Linklaters

M&A transactions and insider trading law – what is new under the Market Abuse Regulation?

Stephan Oppenhoff

June 2015

Introduction.

- The insider rules under the Market Abuse Regulation (MAR) follow from those under the Market Abuse Directive – no fresh start
- All current key concepts of the insider rules remain intact and are in part supplemented by new details and exemptions
    - in particular inside information remains single level entry test for both insider dealing prohibitions and ad hoc publication rules
- Dramatic increase in penalty framework will lead to even more cautious application of the insider rules
- MAR will reduce/eliminate the still numerous national sub-sets of insider rules
- Requirements of MAR in parts to be further detailed by technical standards (EU Commission/ESMA) and ESMA guidelines which are still outstanding

Definition of Inside Information – General.

- Definition of inside information has not been changed in substance
- Inside information is (Art. 7 para. 1(a) MAR)
  - information of a precise nature
  - which is not public
  - which relates to one or more issuers or to one or more financial instruments
  - which if publicly known would be likely to have a significant effect on the prices of the relevant financial instruments
- Current interpretation of inside information by ECJ remains applicable

Definition of Inside Information – Geltl.

- Art. 7 para. 2 MAR implements Geltl decision of the ECJ into statutory law
  - Future final event does not prevent inside information quality of interim steps
  - Circumstances specific enough to enable a conclusion to be drawn as to the possible effect on the relevant prices are precise information
  - Future circumstances which may be reasonably expected to occur are also precise information
    - Test is one of probability only, for precise information probability/magnitude test is inapplicable; but probability/magnitude is relevant for market price relevance
    - „Reasonably expected“ also requires interpretation, likely to mean more likely than not
    - While intellectually challenging, does concept add value?

Definition of Inside Information – Lafonta.

- Since inside information definition of the MAR remains unchanged in substance interpretation of the inside information in the Lafonta decision by the ECJ remains applicable
- Precise information does not require the information making it possible to anticipate the direction of a change in the prices
    - Ruling covers virtually all information on transactional activities of an issuer

Definition of Inside Information – Practical Consequences.

- In practice in particular Geltl and Lafonta decisions have the following consequences:
  - Issuer guidelines of the German FFSA (*Emittentenleitfaden der BaFin*) still give good indication of what constitutes inside information
  - Somewhat unclear standards in Geltl have resulted in issuers applying the rules very cautiously: MAR has not addressed uncertainty and severe increase in fine levels is prone to further this trend
  - Lafonta has little practical consequences in Germany as issuer and issuers' guidelines have always treated transactional activities of issuer as potential inside information

Insider Prohibitions.

- The key insider prohibitions continue to comprise
  - to directly or indirectly deal for one‘s own account or the amount of a third party in financial instruments issue relevant inside information (Art. 8 para. 1 MAR)
  - to recommend that another person engages in insider dealing or to induce another person to engage in insider dealing (Art. 8 para. 2 MAR)
  - to unlawfully disclose inside information (Art. 10 MAR)

Insider Trading Prohibition – Extensions.

- Two extensions of insider trading prohibition which are not overly relevant for M&A transactions:
  - The use of inside information by cancelling or amending previously placed orders (i.e. without knowledge of inside information; Art. 8 para. 1 sentence 2 MAR)
  - The use of recommendations or inducements where the person using the recommendation or inducement knows or ought to know that it was based on inside information

Insider Trading Prohibition – Legitimate behaviour I.

- MAR introduces a concept of legitimate behaviour (Art. 9 MAR), which constitutes rebuttable exceptions of the Spector Photo Group rule that trading in possession of inside information by a primary insider give rise to the assumption that the information is used (Art. 9 para. 6 MAR)
- For M&A transactions the following legitimate behaviour is relevant
  - A person using its own knowledge that it has decided to acquire or dispose financial instruments (Art. 9 para. 5 MAR)
    - Allows stake-building by a bidder before announcement of an intended public takeover
    - Despite narrow wording legitimate behaviour also covers knowledge of partial implementation of intentions so that staggered acquisitions and disposals remain possible

Insider Trading Prohibition – Legitimate behaviour II.

- Engaging in insider dealing, where the trading person has obtained the relevant inside information in the conduct of a takeover or merger and uses that inside information solely of proceeding of that transaction, provided that at the point of approval of the merger or acceptance of the offer by the shareholders, any inside information has been made public or otherwise ceased to constitute inside information (Art. 9 para. 4 MAR)
  - Not applicable for stake-building
  - In line with current BaFin practice
  - But is it not a „self-fulfilling prophecy“?
- Other legitimate behaviour that may become occasionally relevant in connection with M&A transactions is in particular discharging existing obligations (Art. 9 para. 3 MAR) and trading where adequate and effective internal arrangements exist (Art. 9 para. 1 MAR)

Insider Trading Prohibition – Spector Photo Group Defences I.

- Legitimate behaviour in Art. 9 MAR does not hinder other defences against the implication of the use of inside information under the Spector Photo Group rule where integrity of financial markets and enhancement of investor confidence is secured because it is assured that investors can act on equal footing and are protected against the misuse of inside information (Recital 24 MAR)
- The relevant concepts in an M&A transaction context are
  - Master plan doctrine
    - A certain plan made prior to the knowledge of inside information is executed unaltered
    - Meets defence standard as decision was taken prior to knowledge of inside information
    - Often difficult to use because price negotiations are ongoing during (and after) due diligence

Insider Trading Prohibition – Spector Photo Group Defences II.

- So-called face to face-transactions
  - Two parties in equal knowledge of inside information conclude a transaction in a financial instrument
  - Meets defence standard as both parties act on equal information footing
- Trading against indication of direction of price movement
  - Requires „unambiguous“ inside information
  - Meets defence standard as inside information would suggest to do the opposite and therefore no risk of misuse

Prohibition of Selected Disclosure I.

- Selected disclosure of inside information is unlawful unless it is disclosed to another person in the normal exercise of an employment, a profession or duties
  - Wording is very close to the ECJ decision in Grøngaard and Bang which reasonably seems to indicate that lawful disclosure should be construed narrowly
- Selected disclosure permitted in case of (lawful) market sounding
  - respective rules applicable in case of capital market transactions, but also in the context of public takeovers/mergers where
    - the information is necessary to enable shareholders to form a view on their willingness to sell and
    - that willingness is reasonably required by the bidder for its decision to make the takeover bid or merger
  - first statutory rules on market sounding; current practice relied on internal regulations on wall-crossings on the basis of confidentiality agreements

Prohibition of Selected Disclosure II.

- Requirements for permitted market sounding (to be documented):
  - Qualification of information to be disclosed (incl. reasoning) by potential bidder
  - Obtaining consent of target shareholder of being “tainted” (incl. instruction on insider dealing rules and obligation to keep received information confidential)
  - Documentation of the information given to each recipient and relevant point in time
  - Information of recipient (as soon as possible) once the information disclosed ceases to be inside information (in the bidder’s view)
- Do market sounding requirements apply to approach of counterparties with a view to a sale or irrevocable undertaking in the context of a public takeover?

Ad hoc disclosure – Disclosure obligation.

- Base rule on ad hoc disclosure remains unchanged: an issuer shall inform the public as soon as possible of inside information which directly concerns the issuer (Art. 17 para. 1 MAR)
  - Scope has been extended to issuers traded in the unofficial regulated market (*Freiverkehr*) upon their request or approval (Art. 17 para. 1 sub-para. 3 MAR)
  - Issuer remains obliged to publish inside information where it lawfully selectively discloses such information unless the recipient is obliged to keep the information confidential (Art. 17 para. 8 MAR)

Ad hoc disclosure – Delay of disclosure I.

- The base rule on the delay of ad hoc disclosure also remains unchanged
  - Immediate disclosure is likely to prejudice the legitimate interests of the issuer
  - Delay is not likely to mislead the public
  - Issuer is able to ensure the confidentiality of the information (Art. 17 para. 4 MAR)
- MAR does not prescribe whether the issuer must take a conscious decision on the delay
  - Consultation paper by ESMA seems to indicate preference for the current German practice to require decision

Ad hoc disclosure – Delay of disclosure II.

- Where a rumour explicitly relates to inside information the disclosure of which has been delayed confidentiality of the information is no longer guaranteed where that rumour is sufficiently accurate (Art. 17 para. 7 MAR)
  - Test is somewhere unclear and should be one of accuracy and detail
  - Supersedes current German practice (FFSA issuers guidelines IV.3.3) by redrawing line where issuer must react
  - In practice issuers will have to react much earlier than is currently the case

Linklaters LLP

Stephan Oppenhoff

Partner
Rechtsanwalt

Corporate/M&A
Capital Market Law
Corporate Governance

Frankfurt am Main
Tel.: +49 69 71003 445
stephan.oppenhoff@linklaters.com

Mainzer Landstraße 16
60325 Frankfurt am Main
Postfach 17 01 11
60075 Frankfurt am Main
Tel: (+49) 69 71003-0
Fax: (+49) 69 71003-333