Focus
- Prospectus Liability and working with Prospectuses

The Danish Supreme Court's ruling in the bankTrelleborg case on 18 January 2013 has revived prospectus liability in Danish law and in this issue of our newsletter, we take a close look at prospectus liability and the practical precautions which companies and professional agents in the capital markets must observe in order to safeguard themselves against any claims for damages from investors.

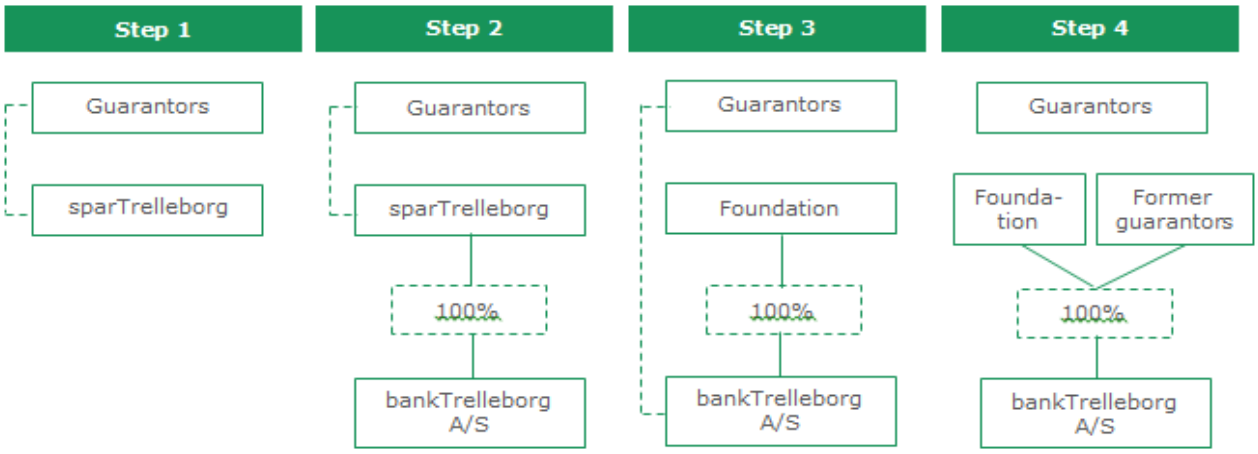
About the bankTrelleborg Case

The case revolved around the question of whether the prospectus that was prepared in connection with sparTrelleborg's conversion from a savings bank into a bank, and the subsequent stock exchange listing of bankTrelleborg, was inadequate, and whether the bank therefore was liable for the losses suffered by a number of former guarantors as a result of their guarantee certificates being converted into shares.

The decision of conversion was made on 28 March 2007. The committee of representatives in sparTrelleborg decided to dissolve the savings bank without liquidation by transferring the savings bank's assets and debts to a limited liability company established for this purpose, and this company became the continuing limited liability savings bank (the continuing bank) under the name bankTrelleborg A/S.

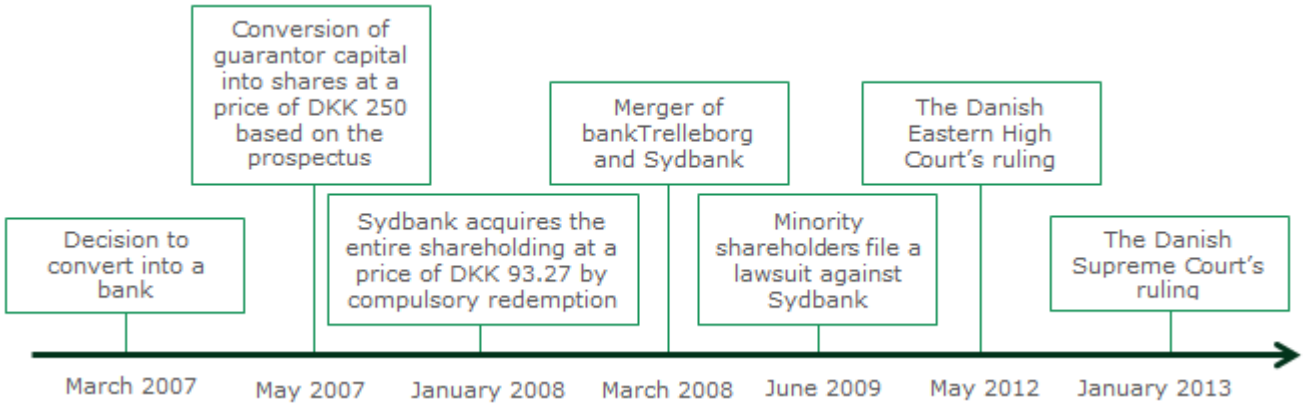
The conversion was carried out using the so-called "foundation model", meaning that shares in bankTrelleborg corresponding to the value of the net assets contributed by sparTrelleborg were transferred to a newly established foundation, the Foundation for bankTrelleborg. The four steps of the foundation model are illustrated in Figure 1.

Figure 1. The four steps of the foundation model



In connection with the conversion and the listing of bankTrelleborg, a number of guarantors had converted their guarantor capital into shares at a price of DKK 250 per share. As a result of bankTrelleborg's financial difficulties, a subsequent compulsory redemption of these shares was carried through at a price of DKK 93.27 per share, and compensation for the difference was claimed. The most significant moments of the case are illustrated in Figure 2.

Figure 2. The most significant moments of the bankTrelleborg case

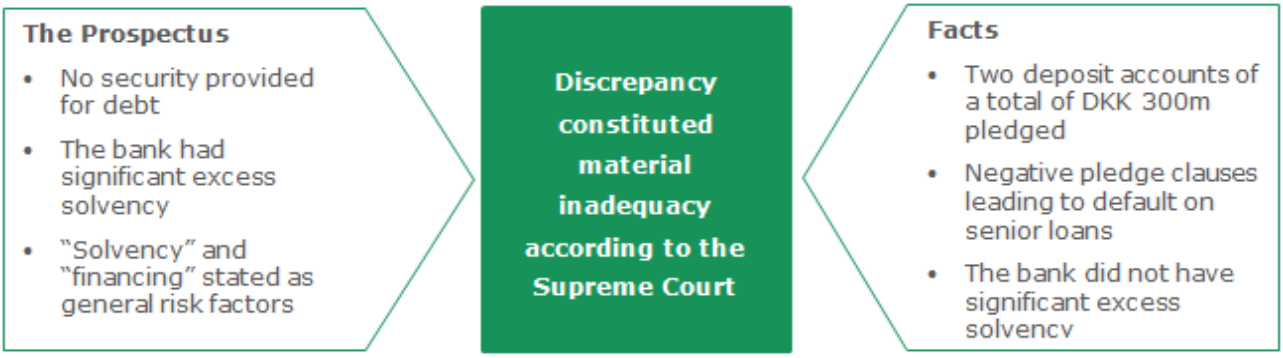


The material Inadequacies of the Prospectus

The cardinal point in the bankTrelleborg case was whether the prospectus was true and fair or whether it was significantly inadequate, cf. the Danish Supreme Court's obiter dictum in the ruling in the Hafnia case from 2002: "Any liability for damages due to inadequacies in the prospectus in the shape of untrue or lacking information is conditional on a complete evaluation showing that the issue in question – in light of the other information in the prospectus – is of material significance to the assessment of the company."

Based on its review of the prospectus, the Supreme Court made the conclusion that it was materially inadequate. The discrepancies between the prospectus and the actual circumstances constituted significant inadequacy according to the Supreme Court are illustrated in Figure 3.

Figure 3. Discrepancies between the prospectus and the actual circumstances



Liability in the bankTrelleborg Case

After it was established that the bankTrelleborg prospectus was materially inadequate, the next step for the Supreme Court was to assess whether bankTrelleborg as the agent responsible for the prospectus had committed a culpable act, consequently giving rise to liability.

In its consideration of bankTrelleborg's conduct, the Supreme Court emphasized that the bank was inexperienced in relation to prospectus preparation, but had opted out of verification nonetheless.

The Supreme Court further emphasized the fact that "a simple and quick inquiry would have found the inadequacies, but such inquiry was never made". Accordingly, it had not been ensured that any procedures for inquiry and control of information of such significance were established or followed in connection with the preparation of the prospectus.

Against this background, the Supreme Court found that the bank had acted in a manner giving rise to liability.

Having stated its reasons, the Supreme Court finally settled the sound principle that it does not suffice to draft the prospectus – it is important to also ensure that the information contained therein provides a true and fair view. This way, the verification process becomes of pivotal importance in that it ensures and documents the adequacy and truth and fairness of the prospectus' material information. The Supreme Court thus emphasizes the requirements to exercise care and ensure that proper procedures are in place with regard to the preparation of a prospectus.

The Supreme Court therefore seems to be in the right when concluding that to the extent that there are material inadequacies which would have been uncovered by verification, it is actionable not to have carried out such verification. On the other hand, a company will not liable in the event that verification is in fact performed, but without uncovering the material inadequacies of the prospectus.

Loss, Causation, Predictability, and contributory Negligence

In relation to the assessment of loss, the Supreme Court's approach implies that in principle, compensation is estimated as the difference between "that which has been contributed and that which is left." In the bankTrelleborg case, this meant that the loss was estimated to be the difference between the conversion price of DKK 250 and the compulsory redemption price of DKK 93.27.

The approach which was taken to estimate compensation is closely related to the rule of assumption concerning causation which the Supreme Court has introduced with its ruling in the bankTrelleborg case and which constitutes the central element in the ruling in that it implies a real innovation in prospectus liability.

The rule of assumption means that when a prospectus is materially inadequate, the assumption that

the investor would not have invested had the prospectus contained the complete information arises. Seeing as this is a rule of assumption, the issuer may dismiss it; however, the Supreme Court sets the bar very high for what is required in order to invalidate the assumption.

In connection hereto, the Supreme Court decided that because an investment is not made solely based on the prospectus, but just as much on the basis of advice and the general market assessment, the fact that the investors had read the prospectus was not enough to invalidate the assumption.

Any hypothetical assumptions of any other possible causes or outcomes in the event that the information emerged during the preparation of the prospectus are enough to invalidate the assumption relating to causation.

Based on the above, the Supreme Court found that both causation and predictability were present.

The final matter touched on by the Supreme Court in the bankTrelleborg case involved whether the investors had displayed any contributory negligence leading to their claims being forfeit in part or in full. This, however, was not the case according to the Supreme Court seeing as no corrected information, including a price reduction, had been published which would have resulted in a reaction from the investors.

Prospectus Liability after the Supreme Court's Ruling

Introductory observations

In the above, we went through the central elements in the Supreme Court's ruling in the bankTrelleborg case. In the following, our efforts are directed at the two circumstances of the case which are considered to be of greatest importance to the assessment of prospectus liability and consequently, the practical work with prospectuses in future – the rule of assumption and the importance of verification. However, we will begin by making a few introductory observations regarding the prospectus regime, i.e. the rules which apply to the content and publication of the prospectuses and which consequently constitute the pivot of the work with prospectuses in practice.

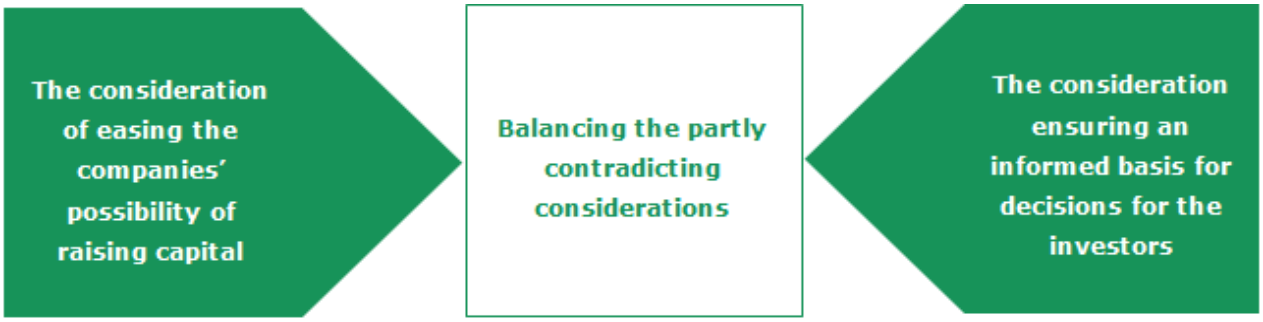
About the prospectus regime

Despite the fact that prospectuses are governed by a significant and far-reaching detailed regulation, it is important to maintain that the many rules are basically a demonstration of what we know as the "seller's duty of loyalty and disclosure".

The fundamental aim of the prospectus rules is to balance between two primary considerations. On the one hand, the consideration of easing the companies' possibility of raising capital and on the other hand, the consideration of securing a high level of information for the protection of the investors that acquire the company's securities. Despite the somewhat contradicting nature of these considerations, the EU has managed to solve this task quite well leading to the creation of a regime which brings the

considerations of the companies and the investors into equilibrium. The balancing of the partly contradicting considerations is illustrated in Figure 4.

Figure 4. Balancing the prospectus considerations



Among others, the effort to meet the consideration of the companies is made by a standardization and harmonization of the rules on the preparation of prospectuses and on the approval of prospectuses for securities within the EU – the so-called "EU passport".

In particular, the effort to meet the consideration of the investors is made by establishing a very detailed amount of information which must be described in the prospectus, the purpose of which is to provide the investors with an enlightened basis for decisions and further, a prospectus summary must be prepared so as to provide a necessary perspective. The prospectus summary must be in a standardized format so that it may be compared with similar prospectus summaries from other companies.

The prospectus regime consists of sets of rules from both Denmark and the EU. In addition to this, a series of recommended legal documents have been issued by ESMA and the Danish FSA expressing the authorities' understanding of the rules.

Figure 5 illustrates the central sets of rules of the prospectus regime in relation to their application to the various methods for tender offers.

Figure 5. Method for tender offers and underlying rules

Method for tender offers	Underlying rules
Listed securities offers (regardless of amount) and unlisted public securities offers above EUR 5,000,000	▪ Prospectus Directive II and Prospectus Directive III ▪ Prospectus Regulation no. 809/2004, Amending Regulation no. 211/2007, Amending Regulation no. 486/2012 and Amending Regulation no. 862/2012

Method for tender offers	Underlying rules
	▪ ESMA Questions & Answers on Prospectuses, 18th updated version – 18 December 2012 (ESMA/2012/855) ▪ The Danish Securities Trading Act, Parts 1 and 6 ▪ Executive Order on Prospectuses no. 643/2012 (major offers) ▪ Prospectus Guidance no. 9592/2012 on major offers and the Danish FSA's memorandum on practical information in relation to major offers – 1 July 2012
Unlisted public securities offers between EUR 1,000,000 and EUR 5,000,000	▪ The Danish Securities Trading Act, Parts 1 and 12 ▪ Executive Order on Prospectuses no. 644/2012 (minor offers) ▪ Prospectus Guidance no. 9591/2012 on minor offers and the Danish FSA's memorandum on practical information in relation to minor offers – 1 July 2012
Unlisted public securities offers below EUR 1,000,000	▪ Not covered by the prospectus regime ▪ Ordinary civil and public law rules apply, including the Danish Contracts Act, the Danish Sale of Goods Act, and the Danish Marketing Practices Act.

As seen in figure 5, the harmonization pursuant to EU law only applies to the listed tender offers and the unlisted public tender offers above EUR 5,000,000. Although the other tender offers are governed by Danish law alone, the legislator and the Danish FSA have to a wide extent attempted to align them to the rules in EU law. The common source of inspiration is therefore evident in the structure of the Danish rules and content which makes for a sound and practical solution.

The rule of assumption

With its ruling in the bankTrelleborg case, the Supreme Court has introduced a rule of assumption which constitutes the central element in the ruling it that it is a real innovation in prospectus liability.

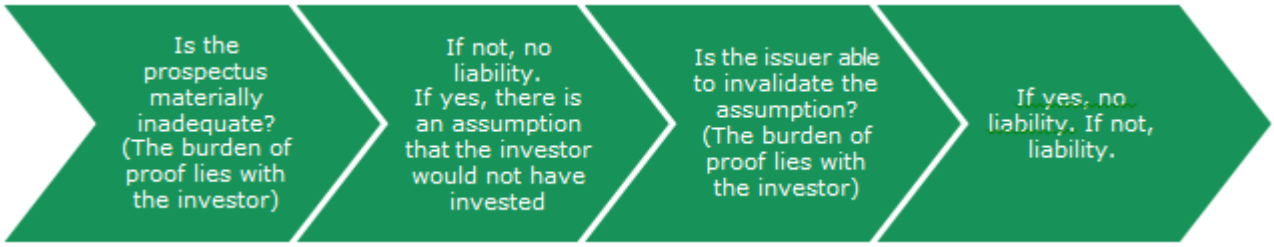
The rule of assumption means that when a prospectus is materially inadequate, the assumption that the investor would not have invested had the prospectus contained the complete information arises.

Seeing as this is a rule of assumption, the issuer may dismiss it; however, the Supreme Court sets the

bar very high for what is required in order to invalidate the assumption.

With the introduction of the rule of assumption, the Supreme Court has revived the prospectus liability in Danish law. The rule of assumption is a real innovation and implies a considerable relaxation of the burden of proof to the extent that it is in fact an outstretched hand to the investors that feel that they have been deceived or mislead in connection with their investment in securities based on the prospectus. In Figure 6, the legal content of the rule of assumption has been illustrated.

Figure 6. The legal content of the rule of assumption



The starting point of the rule of assumption is the common principle in Danish law according to which the burden of proof lies with the person who makes the claim. This means that it is for the investor to prove that the prospectus is materially inadequate.

The rule of assumption implies that if the investor is able to prove that the prospectus is materially inadequate, the assumption arises that the person in question would not have invested had the prospectus been adequate and true and fair.

After this, the burden of proof shifts onto the issuer who must be able to invalidate the assumption which is not an easy task seeing as the Supreme Court sets the bar very high for what is required in order to invalidate the assumption.

In connection hereto, the Supreme Court has established that because an investment is not made solely based on the prospectus, but just as much on the basis of advice and the general market assessment, the fact that the investors had read the prospectus was not enough to invalidate the assumption.

Any hypothetical assumptions of any other possible causes or outcomes in the event that the information emerged during the preparation of the prospectus are not enough to invalidate the assumption relating to causation.

In the event that the issuer fails to carry the burden of proof and thus cannot invalidate the assumption, the issuer will be liable for the loss suffered by the investor.

The importance of verification

Having stated its reasons, the Supreme Court has finally settled the sound principle that it does not suffice to draft the prospectus – it is important to also ensure that the information contained therein provides a true and fair view.

The Supreme Court uses the concept of "verification" as an indication of "procedures for inquiry and control" of information in the prospectus. This concept is different from the one the market agents operate by, according to which verification is the inquiry and verification of the prospectus which is normally carried out by the issuing institution's lawyer (the verification lawyer). Moreover, according to the circumstances, a certain verification (due diligence) will be performed by the issuer's lawyer and auditor.

Regardless of the difference in concepts, the important thing is that an "inquiry and control" of the information must be performed and that the Supreme Court has concluded that to the extent that the prospectus is materially inadequate, and that this inadequacy would have been uncovered by such control, the omission to carry out the control gives rise to liability.

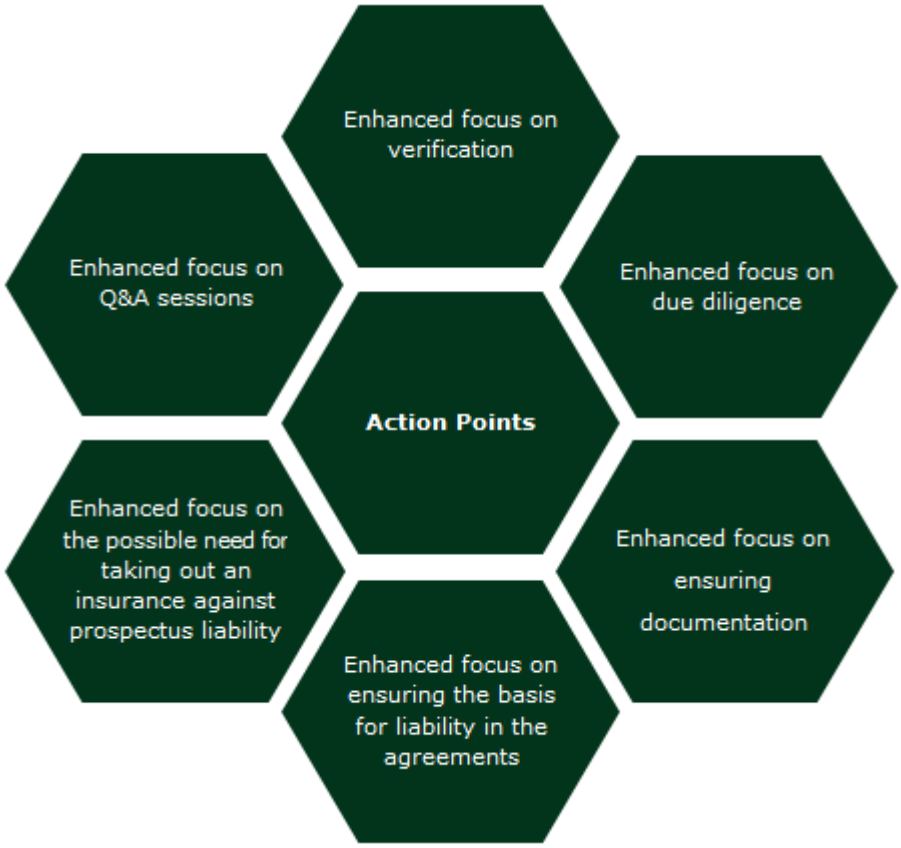
The Impact on the Work with Prospectuses in Practice

The Danish Supreme Court's ruling in the bankTrelleborg case has revived prospectus liability in Danish law which, in particular, is due to the introduction of the rule of assumption, including the facilitation of the investors' possibility to push through with claims for damages.

Combined with the procedural option to make these claims as group actions and the dawning shareholder activism in Danish listed companies, we expect that lawsuits over prospectus liability will be less common than they have been thus far.

For the companies and the professional agents on the capital markets, this intensifies the focus on securing themselves against such claims for damages, and it is clear what is to be done: (i) enhanced focus on a diligent preparation and performance of verification; (ii) enhanced focus on due diligence and Q&A sessions; (iii) enhanced focus on ensuring documentation for the work which has been carried out; (iv) enhanced focus on securing these matters in the agreements that are entered into in connection with the prospectuses (including in the placement agreements); and (v) enhanced focus on the deliberation regarding the need to take out prospectus liability insurances in connection with the tender offers. These action points are illustrated in Figure 7.

Figure 7. Action points after the Supreme Court's ruling in the bankTrelleborg case



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