

## Updated: Meaning of inside information and the importance of prompt decision making

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### Briefing note

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### Case Update - Markus Geltl v Daimler AG

On 1 June 2012 we published an [article](#) commenting on the Advocate General's opinion in the case of Markus Geltl v Daimler AG. Since then, the European Court of Justice (ECJ) has handed down its [decision](#) in the case.

The decision confirms that intermediate steps in a protracted process may themselves constitute inside information and thus be disclosable to the market. It also rejects the position put forward by the Advocate General that potential events or circumstances might constitute inside information and be disclosable where their probability is relatively low but their potential impact on the company's share price is significant.

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### Facts

The case concerned the protracted process for the termination of the Chairman of the management board of Daimler AG. A detailed description of the facts is set out in our earlier article.

### The Legal Framework

In general terms, EU and UK law prohibit trading based on 'inside information' and require listed companies to publish inside information as soon as possible after it comes into existence.

'Inside information' is defined for the purposes of the EU Market Abuse Directive (MAD) as "*information of a precise nature which has not been made public... which, if it were made public, would be likely to have a significant effect on the prices of [relevant securities].*"

The directive further provides that information shall be deemed to be of a precise nature if it:

- Indicates a set of circumstance which exists or *may reasonably be expected* to come into existence or an event which has occurred or *may reasonably be expected* to do so; and
- Is *specific enough* to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the relevant securities.

The definitions of 'inside information' used in the Financial Services and Markets Act and the Disclosure and Transparency Rules (DTRs), which implement the MAD in the UK, are in substantially the same terms as the MAD definition. The AIM Rules, which regulate disclosure of information by AIM Companies, use different concepts, which are generally referred to under the banner of 'price sensitive information'. Nonetheless, the cases and commentary on 'inside information' are still instructive in identifying information that should be disclosed by AIM companies.

### The Judgment

The ECJ was required to rule on three issues in the case:

- Whether information relating to *intermediate steps* in a protracted process to bring about certain circumstances or events can amount to inside information;
- Whether a potential set of circumstances or potential events must be *preponderant or highly probable* to fall within the requirement that they *may reasonably be expected to occur*; and
- Whether the required level of probability for circumstances or events to reasonably be expected to occur should *vary depending on the magnitude of the likely effect of the circumstances or events on the share price of the company* i.e. whether low probability, high impact potential events or circumstances should constitute disclosable inside information.

The principal findings of the ECJ were as follows:

- Information relating to intermediate steps in a protracted process *can be precise information (and therefore constitute inside information) provided it is also specific enough* to enable a conclusion to be drawn as to the possible effect of the information on the relevant securities.  
In coming to this decision, the ECJ emphasised that if such information were not 'inside information' then persons in possession of such information would be at liberty to trade based on the information and to profit at the expense of people not in possession of the information. This would be at odds with the objectives of the MAD – protecting the integrity of the financial markets and enhancing investor confidence, including by ensuring investors are on an equal footing;
- To fall within the requirement that they may reasonably be expected to occur, there needs to be a *realistic prospect that potential circumstances or events will occur*. Neither the 'preponderance' nor the 'highly probable' standard was adopted by the ECJ; and
- The required level of probability that potential circumstances or events will occur (so as to meet the 'reasonably be expected to occur' requirement) *will not vary* depending on the magnitude of their effect on the share price of the company. The standard is always the same – there must be a realistic prospect that they will occur.

### Comment

The ECJ's decision is a welcome one in that it:

- Definitively confirms that information concerning intermediate steps can constitute inside information and provides guidance as to the circumstances where this is likely to be the case; and
- Rejects the suggestion of the Advocate General that events or circumstances might constitute inside information and be disclosable where their probability is relatively low (not impossible or improbable) but their potential impact on the company's share price is significant.

### Intermediate steps

In terms of UK regulation and practice, the ECJ's decision on the issue of intermediate steps is consistent, in our view, with existing [non-binding FSA guidance](#) that it is not acceptable for a company to delay an announcement where a decision relating to material information (such as a change of senior management) has clearly been made but not yet received formal board approval. That said, the decision will likely encourage companies and their lawyers to give greater consideration to whether intermediate steps in decision making processes are disclosable, with difficult judgement calls likely to be required as to whether there is a reasonable prospect of particular events or circumstances coming into existence and whether they are specific enough to enable conclusions to be drawn as to their effect on the company's share price.

In terms of practical implications of the decision:

- Company executives should act in a coordinated and expeditious manner in taking decisions with a view to minimising the risk of intermediate decision making steps becoming disclosable;
- Companies should continue to be aware that intermediate steps in decision making processes and steps taken subject to board approvals may require disclosure prior to formal decisions being made or approvals being given;
- Main Market companies should ensure they understand the application of the disclosure exception contained in DTR 2.5, which enables them to delay the disclosure of inside information in particular circumstances, such as, to maintain the confidentiality of negotiations that would likely be prejudiced by public disclosure; and
- Companies should consider whether their procedures for identifying inside information require updating to ensure information concerning intermediate steps which may amount to inside information is identified, despite the fact that it may relate to a preliminary stage of a process.

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### Linking probability and impact

The ECJ's decision not to follow the Advocate General's suggestion that low probability, high impact potential events or circumstances should be disclosable (where the other elements of the definition of 'inside information' are satisfied) is possibly the most significant aspect of the decision.

Had the ECJ followed the Advocate General's approach on potential events and circumstances, companies would have come under pressure to announce information about potential events or circumstances that are unlikely to occur but would, if they were to occur, have a significant effect on the price of the company's securities. This would have raised the prospect of substantial share price movements based on announcements of mere possibilities.