

The Midtbank-case

EU Directive 1989/592 on insider dealing (IDD) as implemented by the Danish Securities Act (DSA) section 34 and 35 (now repealed and replaced by EU Regulation 596/2014 on market abuse (MAR)). Reported in Ugeskrift for Retsvæsen 2005.984.

In a blaze of media publicity, the Danish Supreme Court ruled on a final judgment on the Midtbank-case on 22 December 2004 and thereby settled a case that had been tried at the three levels of court in Denmark (City Court, Court of Appeal and Supreme Court). The judgement on the Midtbank-case was of significant importance for the Danish corporate and financial sector as it construed how the rules on insider dealing and inside information was to be understood and used. The case is remarkable because the Danish Supreme Court appears to have applied an understanding of the ban on insider dealing in EU law that was only later settled by the CJEU in its decision of 23 December 2009 in case C-45/08, Spector Photo Group.

Background

On 4 May 2000 a foreign bank, Svenska Handelsbanken, made an informal approach to the mid-size Danish bank, Midtbank, and expressed an interest in initiating a partnership between the two banks. Midtbank had some time before amended its articles and dispensed with provisions that would prevent takeovers.

The initial contact from Handelsbanken concerned possible cooperation on certain banking matters, e.g. currency arrangements. Representatives from both banks went into further discussions in August 2000 and during these meetings a potential sale of Midtbank was brought up. However, the discussions did not lead to an agreement on the matter as the parties had very different opinions on the selling price. The two banks split ways in September 2000 without making new meeting arrangements.

The contact between the parties was not resumed until mid-December 2000, when contact was made by phone and new meetings held in January 2001. The following discussions led to the foreign bank making a welcomed offer in April 2001 to the shareholders of Midtbank to acquire all the outstanding shares in Midtbank with an offer price of DKK 850 per share, equivalent to a total of DKK 2,065 billion. The shareholders accepted this offer.

Thus, the initial contact in May 2000 had ended with a takeover bid in April 2001 at a price substantially above the market price that was eventually successful. The problem was that during this period, on three separate occasions shares in Midtbank was traded by people connected with the management of Midtbank.

1st occasion: The chair of the board of directors had acquired on his own behalf an amount of shares in Midtbank in August 2000, which was after contact was taken up with Handelsbanken but before Handelsbanken revealed its intention to bid for Midtbanken. Considering that Midtbank had made itself available for takeover by amending its articles, would or should the chair have known that Handelsbanken might be pursuing a takeover of the bank?

2nd occasion: Midtbank cooperated with several other mid-size banks and one major mortgage institution called Realkredit Danmark. Mortgage financing is very important in Denmark and Realkredit Danmark was one of a few countrywide institutions. As part of this cooperation, Realkredit Danmark had acquired a substantial amount of shares in Midtbank as a strategic position and the acquisition was subject to a right of first refusal that would enable Midtbank to acquire the shares back if the cooperation ceased. In October 2000, Realkredit Danmark was taken over by way of merger by Danske Bank, the biggest of the Danish banks. In November 2000, Realkredit Danmark offloaded at two transactions some of their shares in Midtbank and Midtbank acquired these shares. At this point, Midtbank knew that Handelsbanken wanted to take it over, but negotiations had been terminated due to differences about the acquisition price.

3rd occasion: In February 2001, Midtbank was preparing its annual general meeting to be held later that Spring, where it would announce a buy-back of shares in lieu of dividends as done in the years before. Just as the bank was about to have the notice of the general meeting that included a call for an authorisation from the shareholders for the buy-back printed in the papers, Midtbank was approached by Realkredit Danmark, which explained that as a consequence of its takeover by Danske Bank five months before, it had decided to unload its substantial holding of shares in Midtbank. In order to exercise its right of first refusal, Midtbank would have to accept to buy the shares within a few days that covered a weekend. During the weekend, the board of Midtbank discussed the situation by phone and agreed to buy the substantial block of shares from Realkredit Danmark. After the acquisition, Midtbank announced the transaction as required by law and cancelled the planned buy-back at the general meeting because it had used the funds for the acquisition. When subsequently the public offer by Handelsbanken became known in April, it was evident that Midtbank had acquired the block of shares while negotiating the takeover.

Consequently, these three occasions raised the question whether the board of Midtbank were in possession of *inside information* at the time of these dealings and if so, whether they had violated *the prohibition against insider trading*.

The legal framework

The judgment on the Midtbank-case was delivered on the basis of the Danish Securities Act (DSA), which has recently been replaced as of 3 January 2018 by a new Capital Markets Act as a consequence of the MiFID Reform. At the time, the DSA implemented Directive 89/592 on Insider Dealing (IDD).

According to Sec 34 DSA and inspired by the definition of inside information in Art 1 IDD, the term 'inside information' consisted of two elements: (1) the information about one or more publicly traded securities, including information about the issuer or the market, that had not yet been published, and (2) if the information were published, it would be able to effect the evolution and forming of the price information on one or more of these securities.

Furthermore, the DSA stipulated a prohibition on insider trading in Sec 35 DSA. Accordingly, a person was not allowed to purchase or sell financial instruments, if that person was in possession of inside information that could be of importance for the trade.

IDD was later replaced by MAD. The current regulation MAR entered into force on 3 July 2016 replacing both MAD and the implementing provisions of the DSA. The definition of inside information is found in Art 7 MAR and although it has evolved to include a broader set of information, the core definition of IDD is still included in MAR and in this respect there is no difference between IDD and MAR.

According to MAR section 7, inside information consists of four criteria: (1) information of a precise nature, (2) which has not been made public, (3) relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and (4) which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

According to MAR article 8, insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates. This is very close to the wording used in Art 2 which contained the prohibition on insider dealing in MAD. However, Art 2 MAD differed substantially from the prohibition in Art 2 IDD, which raised the question whether the Supreme Court's decision in the Midtbank case was still valid after MAD had replaced IDD. This question will be dealt with at the end of this law report.

Even though the legal statute has changed to MAR since the ruling on the Midtbank-case, the judgement is still relevant and applicable as it determines how the term 'inside information' and the prohibition on insider dealing must be understood and used. Naturally, even a decision of a national supreme court is secondary to the decisions made by the CJEU, which enjoyed the

prerogative of construing EU law. But as shall be explained, the Danish Supreme Court applied an understanding that foreshadowed the reasoning applied by CJEU in the Spector-case and for that reason it is still reasonable to believe that the old Danish case is relevant even today under MAR.

Inside information

Re 1st occasion: In regards to the chairman's purchase of shares, it was stipulated by both the City Court and the Court of Appeal that he was not in possession of inside information at the time of the purchase in August 2000. At the time of the purchase, Handelsbanken had not yet shown an interest in taking over Midtbank, but solely shown an interest in initiating a partnership between the two banks. The Court of Appeal stated that the mere possibility that Handelsbanken was contemplating a takeover in response to the recent abolition of the takeover defences in Midtbank's articles was not sufficient to be classified as inside information. . The ruling by the City Court on the chair's acquisition was not appealed to the Court of Appeal.

Re 2nd occasion: When addressing the two minor share buybacks by Midtbank from Realkredit Danmark in November 2000, the City Court and the Court of Appeal had different opinions as to when the information on the takeover of Midtbank could be qualified as inside information – which concerned whether the information was of a precise and certain enough nature.

The City Court stipulated that the information on negotiations concerning a takeover was explicit enough to be considered as inside information. On the contrary, the Court of Appeal did not find that the board of Midtbank were in possession of inside information at the time because the negotiations had been broken off. Consequently, the negotiations about a takeover did constitute inside information, but that inside information ceased to exist when the negotiations were terminated and there was, at the time, no indication of a subsequent continuation of the negotiations. The ruling by the Court of Appeal on the smaller share buybacks was not appealed to the Supreme Court.

Re 3rd occasion. Concerning the substantial share buy back in February 2001, both the City Court and the Court of Appeal found that the board of Midtbank was in possession of inside information. However, the Court of Appeal was split (4:2) and the majority found that the decision to acquire the substantial block of shares from Realkredit Danmark was decided on other grounds than to abuse the inside information. The minority did not agree and would convict. The decision by the Court of Appeal was then appealed to the Supreme Court.

The Supreme Court in its unanimous decision agreed that the information about the negotiations with Handelsbanken in February 2001 had constituted inside information, although the information was very uncertain as the parties were still part apart at the time. However, the

Supreme Court supported the majority of the Court of Appeal that the decision of the board of Midtbank was based on other grounds than the inside information and was thus not illegitimate. Consequently, all the directors were acquitted.

All together, the judgements raise an important question; *What is required for something to be qualified as inside information?*

In respect of the 1st occasion concerning the acquisition made by the chair, it is fair to say that the mere possibility that a party is considering a takeover is not enough in itself to constitute inside information. There must be more to support this possibility.

In respect of the 2nd occasion concerning the two smaller share buybacks in November 2000, the Court of Appeal took into account that the two banks were not able to agree on a selling price, which led to the two parties separating at the end of September without making new meeting arrangements. Thus, the break-off of negotiations appeared to be categorical and final. The Court of Appeal stated that there were no ongoing negotiations nor contact between the two banks from the beginning of October until mid-December, when Handelsbanken approached Midtbank by phone. The potential takeover was not a realistic possibility at the time of the share buybacks and therefore the information on the takeover had ceased to exist as inside information. For that reason, the Court of Appeal ruled that the management of the board of Midtbank was not in possession of inside information when the smaller share buybacks took place in November 2000. It must be assumed that in order to terminate the characterisation of a certain information like this as inside information, the break-off must be very final and all communication among the parties engaged in the previous negotiations must have ended. Also, it is likely that a certain time must transpire, in this case it was about two months and less is probably possible if the break-off is sufficiently clear and categorical.

In respect of the 3rd occasion concerning the substantial share buy back in February 2001, all three courts agree that the information qualified as inside information, although, as stressed by the Supreme Court, it was very uncertain at the time whether the parties would agree on the takeover.

The Supreme Court stated that the information of the potential takeover became inside information when the parties continued their negotiations in mid-December. The Supreme Court based this upon the fact that the negotiations had reached a point where the parties were able to discuss a price and different organizational issues in connection to the merger. Thus, the negotiations and the takeover process were at a more committed and realistic state, although yet uncertain. Therefore, the Supreme Court ruled that the management of the board of Midtbank were in possession of inside information when the larger share buyback took place, as the

information had not yet been published and if the information were published, it would be able to effect the evolution and forming of the price information on one the securities of Midtbank.

This would suggest a very low threshold for inside information, which is useful to ensure the full application of the ban on insider dealing. However, as explored by the CJEU in its decision of 28 June 2012 in case C-19/11, *Marcus Geltd*, the threshold of inside information cannot be too low as that would require issuers to publicly disclose information that is yet very uncertain. In that case, the CJEU opted that in order to be considered sufficiently precise, the information about a pending process, such as negotiations about a takeover as where the facts in the Danish case, must have a 'reasonable prospect' of succeeding in order to qualify as inside information. It has been debated whether this would require more than a 50 per cent chance, but it is not apt to use percentage in this way. It is probably more reasonable to draw as the lower threshold the Court's wording in para. 48 that inside information cannot be that "which is not specific or is unlikely to influence the prices of their financial instruments". This suggest a low threshold, as chosen by the Danish Supreme Court.

The case shows that a company's interest in a takeover should not be interpreted as inside information, unless the interest has led to actual committed negotiations. Considerations, soundings and approaches are not enough. Correspondingly, a definite rejection of a *rapprochement* or a clear discontinuance of negotiations should in general entail that the *rapprochement* is considered as brought to an end and therefore not able to constitute inside information. The market should always take the possibility that companies speculate in potential alliances and takeovers into account.

Thus, 'just an interest' is not enough – there is a need for something more before information is considered as inside information. When the negotiations have reached a point where due diligence is carried out or similar confidential examinations take place, it is most likely to be qualified as inside information. Presumably, it will be qualified as inside information as soon as the negotiations get to a serious point. When both parties are committed to the negotiations and are at a realistic possibility, the information on the negotiations is without doubt certain and therefore very likely to be considered as inside information if the remaining requirements are met.

The fact that the inside information has to be of a *precise nature* is accord with what was later on stipulated in *MAD* and later again in *MAR*. The *Midtbank*-case is a great example of when information is of a precise nature and therefore qualified as inside information as it shows that information has to concern certain and realistic facts before it is of a precise nature.

Insider dealing

At the time of the Midtbank-case, it was debated among many EU-member states how the prohibition on insider dealing should be interpreted – especially in terms of “use and abuse”. In general, there used to be two views on how the prohibition should be understood.

The rule of presumption

As seen in the Midtbank-case, the Danish Supreme Court, as was the opinion of the majority of the Court of Appeal, found that the possession of inside information created a presumption of abuse, but that this presumption could be rebutted by evidence that the inside information had not been the reason for the transaction and thus not abused.

The Midtbank-case was decided according to IDD, and when IDD soon after was replaced by MAD, it was questioned whether the Supreme Court’s reasoning was still valid. The reason was that MAD had replaced the wording in IDD of ‘taking advantage’ with the more neutral term ‘use’. This raised the question of whether the inside information still had to be part of the decision to trade of the insider in order to establish insider dealing.

This was settled when CJEU ruled in the Spector-case that if a person deals at a time where that person is in possession of inside information, there is a rebuttable presumption that the inside information was significant to that person and therefore it was used when dealing. The prohibition on insider trading should therefore be considered as breached, unless the accused is able to rebut that presumption. The reasoning of the Court was simple. Inside information is defined as information that would form the basis of a reasonable investor’s decision to trade. If the insider is in possession of inside information, it is natural to presume that he too is influenced by the inside information to trade as any other reasonable investor would be. But this is only a presumption and it may be rebutted if the insider can prove that the transaction was based on other grounds. This was the case in the Danish Midtbank-case and it thus supplements the Spector-decision well. Due to the reasoning behind the presumption of abuse, it is very likely that rebuttal is only possible where the inside information is yet uncertain. Had the inside information about the pending negotiations about the takeover by Handelsbanken been more certain and the takeover thereby more likely to occur, the Midtbank-case would very likely have ended differently.

Later on, this rule of presumption as established in the Spector-case was repeated in MAR. According MAR preamble 24, where a person in possession of inside information acquires or disposes of, or attempts to acquire or dispose of, directly or indirectly, financial instruments to which that information relates, it should be implied that that person has used that information.

Use and abuse

The Supreme Court acknowledged that a rule of presumption existed, but legitimate reasons could justify a trade. This implied that the inside information had to be used in a dishonest way – in other words; it had to be abused.

Regarding the larger share buyback that took place in the beginning of February 2001, the Supreme Court stated a string of arguments why the buy-back had been legitimate. The very fact that the Supreme Court felt it necessary to state all these legitimate reasons in itself suggests that the Court applied a presumption that the possession of inside information indicated abuse that had to be rebutted. The Supreme Court mentioned, *inter alia*, that a company's share buyback normally will be considered as an ordinary business practice and will often be of legitimate reasons. The purpose behind Midtbank's share buyback was to initiate a capital reduction in order to pay dividend distribution to the shareholders and that the share buyback was reported to the stock exchange as required by law. It was also stressed by the Supreme Court that at the time of the share buyback, the two parties were still negotiating and the outcome was uncertain. Furthermore and likely very importantly, it was noted that the share buyback happened at the request of Realkredit Danmark in order to exercise a right of first refusal.

In addition hereto, the Supreme Court emphasised that insider trading will typically happen for the sake of gain, and therefore Midtbank's share buyback was in contrast to an insider trading as it had a legitimate purpose. This observation was not presented as important, but listed among the reasons that had convinced the Court that the buy-back had not been made to abuse the inside information.

Thus, the Supreme Court ruled that even though the management of the board were in possession of inside information, it had not been used in a dishonest way as the purpose behind the share buyback was legitimate and therefore no abuse of the information had happened.

Conclusion

The ruling on the Midtbank-case establishes guidelines on how to understand the term 'inside information'. In accordance with the judgement, an information on a matter has to be certain, realistic and precise in order to be qualified as inside information.

The interpretation by the Supreme Court in the Midtbank-case as well as the CJEU's ruling in the Spector-case establishes a harmonized standard on how the prohibition on insider dealings has to be understood and used.

The understanding and use of the prohibition on insider trading includes a rule of presumption. This means that if a person is in possession of inside information and trades on financial instruments that relate to that information, it is considered that that person has used the inside

information as a basis of decision. However, both the ECJ and the Supreme Court states that if there is a legitimate purpose behind the trade it can initially entail that the prohibition is not considered as breached. In other words, there has to be an element of 'abuse' of the inside information.

Rapporteur: Christine Kjærgaard

NKN-validation: Prof Jesper Lau Hansen