Financial Services Authority

FINAL NOTICE

To: **Exillon Energy plc**

Of: Fort Anne,
Douglas,
Isle of Man,
IM1 5PD

26 April 2012

ACTION

1. For the reasons given in this notice, the FSA hereby imposes on Exillon a financial penalty of £292,950.
2. Exillon agreed to settle at an early stage of the FSA's investigation and therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £418,500 on it.

SUMMARY OF REASONS

3. In the year following its listing on 17 December 2009, Exillon made a series of payments to the Chairman of Exillon Mr Maksat Arip, who was also a beneficiary of a family trust which is Exillon's largest shareholder. These payments were the continuation of a practice of Exillon paying Mr Arip's private expenses and netting such payments off against his unpaid salary that had operated in Exillon before listing.
4. On 9 June 2010, less than six months after listing, the aggregate amount of these payments totalled £587,627, which exceeded 0.25% of the aggregate market value of all Exillon's ordinary shares and triggered various requirements for related party transactions under LR 11.1.10R(2). However, Exillon failed at this time (and subsequently when further expenses payments were made) to comply with the requirements in LR 11.1.10R(2), namely to:
   i. inform the FSA in writing of the details of the transaction;
   ii. provide the FSA with written confirmation from an independent adviser that the terms of the transaction were fair and reasonable; and
   iii. undertake in writing to the FSA to include details of the transactions in the next published annual accounts.
5. In keeping with the practice that had operated in Exillon before listing, between October and December 2010 a reconciliation process was undertaken

as a result of which Mr Arip repaid in full all of the expenses payments plus interest.

6. Exillon had policies and procedures in place intended to ensure compliance with the rules regarding related party transactions. However from the time of listing and throughout 2010 these policies and procedures did not work in practice because:

   i. they relied heavily on senior officers to identify and take appropriate action and the senior officers charged with this responsibility lacked the experience and training to perform this function;

   ii. Exillon did not check that those senior officers understood what was expected of them in the roles they were assigned under the policies and procedures and that they were capable of performing those roles; and

   iii. Exillon did not check that the policies and procedures were effective and had been implemented.

7. As a consequence, Exillon continued to operate as it had prior to listing in relation to the payments to Mr Arip and the relevant senior officers, including Mr Arip, failed to identify the transactions as related party transactions and take the necessary steps to comply with LR11.1.10R(2). Exillon therefore breached Listing Principle 2 by failing to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

8. The FSA did not conclude that Mr Arip acted improperly in relation to the payments made to him. Neither was there any evidence to suggest that Mr Arip or Exillon benefited financially from the payments or that Exillon's shareholders suffered any losses.

DEFINITIONS

9. The following definitions are used in this Notice:

"the Act"	means the Financial Services and Markets Act 2000.
"the FSA"	means the Financial Services Authority.
"Exillon"	means Exillon Energy plc.
"the RPT Policy"	means the Related Party Transaction Policy Exillon had in place at the time it was admitted to listing.
"UKLA"	means the United Kingdom Listing Authority.
"DEPP"	means the FSA's Decision Procedure and Penalties Guide.
"the Tribunal"	means the Upper Tribunal (Tax and Chancery Chamber).

FACTS AND MATTERS

Background

10. Exillon was admitted to trading on the London Stock Exchange's Main Market and placed on the UKLA's Official List with a premium listing on 17 December 2009. Mr Arip and the other board members approved the RPT

Policy on 10 December 2009. Mr Arip was an operational manager for the purposes of the RPT Policy and as such had responsibilities under the policy to identify and take appropriate action in respect of related party transactions.

The Payments

11. Between 26 January 2010 and 27 December 2010 Exillon made payments to or on behalf of Mr Arip, who was at that time a related party of Exillon by virtue of being the Chairman of Exillon, totalling approximately £930,000, for private expenses. Mr Arip was also a beneficiary of a family trust which was a substantial shareholder of Exillon., The private expenses included his children's education expenses, private flights and accommodation for himself and his family; replenishment of his personal credit card; and other expenses for which Mr Arip did not provide documentation to show they were for a business purpose.

12. These payments were made pursuant to an informal arrangement which had been in place before Exillon was listed whereby Mr Arip would defer receipt of his salary and the company would pay his personal expenses. At the end of the year the company would reconcile the unpaid salary against the personal expenses and either it would pay Mr Arip or he would repay Exillon.

13. Additionally, Mr Arip wrongly assumed that Exillon was obliged to pay his children's educational expenses because all employees in the Dubai office (who were junior to him) received this benefit. It was only after checking the terms of his Service Agreement with Exillon that he realized that this was not the case.

14. On 9 June 2010 Mr Arip requested two payments which when aggregated with prior payments caused the total amount to reach £587,627, which exceeded 0.25% of the aggregate market value of all Exillon's ordinary shares and triggered Exillon's obligations under LR 11.1.10R(2). However Mr Arip and the operational managers who authorized the transaction failed to identify the payments as related party transactions and as a result Exillon failed to comply with the relevant requirements.

15. Following 9 June 2010 a number of further payments were made to Mr Arip, each of which, pursuant to LR 11.1.11R(3), resulted in a further breach of related party transaction requirements under LR 11.1.10R(2). The total amount of all the payments was around £930,000.

16. Between 26 October 2010 and 28 December 2010, in keeping with the practice that had operated in Exillon before listing, a reconciliation process was undertaking as a result of which Mr Arip made a series of payments to Exillon, which resulted in full repayment of the outstanding sum plus interest. Notwithstanding Mr Arip's accepting that he had a responsibility to repay the outstanding amount of private expenses, neither he nor the operational managers who had calculated the amount to be repaid, identified Exillon's payment of Mr Arip's private expenses as related party transactions.

Discovery of the Breach

17. On 17 February 2011 Exillon's auditors wrote to Exillon to advise it that Exillon's payments to Mr Arip potentially constituted related party transactions. On 7 March 2011 Exillon's sponsor wrote to the UKLA advising

it that Exillon had categorised the payments as loans to a related party and that Exillon's auditors had agreed with that categorization.

The RPT Policy

18. The RPT Policy relied on the operational managers to identify related party transactions and take appropriate action. However the training provided to the operational managers in November 2009 and February 2010 which included reference to the related party transaction Listing Rules (in LR 11) and the RPT Policy, failed to provide Mr Arip and the operational managers who authorized the transactions with a sufficient understanding of the related party transaction Listing Rules and the RPT Policy. As a result the responsible operational managers failed to identify the payments of Mr Arip's private expenses as related party transactions.

19. The operational managers failed to identify the related party transactions because they saw the payments as pertaining to Mr Arip as an employee rather than a related party. The operational manager who approved the transactions did not speak English and the RPT Policy was only in English and some of the operational managers only spoke Russian (although Russian translation was provided during training). Furthermore comments from two of the operational managers after discovery of the related party transactions regarding their initial training indicated that: (1) future training should be more from an accountants' perspective; (2) there were too many changes to digest in the time provided for the training; (3) additional training in Russian was required; and (4) training should have been repeated subsequently to reinforce it.

Remedial Action

20. In a prospectus published on 29 March 2011 Exillon disclosed in the risk factors that it had failed to comply with its corporate governance, accounting, reporting and compliance policies and procedures with respect to related party transactions and that such failure may have resulted in a breach of FSA rules. In the prospectus Exillon went on to describe the payments to Mr Arip as primarily in the form of cash advances intended to fund business expenses and living expenses.

21. In late April 2011, Exillon disclosed the payments to Mr Arip as interest free loans to the 'Major Shareholder' in Notes to Exillon's audited 2010 IFRS financial statements. It stated in the Notes: "During the year, the Group made a series of payments to the major shareholder to fund business expenses. These amounts were subsequently reclassified as personal loans, and were fully repaid by 31 December 2010."

22. As a consequence of discovery of these related party transactions Exillon made the following changes:

    i. on 3 March 2011 it adopted an emergency procedure whereby the head of the Audit Committee had to approve all payments to related parties;

    ii. on 27 March 2011 additional related party transaction training was held for directors;

    iii. on 8 July 2011 Exillon appointed a Managing Director from Exillon's sponsor as its CEO;

iv. on 17 August 2011 Exillon replaced the emergency procedure with new procedures that included a requirement that the CEO sign off all payments to related parties and that the Chairman or head of the Audit Committee sign off all related party transactions exceeding $10,000 (note that Mr Arip is no longer Exillon's Chairman);

v. on 1 November 2011 Exillon provided further training on compliance with the listing rules to senior management in Russian;

vi. Exillon created an Internal Audit position; and

vii. Exillon started using corporate credit cards and a corporate travel agency.

FAILINGS

23. The UKLA Listing Rules relevant to this Warning Notice are at Annex A. They are:

    i. LR 11.1.4R (Definition of "related party");

    ii. LR11.1.5R (Definition of "related party transaction");

    iii. LR11.1.10R(2) (Modified requirements for smaller related party transactions);

    iv. LR11.1.11R(3) (requirement to aggregate certain related party transactions for disclosure purposes);

    v. LR10 Annex 1 (the class tests); and

    vi. Listing Principle 2 *(*duty to take reasonable steps to establish and maintain adequate procedures, systems and controls*)*.

24. Exillon was throughout 2010 a company incorporated in the Isle of Man with a premium listing of its ordinary shares on the Official List.

25. Exillon breached LR11.1.10R(2) by failing, prior to the aggregate value of the related party transactions exceeding 0.25% of the aggregate market value of all Exillon's ordinary shares on 9 June 2010, and in relation to each subsequent Payment, to:

    i. inform the FSA in writing of the details of the transactions;

    ii. provide the FSA with written confirmation from an independent adviser acceptable to the FSA that the terms of the transactions were fair and reasonable as far as the shareholders of Exillon were concerned; and

    iii. undertake in writing to the FSA to include details of the transactions in Exillon's next published annual accounts including the identity of the related party, the value of the consideration for the transactions and all other relevant circumstances.

26. In addition, at the time Exillon considered making each payment to Mr Arip after 9 June 2010 Exillon failed to comply with LR 11.1.11(3) by failing to:

    i. provide the FSA with written confirmation from an independent adviser acceptable to the FSA that the terms of the latest transaction

was fair and reasonable as far as the shareholders of Exillon were concerned;

ii. inform the FSA in writing of the details of the aggregated transactions; and

iii. undertake in writing to the FSA to include details of the aggregate transactions in Exillon's next published annual accounts including the identity of the related party, the value of the consideration for the transactions and all other relevant circumstances

27. Exillon also failed to comply with Listing Principle 2 by failing to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its related party transaction obligations. Exillon sought to satisfy Listing Principle 2 by implementing the RPT Policy, which was drafted by external advisers. However, the main control the RPT Policy established was to rely on operational managers to identify potential related party transactions but Exillon failed during 2010 to ensure that the operational managers had the requisite knowledge and understanding of the related party transactions definition and rules to identify all potential related party transactions.

SANCTION

28. The FSA's approach in deciding whether to take action and determining the appropriate financial penalty is set out in Chapter 6 of DEPP in force at the time of the misconduct.

29. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating to firms and approved persons, the benefit of compliant behaviour (DEPP 6.1.2G).

30. In determining whether a financial penalty is appropriate and proportionate, the FSA refers to the five steps to determine the penalty to be imposed on firms set out in DEPP 6.5A.

i. At Step 1 (disgorgement) the FSA seeks to deprive a firm of the financial benefit derived directly from the breach. In this case Exillon did not derive any financial benefit from the breach.

ii. At Step 2 (the seriousness of the breach) the FSA determines a figure to reflect the seriousness of the breach, which will be based on a percentage of the firm's revenue from the relevant product or business area, unless this is not an appropriate indicator, in which case the FSA will determine an appropriate alternative. In this case, revenue is not an appropriate indicator because Exillon's revenue stream did not benefit from the payments in question. Accordingly, the FSA has determined to use the value of the related party transactions as the relevant indicator. However, when using related party transactions as the relevant indicator, it is not appropriate to use a 0-20% penalty range considering the related party transactions are the impugned transactions. Accordingly, the FSA has used a 0-100% range to ensure

the penalty properly reflects the seriousness of the breach. The FSA has determined that the breach is a level 3 breach[1] (50% of the value of the related party transactions being £465,000) because:

- it was not a level 4 or 5 breach because it was not deliberate or reckless, did not affect consumers or investors, did not have an adverse effect on markets and did not profit Exillon; but
- it was more serious than a level 1 or 2 breach because it involved a series of transactions continuing over the course of a year and resulted from serious weaknesses in Exillon's related party transaction procedures.

iii. At Step 3 (mitigating and aggravating factors) the FSA may increase or decrease the amount of the financial penalty by a percentage to take into account mitigating or aggravating factors. In this case, Exillon's conduct is aggravated because the listing should have been a trigger for it to ensure all its procedures were effective and fully operational and it failed to do so. Exillon's conduct was, however, mitigated by the following:

- it took a number of remedial steps after the breach was identified to bring its related party transaction compliance procedures up to a high standard;
- its cooperation during the investigation, including waiving privilege over all relevant documents at an early stage without being asked and making Mr Arip available for meetings and interviews at the earliest opportunity (despite him residing overseas), went well beyond the typical level of cooperation experienced by the FSA;
- Mr Arip repaid the payments with interest before it was brought to Exillon's attention that they constituted related party transactions.

Accordingly, the FSA reduced the penalty by 10% to £418,500.

iv. At Step 4 (adjustment for deterrence) the FSA may increase the penalty if it considers it is insufficient to act as an effective deterrent. The FSA did not consider the penalty was insufficient so did not make an adjustment at Step 4.

v. At Step 5 Exillon was given a discount of 30% for settlement at Stage 1 of the settlement process which reduced the penalty by £125,550 to £292,950.

PROCEDURAL MATTERS

Decision maker

[1] On the basis that level 1 would be 0% of the value of the related party transaction, level 2-25%, level 3-50%, level 4-75% and level 5-100%.

31. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

32. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for Payment

33. The financial penalty must be paid in full by Exillon to the FSA by no later than 10 May 2012, 14 days from the date of the Final Notice.

If the financial penalty is not paid

34. If all or any of the financial penalty is outstanding on 10 May 2012, the FSA may recover the outstanding amount as a debt owed by Exillon and due to the FSA.

Publicity

35. 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.

36. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

37. For more information concerning this matter generally, contact Steven Clark (direct line: 020 7066 2172) of the Enforcement and Financial Crime Division of the FSA.

……

Matthew Nunan
FSA Enforcement and Financial Crime Division

EXILLON ENERGY PLC

ANNEX A - RELEVANT STATUTORY AND REGULATORY PROVISIONS

RELEVANT LAW AND REGULATION

Related Party Transaction Listing Rule

LR 11.1.4R defines a related party as [amongst other things] a *person* who is a *director.*

LR 11.1.5R defines a related party transaction as [amongst other things] a transaction (other than a transaction of a revenue nature in the ordinary course of business) between a *listed company* and a *related party.*

LR 11.1.10R requires a *listed company*, when each of the *percentage ratios* is less than 5% but one or more of them exceeds 0.25% to inform the FSA of the details of the transaction, provide a written confirmation from an independent adviser that the terms of the transaction were fair and reasonable; and undertake to include details of the transactions in the next published annual accounts. LR 11.1.10R states that "*…the listed company must before entering into the transaction or arrangement…:*

(a) inform the FSA in writing of the details of the proposed transaction or arrangement;

(b) provide the FSA with written confirmation from an independent adviser acceptable to the FSA that the terms of the proposed transaction or arrangement with the related party are fair and reasonable as far as the shareholders of the listed company are concerned; and

(c) undertake in writing to the FSA to include details of the transaction or arrangement in the listed company's next published annual accounts, including, if relevant, the identity of the related party, the value of the consideration for the transaction and all other relevant circumstances."

LR 11.1.11R requires listed companies to aggregate transactions with the same related party in 12 month period. Listing Rule 11.1.11R states:

(1) If a listed company enters into transactions or arrangements with the same related party (and any of its associates) in any 12 month period and transactions or arrangements have not been approved by shareholders the transactions or arrangements must be aggregated…

…(3) If transactions or arrangements that are small transactions…are aggregated under paragraph (1) of this rule and for the aggregated small transactions each of the percentage ratios is less than 5%, but one or more of the percentage ratios exceeds 0.25% the listed company must comply with:

(a) LR 11.1.10 R (2)(b) in respect of the latest small transaction; and

(b) LR 11.1.10 R (2)(a) in respect of the aggregated small transactions."

The Class Tests

LR Chapter 10 provides a framework for calculating the significance of transactions entered into by listed companies. A transaction is classified by assessing its size

relative to that of the listed company proposing to make it. The comparison of size is made by using the percentage ratios resulting from applying the Class Test calculations to a transaction. The Class Tests are set out in LR 10 Annex 1 G

The Consideration Test is set out in LR10 Annex 1 G (5R):

"*(1) The consideration test is calculated by taking the consideration for the transaction as a percentage of the aggregate market value of all the ordinary shares (excluding treasury shares) of the listed company.*

(2) For the purposes of paragraph (1):

(a) the consideration is the amount paid to the contracting party;

(b) if all or part of the consideration is in the form of securities to be traded on a market, the consideration attributable to those securities is the aggregate market value of those securities; and

(c) if deferred consideration is or may be payable or receivable by the listed company in the future, the consideration is the maximum total consideration payable or receivable under the agreement.

(3) If the total consideration is not subject to any maximum (and the other class tests indicate the transaction to be a class 2 transaction) [2]the transaction is to be treated as a class 1 transaction.

(3A) If the total consideration is not subject to any maximum (and the other class tests indicate the transaction to be a class 3 transaction) the transaction is to be treated as a class 2 transaction.

(4) For the purposes of sub-paragraph (2)(b), the figures used to determine consideration consisting of:

(a) securities of a class already listed, must be the aggregate market value of all those securities on the last business day before the announcement; and

(b) a new class of securities for which an application for listing will be made, must be the expected aggregate market value of all those securities.

(5) For the purposes of paragraph (1), the figure used to determine market capitalisation is the aggregate market value of all the ordinary shares (excluding treasury shares) of the listed company at the close of business on the last business day before the announcement."

The Listing Principles

Principle 2 requires a *listed company* to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

Disciplinary powers

Section 91 of the Financial Services and Markets Act 2000 provides that if the FSA considers that an issuer of securities has contravened any provision of the listing rules, it may impose a penalty of such amount as it considers appropriate.

RELEVANT GUIDANCE

Guidance on Principle 2

LR 7.2.2G sets out that Principle 2 is intended to ensure that *listed companies* have adequate procedures, systems and controls to enable them to comply with their obligations under the *listing rules* and *disclosure rules* and *transparency rules*. In particular, the *FSA* considers that *listed companies* should place particular emphasis on ensuring that they have adequate procedures, systems and controls in relation to: …LR11 *(Related party transactions).*