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ALERT MEMORANDUM

Market Abuse Regulation: A Balanced Approach to the Market Sounding Regime's Applicability in Capital Markets Transactions

June 27, 2017

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Few aspects of the Market Abuse Regulation ("**MAR**") have generated as much angst and uncertainty among market participants planning capital markets transactions as the market sounding provisions of Article 11. Even today, with the anniversary of MAR's coming into effect approaching, key questions on the reach and applicability of the new regime remain unresolved. This memorandum supplements our prior memoranda on MAR by considering the appropriate reach and applicability of the new regime in capital markets transactions and offering thoughts on how market practice in this area might continue to develop amidst the regime's lingering interpretive uncertainties.[1]

In considering questions of reach and applicability, it is helpful to begin by appreciating four preliminary points:

- the new regime (which, broadly, comprises a set of procedural requirements) has concerns with unlawful disclosure of inside information[2] and insider dealing as its general backdrop; that is, that information disclosed during pre-marketing processes might amount to inside information with

[1] For details on other aspects of MAR, please refer to our prior memoranda, available here, here and here.

[2] MAR defines inside information as "information of a precise nature, which has not been made public, relating … to one or more issuers or to one or more financial instruments, and 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."

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respect to, and present recipients with the "potential to benefit financially" from trading in, securities for which trading markets already exist;[3]

- the new regime, if construed as a mandatory one (although see the further discussion on this below), is inherently premised on scepticism of the judgments that market participants might make as to whether their planned disclosures in the pre-marketing context will or will not amount to inside information. Its procedural framework – including, notably, the requirement that market soundings be recorded *even* where a determination is made that no information to be disclosed amounts to inside information – is rooted in the perception that the market sounding context, by its nature, entails a *particular* risk that inside information will be disclosed, and aims to provide regulators with an "audit trail" in subsequent investigations concerning whether disclosure was improper;

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- despite the concerns that animate it, the new regime is also premised on the notion that market soundings are a "highly valuable tool" to ensure that deals run smoothly, and "important for the proper functioning of financial markets."[4] Far from seeking to chill such activities, the new regime aspires to provide market participants with a procedural framework within which information concerning a potential transaction (and, in appropriate instances, non-deal specific inside information as well) *can* be selectively disclosed in pre-marketing activities without fear that this would be considered improper.[5] (Accordingly, disclosures of inside information in the course of market soundings that comply with the new regime are deemed by MAR's Article 11(4) to have been made "in the normal exercise of a person's employment, profession or duties," and are thus not "unlawful" for purposes of Article 10.); and

- from a risk perspective, although there is some risk in *any* judgment that Article 11 procedures are not required, there is also – both in terms of the regime's animating concerns and the practical likelihood that a market sounding will attract regulatory scrutiny to begin with – clearly an increased level of risk in giving prospective investors information that they are more likely to be able to trade on immediately. (A scenario where a regulator monitoring the secondary market observes suspicious trades and makes further inquiries only to find that MAR procedures weren't followed is one that market participants should be particularly keen to avoid.)

Although these points, and the underlying policy preferences and practical realities that they embody, exist in some tension, they are, in our view, an invaluable backdrop to understanding and applying the new regime in a purposive, proportionate and risk-based manner, and in particular, in informing determinations as to *whether* the market sounding regime should be applied to a given set of investor contacts at all.

[3] MAR, Recital 34.

[4] MAR, Recital 32.

[5] MAR, Recital 32.

Note that, for purposes of this memorandum, we begin from the premise that the Article 11 regime is mandatory, and not – as may well be the better view[6] – an optional "safe harbour" from the offence of unlawful disclosure of inside information. This reflects London market practice in the capital markets context to date, which, informed by MAR's implementing measures (and informal early regulatory guidance), has over time come to favour the view that Article 11 does or (amidst the practical imperative of allowing transactions to proceed with greater certainty) should be assumed to have a mandatory aspect. We understand though that, more recently, there has been somewhat greater regulatory openness to the notion that Article 11 is indeed an optional safe harbour, and so the development of regulatory views and further formal guidance in this area continue to bear close watching, as their implications for market practice could be significant.

It is also worth noting that, since MAR's coming into effect, investment banks and buy-side investors (within the EU at least) *have* by and large established appropriate procedures to apply the new regime where it is perceived to be necessary. As such, in those inevitable instances in which the application of Article 11 procedures will be the only feasible route to conduct effective pre-marketing, issuers should generally find that tried and tested procedures are already in place. (For readers unfamiliar with the detailed requirements that Article 11 imposes on issuers and others conducting market soundings where it is applicable, the Annex to this memorandum sets out a fuller summary.)

[6] Although a number of Article 11 provisions could, read literally and in isolation, be construed as mandatory, that construction becomes more difficult to sustain when the Article and the regulation are read as a whole, in the purposive / teleological manner required by EU jurisprudence. For example: (1) MAR, Recital 35 strongly implies that Article 11 is an optional regime that issuers and other disclosing market participants may choose to "take advantage of" in order to access assured protection from the offense of unlawful disclosure of inside information; (2) the language of Article 11(4), which gives effect to the exemption, reflects the same premise, framing the key procedural requirements of Articles 11(3) and 11(5) as a condition to protection that may or may not be complied with; (3) Article 11(5), which contains the bulk of Article 11's procedural requirements that apply to disclosing market participants, is introduced as being "*for purposes of [Article 11(4)]*" – which, as noted, is itself not framed in prescriptive terms; (4) although certain other Article 11 provisions are framed in prescriptive terms without explicit qualifications like "for purposes of [Article 11(4)]," several (although arguably not all) of these appear to be ancillary to Article 11(5), and it would seem contrary to the internal logic of Article 11 to bestow ancillary provisions with autonomous prescriptive status; (5) a mandatory construction would necessarily also extend to soundings in the public M&A context (further to Article 11(2)), a context in which systematic application of Article 11's procedural requirements would be highly impractical (casting even more doubt on whether such a construction could conceivably have been intended); and (6) perhaps most tellingly, member states are not required to provide for sanctions (under Article 30 or under CSMAD) for non-compliance with the procedural requirements of Article 11. Note, moreover, that implementing measures, though worded in a prescriptive way, cannot change the seeming optional safe harbour principle discussed above as such principle emanates from the regulation itself; "level 2" implementing measures cannot contradict "level 1" regulation.

SUMMARY OF KEY APPLICABILITY CONSIDERATIONS

- Where pre-marketing contacts amount to a "market sounding," MAR may require both those disclosing the information and potential investors that receive it to adhere to various (fairly burdensome) procedural requirements.

- In appropriate instances, however, it may be possible for market participants to reasonably conclude that the Article 11 regime does not apply. These instances may include pre-marketing:

  - in offerings by "true" debut issuers (that is, issuers that neither have, nor are part of corporate groups that have, securities already admitted to EU trading venues). (See Part I.A below.);

  - where (i) the new transaction (if completed) , with all its potential terms, conditions and features and (ii) any non-deal-specific information intended to be disclosed are not expected to affect the price of those already-admitted financial instruments. (See Part I.A below, including the examples discussed in that section.);

  - where investor contacts can credibly be viewed as not intended to "*gauge … interest … in a possible transaction and the conditions relating to it.*" (See Part I.B below, including a further debt issuance by a frequent, investment-grade issuer, among the other examples discussed in that section.); and

  - following an announcement of the transaction that ensures a substantive alignment between information in the public domain and information to be disclosed selectively to potential investors. (See Part I. C below.)

- Where the nexus with the EU is so low that a regulator is unlikely to take an interest, it may also be reasonable for market participants to choose not to apply the regime. (See Part II below.)

- When Article 11 procedures are not applied, consideration should be given to other prudential procedures to (among other things) evidence the basis for non-application. (See Part III below.)

I. DETERMINING WHETHER THE MARKET SOUNDING REGIME APPLIES

MAR defines a "market sounding" as comprising:

- any communication of information to one or more potential investors;
- by the issuer, secondary offerors in certain cases and third parties "acting on behalf of" or "on the account of" either of the foregoing;
- prior to the announcement of a transaction;
- in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it, such as its potential size or pricing (*i.e.*, in general, its terms).

Persons potentially subject to the Article 11 regime if they disclose information in the course of a market sounding ("**disclosing market participants**" or "**DMPs**" in MAR's parlance) include, again: the issuer; secondary offerors in certain cases; and third parties "acting on behalf of" or "on the account of" either of the foregoing. The terms "acting on behalf of" or "on the account of" have been construed by ESMA to cover circumstances where a third party (such as an investment bank), *at the request of* an issuer or secondary offeror (regardless of whether the third party has been formally mandated, and regardless of whether the instructions are oral or written), sounds out potential investors with a view to determining transaction characteristics.

Although these are undeniably broad constructs, they are not open-ended. In particular:

- as with MAR generally, Article 11 should be limited by the "scope" provision in Article 2 (although the precise nature of that limitation merits close consideration);
- the term "market sounding" *only* covers communications of information to investors in order to "gauge … interest" in a possible transaction and its terms; and
- the term "market sounding" does *not* extend to communications after the "announcement of a transaction."

Accordingly, as further discussed below, there are instances where it may be reasonable to treat investor contacts that amount to a "market sounding" within the meaning of Article 11 as outside MAR's scope, or to treat a set of investor contacts as not amounting to a "market sounding" because they were not intended to gauge interest in a transaction and its terms or they occurred after an appropriate announcement is made.

A. Determining whether a market sounding is in-scope

Paragraph 1 of MAR's "scope" provision (Article 2) expressly applies the regulation as a whole only to the following financial instruments:

- financial instruments admitted to trading on EU regulated markets, "multilateral trading facilities" ("**MTFs**") or "organised trading facilities" ("**OTFs**") (or, in the case of regulated markets or MTFs, financial instruments for which admission to trading has been requested) (Article 2(1)(a)-(b));[7] and

[7] EU regulated markets, broadly, include the main platforms of the EU stock exchanges. MTFs are financial trading platforms that are not traditional stock exchanges, including a number of popular trading venues like the Euro MTF in Luxembourg, the

- other financial instruments whose price or value depends on or has an effect on the price or value of the aforementioned EU-admitted securities (or securities for which admission to trading has been requested) (together with the foregoing, "**in-scope financial instruments**") (Article 2(1)(d)).

Paragraph 3 further states that the regulation applies to any transaction, order or behaviour concerning such in-scope financial instruments, and paragraph 4 further states that the regulation's prohibitions and requirements apply to actions or omissions concerning such in-scope financial instruments.

The text of MAR's scope provision thus supports the view that the regulation should *only* apply to, and its specific requirements should be understood in the context of, those financial instruments that it deems to be in-scope (and, where relevant to a given MAR provision, transactions, orders, behaviours, actions and omissions that "concern" those in-scope financial instruments). Further, nothing in the text of MAR in our view supports the idea that *any* MAR provision, including Article 11, applies to instruments, transactions, orders, behaviours, actions or omissions that are *not* implicated by the general scope provision in Article 2.[8] Indeed, Article 2's relevance to the question of when the Article 11 regime applies has been expressly acknowledged by ESMA.[9]

Nevertheless, the question of when a given market sounding implicates Article 2 gives rise to considerable interpretive uncertainties. In considering this question, practice in the London market has increasingly come to focus on the scope provision's paragraph 1; that is, by asking whether the transaction being sounded is of a financial instrument that *itself* is (or on completion of the transaction, would be) an in-scope financial instrument. When expressed thus:

- for a "true" debut issuer (that is, an issuer with no other securities admitted to trading on EU trading venues and not part of a corporate group with securities that are admitted to trading), Article 11 is unlikely to apply; and

- for issuers other than "true" debut issuers, the reach of the new market soundings regime would largely be limited to follow-on offerings of already-admitted securities, and offerings of securities that have a price-value relationship with already-admitted securities.

The first conclusion, in our view, is an entirely reasonable one (as further discussed below).

Global Exchange Market in Ireland, the Alternative Investment Market in the UK and the Open Market of the Frankfurt Stock Exchange. OTFs are a new category of trading venue introduced by MiFID II for bonds, structured finance products, emission allowances and derivatives. OTFs are similar to MTFs, but the execution of orders is carried out by the OTF operator in a discretionary way. MAR will only apply to OTFs from January 3, 2018.

[8] Although certain MAR provisions do contain specific restrictions on scope, including, for example to categories of issuers (as with, *e.g.*, the obligation under Article 17 to disclose inside information as soon as possible, or, *e.g.*, the PDMR reporting obligations and closed period restrictions in Article 19, both of which are limited to companies whose debt, equity or other securities are admitted to trading on EU trading venues with their approval, or that have requested such admission to trading), or to specified types of financial instruments, based on the plain language of Article 2 (and the absence of language suggesting supersession), these are best viewed as incremental limitations on scope that apply in addition to Article 2.

[9] ESMA, in its final report on draft technical standards on MAR, after discussing Article 11's applicability in the context of block trades and certain other specific scenarios, offers the following general guidance under the heading "Other scope issues": "More generally, in response to comments and requests for clarification on when the market soundings regime under MAR applies, ESMA would refer to Article 2 of MAR determining scope and Article 7 of MAR which defines inside information."

The second conclusion though – and the primacy it accords to whether a price-value relationship exists between the new securities and already-admitted securities – appears questionable for at least two reasons:

- an assessment of whether the "price" or "value" of the new securities has an effect on the price or value of already-admitted financial instruments is an imperfect device to capture what the Article 11 regime is aimed at – in effect, *any* information disclosed in the context of a market sounding that *may* amount to inside information for financial instruments with an existing trading market. It is unclear, for example, that a focus on "price" or "value" would adequately capture terms and conditions of a new transaction that are not pricing terms, but that may nevertheless be highly significant to already-admitted financial instruments (*e.g.*, the details of a new debt offering's restrictions on dividends and buybacks that may be highly significant to already-admitted equity), and even less clear that it would capture *unrelated* non-deal-specific information that might be disclosed in the course of a sounding (*e.g.*, an acquisition under negotiation whose public disclosure is being legitimately delayed)[10];[11] and

- it depends on a very narrow reading of paragraphs 3 and 4 of the scope provision discussed above, in essence assuming that the only market soundings that "concern" in-scope financial instruments (and are thus capable of being brought into MAR's scope by virtue of paragraphs 3 or 4) are those where the securities being sounded are *themselves* in-scope financial instruments. Although it is tempting to read the "concerns" reference in paragraphs 3 and 4 in this limited way, there are reasons to be sceptical. Indeed, in view of the backdrop to the regime (including its focus on the *risk* that information disclosed could be inside information, its scepticism of the judgments that market participants make in advance and its desire to provide regulators with an "audit trail"), it is arguable that, for an issuer with already-admitted financial instruments, many market soundings will constitute a behaviour or action that

[10] Although Article 11's concerns with unlawful disclosure of inside information and insider dealing relate most obviously to the possibility that information on the transaction that is the subject of the sounding might *itself* amount to inside information (*e.g.*, the fact that it is contemplated, its potential terms), they are not *limited* to deal-specific information. The new regime recognizes that issuers might be in possession of non-deal-specific information whose public disclosure has been legitimately delayed but that it is necessary to selectively disclose in pre-marketing to provide context to the transaction being sounded.

[11] Also, the examples given in Article 2(1)(d) itself (and also in Recital 10) suggest that the financial instruments intended to be brought within MAR's scope on the basis of a price-value relationship are, by and large, derivatives, convertibles and other financial instruments with a *continuing* price-value relationship with already-admitted financial instruments (*i.e.*, a relationship that extends into the aftermarket). Yet an analytical approach to Article 11 that hinges on the price-value language in Article 2(1)(d) and limits Article 2(1)(d) to just derivatives, convertibles and other financial instruments with a continuing price-value relationship would limit Article 11 to such a small subset of transactions as to make it almost meaningless. To avoid that result, analytical approaches to Article 11 that hinge on the price-value language in Article 2(1)(d) necessarily seek to read the price-value language in Article 2(1)(d) more broadly, and in effect seek to bring into MAR's scope financial instruments where the price effect of new securities being sounded occurs only as a result of the new securities' *initial issuance*. That broader interpretation in the market sounding context may, however, be problematic in other contexts. In particular, for issuers with multiple classes of public securities but only one class listed in the EU who have to date reasonably understood the reach of their *other* MAR obligations (for example, PDMR reporting or the obligation to disclose inside information) in the context of their EU-admitted securities and other securities in a price-value relationship with those securities, a broader interpretation of what a price-value relationship entails in the context of market soundings risks an inconsistent interpretive approach to MAR at best, and an unintended broadening of those other MAR obligations at worst. (For example, companies with EU-listed vanilla debt could conceivably find themselves having to notify PDMR trades in their non-EU-listed equity through a broader price-value relationship construct.) Although, as discussed below, an assessment of price impact on EU-admitted securities at initial issuance is, in our view, an important element of the scope analysis for market soundings, this is not by virtue of Article 2(1)(d), which risks the unintended knock-on effects on other MAR provisions noted above, but rather through the interaction of Articles 2(3) and 2(4) and the unique backdrop to the Article 11 regime, as a result of which a market sounding of a transaction with only an initial price impact could be said to "concern" an already-admitted financial instrument.

"concerns" already-admitted financial instruments simply by taking place. (We note, moreover, that at least one regulator, the UK FCA, appears to have reached this very conclusion on the appropriate reach of Article 11.)[12]

For an issuer with already-admitted securities, the necessary conclusion to avoid MAR's application on the basis of Article 2 is thus likely *not only* that the securities that are the subject of the market sounding are not in-scope financial instruments, but *in addition* that the *market sounding as a whole* does not otherwise "*concern*" any already-admitted financial instruments.

This is a challenging conclusion to reach, particularly as there are (for the reasons noted above) arguments that any market sounding will innately "concern" already-admitted financial instruments simply by taking place. Nevertheless, in the absence of further ESMA guidance expressly affirming that position, we believe that it remains open to market participants to reach this conclusion in limited instances. More specifically, in view of MAR, Recital 8 (the plain language corollary to Article 2), which, read together with Article 2, implies that conduct or action will "concern" already-admitted financial instruments if it "can" (prospectively) "have an effect" on those financial instruments, and the underlying concerns with tradable information at which Article 11 is aimed, we believe it would be reasonable to reach the conclusion that a market sounding neither has a price-value relationship with nor otherwise "concerns" already-admitted financial instruments if:

- the transaction being pre-marketed (prospectively, assuming its completion), and its terms, conditions or features (considering the full range of reasonable potential outcomes for terms, conditions and features that remain unsettled at the time of the sounding); and

- anything else to be disclosed in pre-marketing (again, giving prospective effect as needed), are not expected to affect the price of those already-admitted financial instruments.

A conclusion of this sort will of course be impossible in circumstances where the information to be disclosed has been determined to be inside information (since that determination entails a judgment that a significant effect on price is likely). It is also, to be clear, a much more demanding conclusion than a conclusion that the information in question is not inside information, including because it entails a determination that *no* price effect is likely (as opposed to an inability to conclude that a *significant* price effect is likely) and because it assumes a completed transaction while considering the full range of potential forms that transaction and its terms, conditions and

[12] The FCA's view, expressed in a consultation paper, is that the scope of Article 11 extends to "all transactions of an issuer which has existing financial instruments admitted to trading on a trading venue, or where a request for admission on to a trading venue has been made … provided that the other elements of the market sounding definition are met in a given circumstance, and regardless of whether or not the information communicated is inside information."

Although this language has been interpreted by some as glossing over the relevance of Article 2 entirely, that reading seems suspect given that the FCA still limits the reach of the Article to instances where a particular issuer has *some* financial instruments admitted to trading or has requested such an admission to trading.

It also bears noting that the FCA reads the reference to "possible transactions" in the definition of market soundings in Article 11 as extending to *any* transactions (or, possibly, since the definition also requires "potential investors," any transactions with an investment element), but in any case *not* merely to transactions in "financial instruments." Article 11 is itself silent on the types of transactions that it captures (except by making clear, through the reference to "potential investors," that an investment element is needed), but this view – although credible on the basis of the plain language of Article 11 and, arguably, from a policy perspective – seems at odds with certain of MAR's recitals that suggest that a reference to "financial instruments" should be read in. The issue is largely beyond the scope of this memorandum, which is focused on capital markets transactions (and so transactions in financial instruments), but this reading would have a number of other unfortunate implications if the Article 11 regime is a mandatory one.

features might reasonably take (as opposed to inside information judgments, where the speculative or uncertain nature of the transaction or aspects of it may, at times, be relevant to the question of whether information is sufficiently "precise").[13]

Whether any given market sounding will be within MAR's scope based on the points above will invariably involve a facts and circumstances analysis, but to consider some typical cases:

- *Debut offering for a company with no other securities admitted to trading (and not part of a corporate group with securities admitted to trading)*: For a "true" debut issuer, Article 11 procedures should generally not be needed. Article 11 will not apply (even technically) to market soundings until a request for admission to trading is made, and although it will apply technically to any market soundings that occur after such a request (which may occur in certain transactions on certain EU trading venues), in the absence of a relevant trading market at the time of the sounding (and assuming that an offering document or announcement conveying all material information discussed in the meetings will be published before a trading market forms), the risks of not following Article 11 procedures would still, in our view, be low.

- *Follow-on offerings*: Market soundings in respect of follow-on offerings of securities already admitted to trading on EU trading venues will be within MAR's scope.

- *Rights offerings*: Assuming that the underlying equity is already admitted to trading on an EU trading venue, rights offerings will be within MAR's scope.

- *Debt-listed company planning IPO*: We would expect instances where Article 11 does not apply to a company with only listed debt planning an IPO to primarily involve investment-grade issuers whose debt responds mainly to interest rate movements and is thus unlikely to be impacted by the fact of the IPO, its terms, conditions and features (including any anticipated changes in ownership or corporate governance, or any potential infusion of junior capital) or by other non-deal information that might be conveyed. For other companies, considerable scrutiny is required; for example, Article 11 seems far more likely to apply to a sub-investment grade issuer planning an IPO (and for which the IPO might be a credit positive).

- *Debt-listed company planning a further debt issuance*: We would expect a conclusion that Article 11 does not apply to generally be limited to fairly regular issuers with investment-grade ratings. Considerable scrutiny is likely appropriate in other circumstances.

- *Equity-listed company planning debut debt issuance*: An issuer with already-admitted equity undertaking a debut debt issuance will generally merit close scrutiny. There may be instances where Article 11 is unlikely to apply (for example, a debut offering of *EU-listed* debt by a large public company that regularly issues investment-grade debt *outside the EU*). Yet for many public companies accessing the public debt markets for the first time (including early-stage and sub-investment grade ones), a conclusion that Article 11 does not apply may be challenging to reach.

[13] As noted above, MAR defines inside information as "information of a *precise nature,*" which, if it were made public, would be likely to have a significant effect on price. Information is deemed to be of a precise nature if it indicates a set of circumstances that exist or that may reasonably be expected to come into existence, or an event that has occurred or that may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on price.

B. Gauging interest in a potential transaction

Investor contacts that do not seek to "gauge … interest" in a potential transaction and its terms are not "market soundings" as defined, and are thus outside the scope of the new regime.

This is an area on which regulatory guidance is limited, however, and so in relying on a conclusion that particular investor contacts are not intended to gauge interest in a transaction and its terms to avoid Article 11's application amidst a purposive and risk-based approach to the regime, regard should be had to all the surrounding facts and circumstances, and in particular to:

- whether (and if so, the extent to which) planned investor contacts and disclosures may give rise to the mischief at which Article 11 is aimed – *i.e.*, the potential for financial benefit from trading on a misalignment between the information available to the prospective investors being sounded and the information then in the public domain; and

- the extent to which the investor contacts in question are comparable to the typical case for which Article 11 procedures were, we believe, intended – in effect, presentations to a limited set of investors amidst uncertainty as to whether a transaction on particular terms might succeed, where the issuer generally has only a limited window to make its case, and where feedback is likely to be decisive to any decision to proceed with the transaction as then contemplated.

In general, the greater the likelihood that the information to be conveyed may constitute tradable inside information and the more that investor contacts are comparable to the typical case for which we believe Article 11 was intended, the greater the caution that is appropriate in relying on a conclusion that investor contacts are not intended to gauge interest in a transaction and its terms (and the greater the use of prudential procedures is likely to be appropriate; see Part III below). It is also important to remember that even in instances where Article 11 is inapplicable, the general prohibition on unlawful disclosure of inside information outside the "normal exercise of a person's employment, profession or duties" in Article 10 will remain, and the issuer will still remain subject to an obligation to disclose inside information as soon as possible (unless there is a legitimate basis for delay). Accordingly, it will still be important in such cases for transaction participants to assess whether the information to be disclosed amounts to inside information, and where it is or might be, consider the potential need for an announcement or the use of alternative wall-crossing procedures to avoid unlawful disclosure.

Examples of investor contacts in which non-application of Article 11 could, we believe, reasonably be considered on the basis that these are not intended to gauge interest in a transaction and its terms include the following:

- *Regular investor meetings*: Regular outreach by an issuer to its existing investor base to keep it informed of notable developments (when no transaction is planned) should not constitute a market sounding.

- *Non-deal roadshows*: "Non-deal" roadshows in advance of planned transactions, but in which the planned transactions will not be discussed at all – including through slide presentations, oral remarks or in Q&A – should not constitute market soundings.[14] The fact that banks mandated on a planned transaction play a role in setting up, or participate in, the relevant meetings should not be relevant. Nor should it be relevant

[14] It is not uncommon to see presentation materials for non-deal roadshows include suggestive language like "a transaction may follow" or a "transaction will follow," subject to market conditions. Although we do not believe that a statement of this sort in isolation necessarily constitutes gauging interest in a transaction *and its terms*, we recommend that such statements be struck (since, even absent other references to a transaction in presentation materials, they may call into question whether a non-transactional script was in fact adhered to in oral discussions).

that a transaction may be formally launched a short time after the relevant meetings,[15] or that such meetings might, in a general sense, condition the market for the securities to be offered.[16] The question in our view is a binary one – will the planned transaction be discussed or not? If the answer is no, then not only should the regime not apply technically, but the mischief at which it is aimed should not arise.

It would be prudent, however, for market participants planning non-deal roadshows to consider whether the facts and circumstances lend credibility to the premise that a non-transactional script will in fact be adhered to. For a regular issuer that regularly engages in investor outreach, this may be a relatively easy conclusion to reach. It may be less credible for an infrequent issuer without a history of investor outreach, or an issuer whose past meetings have invariably been followed with transactions in short order or where planned meeting content is inconsistent with past meetings in a way that could be construed as a cue to off-the-page transactional discussion. Again, this should not change the binary nature of the inquiry, but a less credible fact pattern may merit greater scrutiny and use of prudential procedures, such as scripted oral remarks (see Part III below).

- *"Issuer" focused meetings with a stated transactional backdrop*: In certain cases, it may be possible to view pre-marketing even *with* a planned transaction as the stated backdrop as not constituting a market sounding on the basis that, although it is intended to gauge interest in "a potential transaction" in a general sense, it is not intended (as the plain language of Article 11 appears to *additionally* require) to gauge interest in "the conditions relating to it such as its potential size or pricing." In such instances, however, thought should be given to whether the stated transactional backdrop (and any resulting misalignment of information) merits a different approach or, potentially, the use of alternative wall-crossing or other prudential procedures. An example of a scenario that is unlikely to raise significant concerns in this regard or require heightened procedures might be investor meetings by regular well-known issuers that are intended to provide an update on issuer-specific developments (as part of gauging interest in and facilitating a planned transaction), but where the terms of that planned transaction (or the range of reasonably possible terms) were the transaction to proceed are not seriously in doubt.[17]

- *Negotiated private placements*: At least one industry body, *L'Association française des marchés financiers*, has published guidance that suggests that traditional "insurance company" type private

[15] Although a cooling-off period may have value from other perspectives (for example, by lowering the risk of the non-deal roadshow being deemed to constitute prohibited U.S. publicity), we are sceptical of the value of a cooling-off period from a MAR perspective. If a regulator suspects insider trading following a non-deal roadshow, and MAR procedures were not followed (*i.e.*, recordings or agreed notes that could allay suspicion do not exist), the fundamentally unhelpful fact in this scenario is that a transaction was actually planned when the meetings occurred – which a cooling-off period does not mitigate.

[16] Although some of these points are relevant to assessing whether non-deal roadshows are properly construed as offering activity from a U.S. securities law perspective, in view of the selective disclosure backdrop to Article 11, they are not, in our view, relevant to the question of whether a roadshow constitutes a "market sounding."

[17] In contrast, an example of a scenario where similar reasoning could be applied but that might be more likely to raise concerns is an early-stage IPO pilot fishing meeting where the intention to undertake an IPO is stated in very general terms (and where interest in an IPO is thus being gauged in a general sense), but where the focus is on introducing the issuer without an intention to convey any specific terms. In general, although we agree that non-application in such cases is, in concept, possible, it seems to us that a very high degree of caution and discipline will be required in such cases to ensure that terms, conditions or features (including, for example, intended listing venues or likely size) are not conveyed (and the technical basis for non-application is credibly preserved). Where that discipline can be maintained, however, it should be possible for disclosing market participants to receive input that potential investors might choose to convey on these points. Note, moreover, that this fact pattern also assumes that the issuer already has other securities listed on EU trading venues since, absent that, MAR is in any case unlikely to apply (see Part I.A above).

placements, where transaction terms are tailored through direct negotiations with long-term investors, should not be viewed as market soundings.[18] This is based on the theory that, in such transactions, investor contacts form part of an inherent process of negotiations with the entire set of potential investors with whom a transaction might occur, rather than a (helpful, though not inherently necessary) means to test an offering's viability before presentation to a wider group of investors.[19] In our view, this is a plausible reading of Article 11, whose procedural framework was not, we believe, intended to apply to transactions with a significant and inherent negotiated element (in effect, requiring potentially drawn-out contractual negotiations to be recorded). It is also consistent with a distinction that ESMA has accepted exists between investor contacts that are "trying to gauge the conditions relating to the potential size or pricing of a transaction" (to which the market sounding regime applies) and those, with negotiated private placements a fine example, that are "actually trying to *conclude* [a] transaction" (to which it does not). Nevertheless, as negotiated private placements may also give rise to a misalignment of information, thought should be given in such cases to the need for alternative wall-crossing or other prudential procedures.

- *Other marketing efforts aimed at concluding a transaction*: As noted above, ESMA has acknowledged that investor contacts that are "actually trying to *conclude* [a] transaction" are not subject to Article 11. In many transaction contexts without a significant negotiated element (see "Negotiated private placements" above), this distinction is unlikely to be relevant since the point at which the focus of investor contacts will tend to shift to concluding a deal will often reasonably be viewed as the point at which a formal launch announcement is made – at which point the market sounding regime should in any case have ceased to be relevant (see Part I.C below). In certain transaction contexts, however – for example where the main marketing effort occurs on an entirely wall-crossed basis prior to a formal launch announcement[20] or where the main marketing effort proceeds on a non-wall-crossed basis but no launch announcement is customarily made or thought necessary[21] – it may be possible to view investor contacts that amount to the main marketing effort as aimed at concluding the transaction and outside Article 11's ambit solely on that basis. In such instances, the significance of the transaction and other information being disclosed and surrounding prudential measures will invariably require careful consideration.

- *Procedural interactions*: It may at times be necessary to apprise investors of a forthcoming transaction days or even weeks in advance of launch solely in order to permit them to complete the procedural requirements necessary to participate (*e.g.*, obtaining internal approvals; in the case of local currency instruments, establishing local currency credit lines). Interactions of this sort should, we believe, generally be permissible without following market sounding formalities – although these would

[18] AMAFI / 17-13EN (February 9, 2017). Though not submitted for approval to the French financial markets authority (the "**AMF**"), the release states that it draws on discussions with representatives of the AMF.

[19] The reasoning described above could potentially be extended to other scenarios also – for example, discussions concerning potential restructuring solutions between a distressed issuer and an ad-hoc committee of creditors (assuming it represents a sufficient portion of the relevant debt to determine the outcome of a subsequent vote of all relevant debtholders) – although this would likely also require alternative wall-crossing and other prudential procedures (see Part III below).

[20] This may, for example, be the case in certain debt offerings where a formal launch announcement is typically made, but where virtually all investors are marketed to on the back of a preliminary offering document before that point on a wall-crossed basis, and investor contacts thereafter are generally limited to circulation of an updated offering document and an accelerated bookbuild process.

[21] This would require a minimal judgment that the transaction does not amount to inside information, since, absent the ability to form that judgment, the commencement of a marketing effort on a non-wall-crossed basis would need to be preceded by (or coincide with) an announcement in order for the issuer to discharge its obligation to disclose inside information as soon as possible.

preferably occur on a no-names (or, potentially, multiple names) basis or, where that is impracticable, after considering the need for alternative wall-crossing or other prudential procedures.

C. Investor contacts after the "announcement of a transaction"

As noted above, Article 11 only applies to communications of information before the "announcement of a transaction." MAR does not, however, define "announcement" in this context, and there is no regulatory guidance on the nature of the announcement that suffices to remove investor contacts from the market soundings regime.

Although the practice of making announcements varies widely by transaction type and jurisdiction, in instances where market practice is to precede the main marketing effort (that is, marketing to essentially all eligible investors (as opposed to a subset)) by a formal "launch" announcement, that launch announcement should typically suffice. In such cases, the announcement can both credibly be viewed as the point at which market participants' focus shifts to trying to "conclude" the transaction, and (in our experience) will also generally contain all information known at the time to be inside information.

Further, as part of a purposive, proportionate and risk-based approach to Article 11, we believe that even a *pre-launch* announcement of a transaction (often indicating that it will follow, subject to market conditions) could reasonably be treated as an "announcement" for Article 11 purposes if it, together with all other information then in the public domain, leads to substantive alignment between the information in the public domain and information to be disclosed to potential investors in pre-marketing. This is because an announcement of this sort would largely remove the mischief at which Article 11 is aimed – *i.e.*, the potential for financial benefit from trading on a misalignment of information – by addressing the misalignment that is at the root of that mischief.

What constitutes "substantive alignment" will necessarily be an intensely facts and circumstances based inquiry. It seems clear that, at a bare minimum, it would be necessary to disclose any aspects of the planned transaction then known and planned to be disclosed in pre-marketing that are likely to be inside information when the deal is "fully-baked," and similarly, to disclose any non-deal-specific inside information that is intended to be conveyed. It also seems clear that the most prudent and lowest-risk approach will generally lie in achieving as precise and total an alignment of information as practicable.[22] It is important to be mindful, however, that – in the absence of regulatory guidance – *any* approach to an "announcement" premised on an alignment of information will necessarily be a risk-based one, and we would accordingly hesitate to frame the abstract ideal of precise and total alignment as a hard requirement.

Indeed, in view of the different facts and circumstances that might be relevant as part of a purposive, proportionate and risk-based approach, the most important point for market participants to bear in mind with respect to alignment of information, in our view, is this: the greater the information in any announcement (and in the public domain following any announcement), the stronger the argument will be that the announcement made constitutes an "announcement" for purposes of Article 11 and the less constrained subsequent discussions with investors will have to be regarding the potential transaction.

In assessing how much information needs to be included in any announcement, regard should, in our view, be had to *all* the surrounding facts and circumstances, including, for example:

[22] For example, if a preliminary prospectus or investor presentation will be made available to investors in pre-marketing, and its public disclosure at the time of a pre-launch announcement would be consistent with commercial sensitivities and deal-specific publicity restrictions, consideration should be given to making those documents, or relevant information in those documents, publicly available.

- market and regulatory sentiment about the issuer and its securities;
- the general corporate governance and transparency record of the issuer;
- what sort of transaction and what sort of terms the market would expect;
- the extent to which the expected terms and conditions of the proposed transaction are customary;
- what the proceeds of the proposed transaction are intended to be used for;
- the types of securities the issuer already has admitted to trading, and the trading venues on which those securities currently trade, and in the case of securities admitted to trading on EU trading venues, whether such admissions were voluntary or involuntary;
- where the investor base in already admitted securities is primarily located;
- where the new securities being offered are to be admitted to trading and marketed;
- the location of the issuer and its group, in particular the strength of its nexus with the EU; and
- other prudential measures being put in place in connection with the investors contacts planned.

Note, moreover, that even where an absence of substantive alignment on particular terms, conditions or features of a potential offering precludes the possibility of communicating specific proposals, issuers and other disclosing market participants should not be precluded from receiving input that potential investors might choose to convey on those terms, conditions or features following an announcement based on the information that is conveyed to them.[23]

II. EU NEXUS AND ITS IMPLICATIONS

MAR's prohibitions and requirements have general extraterritorial effect, and as such, except in instances where a "market sounding" is outside MAR's scope by virtue of Article 2 (see Part I.A above), Article 11 will technically apply to *any* "market sounding" as defined. This includes market soundings that occur wholly outside the EU, target only non-EU investors and where no EU listing of the new securities is contemplated.

In practice, however, in view of the considerable practical challenges of implementing Article 11 procedures outside the EU and based in part on informal regulatory sanction of the practice, market participants have increasingly chosen to not apply the regime where the nexus with the EU is perceived to be low. A judgment of this sort can, in our view, be reasonable in appropriate instances as part of a purposive, proportionate and risk-based approach to the regime.

In considering whether the nexus with the EU is in fact sufficiently limited to support a judgment that Article 11 procedures need not be applied, the following factors may merit consideration:

- whether the issuer (and the corporate group of which it forms a part) is based in the EU;

[23] Although specific questions to solicit such views are not necessarily problematic, the content of the questions – and any information about intended terms conveyed through them – should also be consistent with the paradigm above.

- whether an EU trading venue is an intended listing venue for the new securities being sounded;
- whether the issuer's securities (or those of the corporate group of which it forms a part) that are already admitted to trading on EU trading venues were voluntarily admitted;
- whether the information to be disclosed in the market sounding (including as to the transaction and its terms) will amount to inside information in respect of any already-admitted EU securities; and
- whether marketing in the EU (or to EU-based investors) is intended, and if so, whether other disclosing market participants involved in the EU marketing (particularly, investment banks) are based in jurisdictions where Article 11 may be perceived by their regulator(s) as establishing a mandatory regime.

Although none of the above need necessarily be determinative of whether EU nexus is sufficiently limited to not require application of Article 11 procedures (and other factors may also merit consideration on a deal-specific basis), as a general matter, the risk of not applying Article 11 procedures is likely to be considerably lower where the answers to the above questions are predominantly negative.

III. PROCEDURES WHEN THE ARTICLE 11 REGIME IS NOT APPLIED

Where Article 11 procedures are not applied to a given set of investor contacts, consideration should be given to whether alternative prudential procedures are nevertheless appropriate. For example, it will often be desirable to document the basis for Article 11's inapplicability (should a regulator inquire) in advance of any investor contacts. It will also often be desirable to implement basic record-keeping procedures with respect to the contacts themselves (*e.g.*, retention of any slide presentation used, notes to memorialize that oral remarks and responses to Q&A were in fact consistent with any slide presentation and did not convey any notable additional information). In instances where message discipline is important to ensure that the basis for non-application remains credible, scripted oral remarks and scripted responses to likely questions merit consideration. Limitations on potential investors, making use of alternative wall-crossing procedures or obtaining other investor undertakings and acknowledgements may also be appropriate in certain cases. Again, as with many other facets of the regime, the decision as to the full package of procedures to be put in place should in our view be made having regard to *all* the surrounding facts and circumstances on a deal-by-deal basis.

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ANNEX

APPLYING MAR PROCEDURES

Set forth below is a brief summary of the procedural requirements Article 11 imposes on disclosing market participants ("**DMPs**") in conducting a market sounding as defined.

Market sounding recipients ("**MSRs**") are also subject to certain obligations under MAR, including an obligation to assess for themselves whether they are in possession of inside information and whether inside information has ceased to be inside information (Article 11(7)), and under implementing measures, to establish procedures to control the flow of information internally, appropriately train staff and keep appropriate records.

We would be pleased to provide more tailored advice on the establishment of appropriate Article 11 procedures to DMPs and MSRs upon request.

A. Step 1 – Analysing whether the information is inside information

An overarching obligation under Article 11 is for a DMP, prior to conducting a market sounding, to specifically consider whether the market sounding will involve the disclosure of inside information.

The DMP is required to make a written record of its conclusion and the reasons for that conclusion so that it can provide the regulator with these records if it requests. One of the first questions, therefore, that the DMP needs to consider is whether it is in possession of inside information; not just in respect of the planned transaction, but in respect of any other information that might be disclosed as part of the sounding. For example, if the proceeds of the transaction might be used for an acquisition, and that fact will be disclosed, consideration needs to be given to whether that information constitutes inside information.

B. Step 2 – Applying appropriate procedures

The key procedural requirements applicable to DMPs turn on their assessment in Step 1 above as to whether information to be disclosed includes inside information or not. The boxes below summarize these requirements at a high level.

IF THE MARKET SOUNDING INVOLVES DISCLOSURE OF INSIDE INFORMATION
a. Necessary disclosures by the DMP: o that the communication is to take place for the purposes of the market sounding; o where the market sounding is to be conducted by recorded telephone lines, or audio or video recording is to be used, that the conversation will be recorded; o that the MSR will receive information that the DMP considers to be inside information; o an estimate of when the information will cease to be inside information, what may alter that estimate and, in any case, information about the manner in which the MSR will be informed of any change in that estimate; o the restrictions and confidentiality obligations upon the MSR in connection with its receipt of inside information;

- (once the MSR consents to receipt of the inside information) specific identification of the information the DMP considers to be inside information; and
- having monitored the status of the inside information disclosed, that the information has ceased to be inside information as soon as possible upon it so ceasing.

b. Consents and confirmations that the DMP must obtain from the MSR prior to the market sounding taking place:

- that the communication is taking place with the person entrusted by the MSR to receive market soundings;
- where the market sounding is conducted by recorded telephone lines, or audio or video recording is being used, the MSR's consent to such recording;
- consent to receiving the market sounding; and
- consent to receiving inside information.

c. Record-keeping requirements imposed on the DMP (records to be kept for at least five years):

- having assessed that the market sounding will involve the disclosure of inside information, the DMP must make a written note of the reasons for the determination;
- if the particular market sounding will be recorded with the consent of the MSR, the DMP must make a record of that consent;
- if the particular market sounding will not be recorded (or the MSR does not consent to a recording), written minutes or notes should be drawn up, and agreed and signed by both parties after the market sounding. If the parties fail to agree the record within five working days after the market sounding, the DMP should keep two versions, each signed by one party. If the MSR fails to provide signed written minutes or notes, the DMP should retain its own signed copy;
- the DMP should maintain a detailed record of all of the market sounding requirements applied (including consents obtained), as well as a record of whom inside information has been disclosed to and what inside information was disclosed; and
- the DMP must maintain a record of potential investors who do not wish to be sounded in relation to either all potential transactions or particular types of transactions.

IF THE MARKET SOUNDING DOES NOT INVOLVE DISCLOSURE OF INSIDE INFORMATION

a. Necessary disclosures by the DMP:

- that the communication is to take place for the purposes of the market sounding;
- where the market sounding is to be conducted by recorded telephone lines, or audio or video recording is to be used, that the conversation will be recorded; and
- that the MSR will receive information that the DMP considers not to be inside information.

b. Consents and confirmations that the DMP must obtain from the MSR prior to the market sounding taking place:

- that the communication is taking place with the person entrusted by the MSR to receive market soundings;
- where the market sounding is conducted by recorded telephone lines, or audio or video recording is being used, the MSR's consent to such recording; and
- consent to receiving the market sounding.

c. Record-keeping requirements imposed on the DMP (records to be kept for at least five years):

- having assessed that the market sounding will not involve the disclosure of inside information, the DMP must make a written note of the reasons for the determination;
- if the particular market sounding will be recorded with the consent of the MSR, the DMP must make a record of that consent;
- if the particular market sounding will not be recorded (or the MSR does not consent to a recording), written minutes or notes should be drawn up, and agreed and signed by both parties after the market sounding. If the parties fail to agree the record within five working days after the market sounding, the DMP should keep two versions, each signed by one party. If the MSR fails to provide signed written minutes or notes, the DMP should retain its own signed copy;
- the DMP should maintain a detailed record of all of the market sounding requirements applied (including consents obtained), as well as a record of whom non-inside information has been disclosed to and what non-inside information was disclosed; and
- the DMP must maintain a record of potential investors who do not wish to be sounded in relation to either all potential transactions or particular types of transactions.