty margins and future payments to Entertainment Rights being phased over a longer period, which would reduce the contribution from the Agreement to Entertainment Rights' profits by US\$13.9 million. Also under the Variation, certain intellectual property rights reverted back to Entertainment Rights from Genius. This reduction in profits represented a significant percentage of Entertainment Rights' estimated profits for the financial year ending 31 December 2008.
- 2.4 On the basis of the facts and matters described below the FSA is satisfied that:
- a) due to the size of reduction in profit in comparison to Entertainment Rights' anticipated profits the information about the Variation constituted inside information and as a result a disclosure obligation arose under DTR 2.2.1 when the Variation came into effect on 10 July 2008. The failure to disclose until 26 September 2008 resulted in a breach of this rule;
 - b) the failure to disclose led to the creation of a false market in Entertainment Rights' shares from 10 July 2008 to 26 September 2008. As a result there was also a breach of Listing Principle 4.

Relevant Statutory Provisions and Guidance

- 2.5 Pursuant to Part VI of the Act, the FSA makes the Listing, Prospectus and Disclosure and Transparency Rules and is responsible for the official listing of securities in the UK. Disclosure rules under Part VI must require an issuer to publish specified inside information (section 96A of the Act). Between 10 July 2008 to 26 September 2008 (the "material time"), these rules set out the requirements for the admission of securities to the Official List and the continuing obligations of companies whose securities are so admitted.
- 2.6 For these purposes "inside information" is defined in section 118C of the Act as:
- "(2) ... information of a precise nature which –*
- (a) is not generally available,*
 - (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and*
 - (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments. ...*

(5) *Information is precise if it –*

- (a) *indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and*
- (b) *is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.*

(6) *Information would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions.”*

- 2.7 The FSA is authorised under section 91(1) of the Act to exercise its power to impose a financial penalty where it is satisfied that an issuer has contravened any provision of the Part VI rules.
- 2.8 The Disclosure and Transparency Rules for listed companies are set out in the FSA’s Handbook. DTR 2.2.1 states that: *“An issuer must notify a RIS [Regulatory Information Service] as soon as possible of any inside information which directly concerns the issuer unless DTR 2.5.1R applies.”*¹
- 2.9 The FSA has, pursuant to section 157 of the Act, published guidance on DTR obligations in the Handbook which would have been available to Entertainment Rights. In deciding to take the action proposed, the FSA has had regard to specific guidance on the identification of inside information set out from DTR 2.2.3G to DTR 2.2.8G.
- 2.10 Chapter 7 of the Listing Rules sets out the Listing Principles which apply to every listed company with a primary listing of equity securities. The purpose of the Listing Principles is to ensure that listed companies pay due regard to the fundamental role they play in maintaining market confidence and ensuring fair and orderly markets.
- 2.11 Listing Principle 4 provides that *“a listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities.”*
- 2.12 The FSA regards the continuing obligation requirements of the Disclosure and Transparency Rules and Listing Principles as a fundamental protection for shareholders. These requirements are designed to promote full disclosure to the market of all relevant information on a timely basis to ensure that all users of the market have simultaneous access to the same information. Observance of these continuing obligations is essential to the maintenance of an efficient, fair and orderly market in securities and to maintaining confidence in the financial system.

3. FACTS AND MATTERS RELIED UPON IN THE WARNING NOTICE

¹ DTR 2.5.1 is not relevant in this case.

Background

- 3.1 Entertainment Rights is a listed issuer of securities on the London Stock Exchange Official List. Entertainment Rights was founded in 1999 and in January 2007 acquired Classic Media (i.e. Gold Key). At the material time its shares were included in the FTSE Small Cap index.
- 3.2 Entertainment Rights describes its principal activity as controlling or owning distribution and exploitation rights to a broad catalogue of children's and family programming, with a portfolio of world famous characters and a library of over 3,600 hours of content. Annual revenues for the group have increased from £1.9 million in 1999 to £68.1 million in 2007, the last reported financial year. Genius is Entertainment Rights' primary US distributor.

The Agreement with Genius

- 3.3 Entertainment Rights' relationship with Genius is governed by two contractual agreements:
- (a) a distribution agreement between Gold Key and Genius entered into prior to the acquisition of Gold Key by Entertainment Rights; and
 - (b) a binding term sheet agreement with Genius.
- 3.4 The contractual arrangements forming the Agreement for the distribution of DVDs in the United States were completed on 29 December 2006. An announcement was made to the market concerning the Agreement on 8 January 2007.
- 3.5 Between September 2007 and April 2008, there were various negotiations and correspondence between Entertainment Rights and Genius relating to the Agreement, including proposals to revise the payment schedule under it.

Board Meeting Discussions and the Variation

- 3.6 At an Entertainment Rights Board meeting on 24 April 2008, the Board discussed the possibility of making concessions in relation to the Agreement to secure payment from Genius. Following this meeting there were exchanges between the respective CEOs, from April to June 2008, in relation to the Agreement.
- 3.7 Following the exchange of various drafts of the proposed amendments, on 10 July 2008 the Variation was executed and came into effect. The Variation amended payment terms from Genius to Entertainment Rights, resulting in lower royalty margins on DVD sales and a revised payment profile for advances so that future payments were phased over a longer period of time to 2011, which would reduce the contribution from the Agreement to Entertainment Rights' profits by US\$13.9 million. Also under the Variation, certain intellectual property rights reverted back to Entertainment Rights from Genius, which it was anticipated would be valuable for the company to exploit.
- 3.8 At a further Board meeting on 31 July 2008, the Board noted that trading receipts of US\$8.4 million had been received from Genius. It was noted that the Variation would have a negative impact on the 2008 results and that therefore consideration needed to be given to how this was communicated. It was further noted that it was too early at

that stage to quantify the impact of the revised Agreement with any certainty, leading to a need to carefully consider the timing of any announcement and the impact on market guidance.

- 3.9 In or around August 2008, the company reconsidered its view as to the materiality of the Variation, and consequently considered that it was likely to give rise to disclosure obligations. As a result, Entertainment Rights:
- (a) requested that the acting CFO prepare a report to quantify the impact of the Variation and to review the company's expected trading outturn for the current financial year;
 - (b) appointed a firm of corporate finance advisers.
- 3.10 At a Board meeting on 25 September 2008, the results of the acting CFO's report were considered. The acting CFO projected a cash balance at 31 December 2008 of £3.2 million, which was £11 million below the original budget. The key reason for this variance was the decrease of receipts from Genius as a result of the Variation. The acting CFO tabled a paper summarising the impact from the Variation on profitability and cash flow. The Board noted that there was a clear impact, since it resulted in a shortfall of circa £8 million against market consensus of full year revenue of £73.5 million. The Board noted that it was now in full possession of information that would lead it to believe that there would be a shortfall against market expectations. The company's financial advisers noted that the announcement could not be delayed and further that the company was currently not in breach of its bank covenants, but was in discussions with its banks. It was recommended that a statement on net debt be included in the Announcement in order not to mislead the market. It was agreed that the company's financial advisers should alert the FSA to the Announcement.

The Announcement

- 3.11 On 26 September 2008 Entertainment Rights issued the Announcement as a trading update announcement regarding the Variation. This Announcement included a statement that "*as a result of the changes to the Genius distribution agreement, the Board now expects a reduction in EBITDA for the financial period to 28 February 2009 of around £7m and a reduction of £6.5m for the 2010 financial year*" and also informed the market that the company's drawings under its debt facilities had increased.
- 3.12 Following the Announcement on that day, the share price fell by 55%.

4. CONCLUSIONS

Analysis of the breaches

- 4.1 Entertainment Rights executed the Variation on 10 July 2008. The impact of the Variation on anticipated profits was information that would, if generally available, be likely to have a significant effect on the Entertainment Rights share price and was information which a reasonable investor would be likely to use as part of the basis of his investment decisions.

- 4.2 This information was inside information and Entertainment Rights therefore had an obligation to notify a Regulatory Information System as soon as possible. By failing to do so until 26 September 2008, Entertainment Rights breached DTR 2.2.1 in that it failed to release inside information as soon as possible and Listing Principle 4 in that it failed to communicate information in such a way as to avoid the creation or continuation of a false market.

Inside Information

- 4.3 The Variation was inside information as defined under section 118C of the Act in that:
- (a) The information was precise. The variation in contract terms was certain. The impact of the Variation on anticipated profits was capable of calculation and had been calculated by Entertainment Rights. The information was specific enough to enable a conclusion to be drawn that it was likely to have a negative effect on Entertainment Rights' share price.
 - (b) The information was not generally available. There is no evidence that the market was aware of the Variation.
 - (c) The information related directly to Entertainment Rights.
 - (d) The information was likely to have a significant effect on the price of Entertainment Rights shares. It was information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions. The Variation would reduce EBITDA by around £7million for the period to 28 February 2009 and by a further £6.5million for the 2010 financial year.
- 4.4 The FSA is therefore satisfied that the Variation was inside information as defined under section 118C of the Act.

The justification for non-disclosure

- 4.5 In the various Board meetings between 4 June and 31 July 2008, the Board considered that there would be various opportunities over the course of the year to mitigate the negative impact of the Variation and concluded that the existence of these opportunities permitted the deferral of any announcement of the Variation.
- 4.6 The FSA has made clear in the April 2004 UKLA List! Publication and in past Enforcement cases that justifying non-disclosure of information by offsetting negative and positive news is not acceptable. Companies should disclose both types of information and allow the market to determine whether they cancel each other out. This is particularly the case where, as here, there is no actual positive news but a mere hope of positive news in the future.

5. SANCTION

- 5.1 The FSA's policy on the imposition of financial penalties and public censures is set out in Decision Procedure & Penalties at DEPP 6. The principal purpose of financial penalties is to promote high standards of market conduct by deterring those who have

committed breaches from committing further breaches, helping to deter others from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

5.2 The FSA considers that the seriousness of Entertainment Rights' breach of DTR 2.2.1 and Listing Principle 4 merits a financial penalty. The factors which support the imposition of a substantial financial penalty on Entertainment Rights include:

- (a) at the material time Entertainment Rights' shares formed part of the FTSE Small Cap Index and contravention of DR 2.2.1 and Listing Principle 4 impacted on the orderliness of the capital markets and public confidence in those markets;
- (b) the delay in announcing the Variation was extensive, i.e. from 10 July 2008 to 26 September 2008, a period of 78 days, during which time there was a false market in Entertainment Rights' shares;
- (c) Entertainment Rights failed to take professional advice in a timely manner in relation to its disclosure obligations;
- (d) Entertainment Rights' internal processes failed to identify in a timely fashion the need to consider itself whether the effect of the Variation was inside information, even though its Board was made aware of the potential impact shortly before the Variation was executed. The Board considered the issue on a number of occasions without appreciating the need to make an announcement;
- (e) the justification for non-disclosure, namely the hope of mitigating the loss arising from the Variation, was inadequate. This is particularly serious given that there have been previous Enforcement cases and published FSA guidance in this area;
- (f) the impact of the Variation on profits was substantial.

5.3 The mitigating factors which have been taken into account in this case are:

- (a) the breach was not deliberate or reckless;
- (b) Entertainment Rights has adopted a number of recommendations from its legal and financial advisers to improve its internal processes and to strengthen its Board;
- (c) Entertainment Rights made a full and frank admission to the FSA, took the first available opportunity to settle and proactively sought an early resolution to the matter; and
- (d) no previous disciplinary action has been taken against Entertainment Rights.

5.4 In determining the proposed financial penalty the FSA has considered the need to deter Entertainment Rights and others from engaging in this type of activity. The FSA has also had regard to penalties in other similar cases. The FSA considers that a financial penalty of £350,000 is appropriate. This penalty is discounted by 30% pursuant to the stage 1 early settlement discount scheme. Therefore the total penalty will be reduced to £245,000.

6. DECISION MAKER

- 6.1 The decision which gave rise to the obligation to give this notice was made on behalf of the FSA by Margaret Cole, Director of Enforcement and Alexander Justham, Director of Markets Division, being Settlement Decision Makers for purposes of the FSA's Decision Procedure and Penalties manual (DEPP).

7. IMPORTANT

- 7.1 This Final Notice is given to Entertainment Rights under in accordance with section 390 of the Act.

Manner of and time for Payment

- 7.2 The FSA is in possession of evidence that it would cause Entertainment Rights serious financial hardship or financial difficulties if they were required to pay the full payment in a single instalment. Accordingly the financial penalty of £245,000 must be paid in full in instalments as follows:

- The first instalment of £122,500 to be paid by 19 January 2009
- The second instalment of £122,500 to be paid by 19 March 2009.

If the financial penalty is not paid

- 7.3 If all or any of the first instalment of the financial penalty is outstanding at its due date for payment, the full amount outstanding of the financial penalty shall then become immediately due and payable.
- 7.4 If any of the financial penalty is outstanding on 20 March 2009, the FSA may recover the outstanding amount as a debt owed by Entertainment Rights and due to the FSA.

Publicity

- 7.5 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.
- 7.6 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA Contacts

- 7.7 For more information concerning this matter generally, you should contact Ken O'Donnell on 020 7066 1374 or Claire Cross on 020 7066 3682 at the FSA.

Jamie Symington
Head of Department
Wholesale Enforcement Division