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Reforms to French Regulation of Takeover Bids

On September 28, 2006, the French government promulgated an executive decision implementing the Public Takeover Act of March 31, 2006 (the "Act").[1] The Act transposes into French law the EU Takeover Directive (the "Directive") and modifies a number of significant aspects of French securities law.[2]

The most important of these changes concerns defenses to hostile takeovers. The Act clarifies and reinforces the rights of shareholder assemblies and corporate boards to adopt defensive measures before a hostile bid is launched and while the offer is pending. In particular, the Act explicitly permits rights issuances in certain circumstances. In addition, the Act broadens the regulatory jurisdiction of French market supervisors, imposes new rules for mandatory tender offers and squeeze-out offers, provides a new definition of concerted action by bidders, and increases the information that must be provided to shareholders and shop committees in a takeover battle.

France has recently witnessed several hotly contested and politically sensitive takeover proposals, including Pepsi's rumored bid for Danone, the Italian oil company Enel's bid for Suez, and Mittal's protracted bid for Arcelor. The new modifications to French takeover rules will have major impact on such contests in the future.

I. Modifications to the power of shareholder assemblies

In contrast to the United States, where corporate boards have broad powers to adopt defensive mechanisms, in France such measures generally require the approval of a shareholder assembly held after the bid is launched. Shareholder assemblies are therefore at the heart of any corporate defense.

As a matter of French corporate law, many corporate decisions, such as the transformation of the target's corporate form, share buy-back programs, capital increases, or rights issuances, require shareholder

[1] Decision (*Arrêté*) of September 28, 2006 concerning the adaptation of the General Regulations of the *Autorité des marchés financiers* ("AMF") (the "Decision"); Act no. 2006-387 of March 31, 2006 concerning public acquisition offers (the "Act"). Technical implementing instructions have also been published by the AMF. Instruction no. 2006-07 of July 25, 2006.

[2] EU Directive 2004/25/EC of April 21, 2004 (the "Directive").

approval. In normal situations, the power to implement such decisions may be delegated by the shareholder assembly to the board of directors, allowing managers greater flexibility.

However, French law prior to the Act provided that, as of the filing of a tender offer or exchange offer, all such delegations by the shareholder assembly to the Board were suspended unless the delegation concerned only normal activities of the company and if the powers delegated did not have the potential to cause the offer to fail.[3] In effect, this provision required any active defensive measure to be approved by a general shareholders meeting after the filing of the offer.

This rule created several problems. Defensive measures could not in general be approved by shareholders prior to an offer and put in place subsequent to the offer by the Board. In addition, as French law requires notice of a shareholders meeting for a publicly traded company to be published at least 30 days prior to the meeting, it was often difficult to organize a shareholders meeting prior to the closing of the offer.[4]

The Act largely reiterates the prior rule. While a tender offer is pending, the Board or managers of the target company may not implement any defensive measures that could result in the failure of the offer without the approval of a shareholder assembly held after the filing of the bid.[5] The Act provides only two general exceptions to this blanket restriction of the Board's power during the pendency of the offer: the Board retains the authority to seek other, alternative offers and the power to appoint managers. The shareholder assembly therefore clearly remains primarily responsible for determining takeover defenses.

However, the Act also provides for one new and significant exemption from the shareholder approval rules, the so called "reciprocity" clause. This provision specifies that the requirement for shareholder approval of defensive measures during the period of the offer does not apply if the bidding company is not itself subject to equivalent restrictions.[6] For instance, in the case of a bid by an American company for a French target, shareholders' approval of any defensive measures adopted prior to the bid and delegated to the board would not be suspended, since the American company is not subject to the same limitations.[7]

The application of the reciprocity clause in the case of multiple simultaneous offers raises potential concerns. If the target receives offers from multiple companies, some of which are not subject to shareholder pre-approval rules, the target board will be exempt from the pre-approval rules even with

[3] French Commercial Code, former Art. L. 225-129-3, abrogated by the Act, Art. 22.
[4] Decree no. 67-236, March 23, 1967, Art. 130.
[5] French Commercial Code, Art. L. 233-32.
[6] French Commercial Code, Art. L. 233-33.
[7] French Commercial Code, Art. L. 233-33. Disputes surrounding the application of the reciprocity clause will be decided by the AMF. Following the filing of a complaint with the AMF, the target company will have 10 days in which to file a reply, and that the AMF will have 5 more days to issue a ruling. AMF General Regulations, Art. 231-42.

respect to defenses against those bidders that are governed by such rules. It would therefore be in the target's interest to solicit the intervention of a company not covered by pre-approval rules. For this reason, the Act specifies that the exemption does not apply if the non-covered company is acting in concert with the target.[8]

Even though the reciprocity clause dispenses, in certain situations, with the need for shareholder approval after the launch of a bid, the board's freedom of action is still comparatively limited. Any defensive measure adopted by the board pursuant to a delegation of powers by the shareholder assembly must have been explicitly authorized for use in case of a tender offer by a shareholder assembly held within 18 months of the offer.[9]

II. Reform of specific takeover defenses

One of the key reforms of the Act is an increase in the array of French defensive measures available to French companies.

Takeover defenses prior to the Act

Prior to the Act, French law allowed companies to adopt several types of defenses before the filing of an offer. These measures remain largely unchanged by the Act.

- Stock market regulations impose mandatory threshold-crossing declarations for shareholders that acquire more than a certain percentage of a listed company's capital or voting rights. Such declarations serve to give target companies warning of the accumulation of large blocks of shares that could signal a bid.[10]

- The corporation can be transformed into a *société en commandite par actions*, a hybrid form of corporate vehicle in which voting rights and economic interests in the company are held separately.[11]

- The bylaws of the company can be modified to impose a ceiling on the number of votes that any shareholder may cast at a shareholders meeting.[12]

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[8] French Commercial Code, Art. L. 233-33.

[9] French Commercial Code, Art. L. 233-33, para. 2. Among other things, shareholders may pre-approve defensive rights issuances, as discussed below. The Act facilitates the approval of such defensive measures by providing that the shareholder assembly held in the context of a tender offer need only meet the quorum and majority requirements for an ordinary general assembly, *i.e.*, quorum of 20% of shareholders, and decisions taken by simple majority, rather than the 25% of shareholders and two-thirds majority normally needed to change a company's bylaws. French Commercial Code, Art. L. 233-32(II).

[10] An acquirer of shares of a company listed in France must notify the target company when it obtains 5%, 10%, 15%, 20%, 25%, 33%, 50%, 67%, 90% and 95% of the outstanding shares of the target. French Commercial Code, Art. L. 233-7.

- The bylaws can grant double voting rights to shareholders having held their shares for at least two years.[13]

Such pre-bid defenses, however, face legal and regulatory limitations. For instance, the transformation of a corporation into a *société en commandite* may not be undertaken for the sole purpose of disrupting a bid,[14] and such a transformation necessarily requires the controlling shareholder to file a tender offer for the minority shares.[15] Ceilings on voting rights have also been limited in their effectiveness by the French market regulator, the *Autorité des marchés financiers* (the "AMF"), which requires listed companies to suspend such restrictions when an offeror acquires more than two-thirds of the outstanding capital.[16]

French companies also dispose of a number of defensive techniques that can be adopted after an offer has been filed. Prior to the Act, a number of these were legally suspect or impractical given the time constraints normal in a takeover context.

For example, the target company can approve a capital increase. However, if the capital increase would take place after a bid is filed, it requires the adoption of a resolution by a shareholder assembly, and authority to approve the capital increase cannot be delegated to the board of directors prior to the bid.[17] In addition, it is difficult in practice to convince shareholders to subscribe to a capital increase at a price equal to or above the bidder's offering price.

The target can also launch a share buy-back program, intended to remove from the market those shares that might otherwise be sold to the bidder. However, such a buy-back program must be explicitly authorized by a shareholder assembly prior to the launch of the bid, and can be implemented only in response to an offer made exclusively in cash.[18] In addition, the shares repurchased by the company must represent no more than 10% of the outstanding shares; are immediately stripped of their voting rights; and may not be counted for purposes of determining the quorum at shareholders' meetings.[19] A French court has also held that the resale of such shares to a 'white knight' would be prohibited as contrary to the French market rule prohibiting restrictions of the free play of bids and counter bids.[20]

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[11] French Commercial Code, Art. L. 226-1 *et seq.*
[12] French Commercial Code, Art. L. 225-125.
[13] French Commercial Code, Art. L. 225-123.
[14] CA Paris, 1st chamber, April 27 1993, JCP E 1993, p. 457.
[15] AMF General Regulations, Art. 236-5.
[16] *Commission des opérations de bourses* ("COB") Annual Report, 1992, p. 48; COB Annual Report, 1993, p. 50-55; codified by the Act as French Commercial Code, Art. 225-125; implemented as AMF General Regulations, Art. 231-43.
[17] French Commercial Code, Art. L. 233-32-I.
[18] AMF General Regulations, Art. 232-17, para. 2.
[19] French Commercial Code, Art. 225-210.
[20] T. Com. Paris, March 16, 1992: RJ com., 1992, p. 209 (affair Perrier), note Couret.

Bylaw restrictions on the transfer of shares are suspended during a public offer. AMF regulations specify that provisions in a target company's bylaws requiring approval of new shareholders are not enforceable as against shareholders having acquired shares pursuant to a tender offer.[21]

Two other defenses more common in the United States are generally considered illegal in France. Golden parachutes granted to senior executives are not permitted in France, as they are viewed as constituting an abusive use of corporate assets and an illegal restriction of shareholders' freedom to dismiss company officers. Similarly, the sale of corporate 'crown jewels', *i.e.*, strategic or indispensable assets, to render a company less desirable, would be prohibited as contrary to the corporate interest of the target company.[22]

Reforms resulting from the Act

The most significant reform resulting from the Act concerns a target company's ability to adopt rights issuances after a bid has been launched. Defensive rights issuances have generally been controversial under French law: in 2004, the AMF stated in a formal ruling that warrants issued by Sanofi in its defense against a hostile bid by Aventis were incompatible with French stock market regulations.[23]

The AMF's position has been overturned by the Act, which provides that the shareholder assembly may approve "the issuance of warrants, and their free attribution to shareholders having that status prior to the end of the offer period, for the subscription to shares of the company on preferential terms."[24] In the press and legislative commentary surrounding the Act, rights issuances have been promoted as the most potent defense against a hostile bid.

The conditions under which such issuances can be made are strictly regulated by the Act.[25] The issuance must receive prior approval from the shareholder assembly, either after the bid has been launched, or within 18 months prior to the bid if the reciprocity clause discussed above applies. The shareholder assembly must determine the maximum capital increase permitted and the maximum number of warrants to be issued.

The shareholder assembly may delegate to the board the authority to determine the conditions under which the warrants will be issued and the conditions under which they may be exercised, including the exercise price. If warrants are to be issued, that decision must be made public prior to the close of the offer, though the Act does not require that the warrants be exercised during the pendency of the offer.[26]

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[21] AMF General Regulations, Art. 231-6.
[22] See, COB, Annual Report, 1987, p. 134.
[23] AMF communiqué, April 23, 2004.
[24] French Commercial Code, Art. L. 233-32(II). The shareholder assembly will be governed by rules requiring 20% of shareholders to constitute a quorum, and may adopt resolutions on a simple majority vote.
[25] French Commercial Code, Art. L. 233-32(II).
[26] French Commercial Code, Art. L. 233-32(II).

The Act specifies that warrants may not favor one prospective acquirer over another, but rather must treat all bidders equally. Warrants issued as a defense against a tender offer become automatically null and void if the offer is withdrawn, fails, or lapses.[27]

A second innovation of the Act, known as the “Nissan Amendment,” concerns the obligation of a bidder to launch a bid for listed subsidiaries of the target company.[28] The Act provides that if (i) a French target company holds more than one-third of the capital and voting rights of a subsidiary listed either in the EEA or on an “equivalent foreign market,”[29] and (ii) such subsidiary is an “essential asset” of the French target company,[30] the bidder must, no later than the opening of the offer, make an irrevocable tender offer for the shares of that subsidiary. These provisions can complicate and substantially increase the price of an offer by forcing a bidder to simultaneously purchase several companies.

The Act also provides additional flexibility concerning treatment of bylaw provisions and shareholder agreements during a tender offer. The Act maintains the prior rule that provisions in the target’s bylaws restricting the transfer of shares are automatically suspended with regard to shares purchase by a bidder in the course of a tender offer.[31] In addition, the Act permits companies to chose in their bylaws whether shareholder agreements imposing transfer restrictions should also be suspended with regard to a tender offer bidder.[32] Bylaw restrictions on the exercise of voting rights are automatically terminated as regards a tender offer bidder that acquires two-thirds of the target’s outstanding capital or voting rights.[33] The company’s bylaws may reduce this threshold to one-half of the target’s shares.[34] A company may also provide in its bylaws that restrictions on voting rights imposed by the bylaws or by shareholder agreements be terminated as of the first shareholder assembly held to approve defensive measures against a tender offer.[35]

The Act permits a target company’s bylaws to grant specified shareholders extraordinary authority to appoint and dismiss directors and CEOs.[36] Such grants to shareholders trusted by management can

[27] French Commercial Code, Art. L. 233-3(II).

[28] French Monetary and Financial Code, Art. L. 433-3(IV); AMF General Regulations, Art. 231-13. The term “Nissan Amendment” arises from the fact that, pursuant to these provisions, a bid for the French company Renault would require a simultaneous bid for the Japanese-listed company Nissan, of which 44.4% of the shares are held by Renault.

[29] The term “equivalent foreign market” is not defined in the Act or in the Decision, but is presumably intended to include such markets as the New York Stock Exchange and the Tokyo Stock Exchange, which are not considered “regulated markets” for purposes of French law pursuant to the French Monetary and Financial Code, Art. L. 421-3.

[30] Neither the Act nor the Decision define the term “essential asset.” “Essential asset” may be given the meaning of an essential proportion of the target’s assets, or rather the principal or very important asset. AMF General Regulations, Art. 231-13.

[31] French Commercial Code, Art. L. 233-34.

[32] French Commercial Code, Art. L. 233-35.

[33] French Commercial Code, Art. L. 225-125; AMF General Regulations, Art. 231-43.

[34] French Commercial Code, Art. L. 233-38; AMF General Regulations, Art. 231-44.

[35] French Commercial Code, Arts. L. 233-36 and 233-37.

[36] French Commercial Code, Art. L. 233-39. The bylaws may also provide that such extraordinary nominating powers be terminated if the bidder receives more than one-half the outstanding capital or voting rights of the target. AMF General Regulations, Art. 231-45.

prevent rapid replacement of management and a change in the board of directors, even following a successful tender offer.

III. French regulatory jurisdiction

Prior to the Act, the AMF had jurisdiction over public offers only if the shares of the target were admitted to trading on a regulated market in France. The Act expands the AMF's territorial jurisdiction.

The AMF will now have mandatory jurisdiction over tender offers in two circumstances:

(i) if the target company's registered office is in France and its shares are listed on a regulated French market, in which case the AMF will have sole jurisdiction;[37] or

(ii) if the target company's registered office is within the European Economic Area (EEA) outside of France, and its shares are admitted to trading only on a French regulated market, or France is the first EEA jurisdiction in which the shares were admitted to trading.[38]

Additionally, the AMF may have jurisdiction in two other situations:[39]

(i) if a company has its registered offices in the EEA, outside of France, has shares listed on several European markets including France, and at the time that its shares were first listed, opted for French regulatory supervision;[40] or

(ii) if the company has its registered office outside the European Community, or in another EEA jurisdiction, and its shares are listed on a French regulated market.[41]

The rules on non-mandatory jurisdiction are of great significance for issuers not based in France but having a French listing. Mittal's recent bid for Arcelor has highlighted the potential issues that can arise in such a case. Arcelor's registered office is in Luxembourg, but its shares are listed in France, which has the highest trading volume by far in Arcelor shares. When Mittal's bid opened, the AMF ruled that questions concerning company law would be governed by Arcelor's jurisdiction of incorporation, but that AMF rules relating to transparency and market intervention would apply.[42] Such *ad hoc* assertions of jurisdiction may create difficulties for companies in the development of a takeover strategy or in defending against hostile offers.

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[37] French Monetary and Financial Code, Art. L. 431-1(I).
[38] French Monetary and Financial Code, Art. L. 431-1(II).
[39] French Monetary and Financial Code, Art. L. 431-1(II).
[40] If a company not having its registered office in France wishes to opt for French supervision, it must make that election at the time that its shares are first admitted to trading. It cannot choose its regulator separately depending on the transaction.
[41] French Monetary and Financial Code, Art. L. 431-1(IV).
[42] For instance, the AMF required that all trading in Arcelor shares take place on a regulated market, and prohibited parties acting in concert with Arcelor or Mittal, or the financial institutions advising them, to trade in Arcelor shares. AMF *communiqués*, February 3, 2006 and February 6, 2006.

IV. Mandatory withdrawal offers and squeeze-outs

French law provides that once a majority shareholder holds at least 95% of the shares of a publicly traded company, it must make a withdrawal offer for the remaining shares.[43] The Act specifies that, subject to certain exceptions, the price offered for the minority shares must not be lower than the highest price paid by the majority shareholder for such shares over the 12 months prior to the offer.[44]

Prior to the Act, mandatory squeeze-outs of minority shareholders were possible only after a voluntary withdrawal offer. The Act allows mandatory squeeze-outs directly after a normal tender offer, without the necessity of first launching a separate withdrawal offer.[45] The Act provides that, within 3 months following the conclusion of a tender offer, if the acquirer holds at least 95% of the shares of the target, it may require all remaining shares to be transferred to it. The price of such shares will be either the last price proposed during the tender offer, or a price determined by a multi-criteria valuation.

The Act also provides that if the original offer was an exchange offer, in whole or in part, the mandatory squeeze-out price may be paid in shares, so long as a cash payment is proposed as an alternative.[46] This reform is beneficial both to minority shareholders, who may take advantage of any price increase in the offeror's shares, and to offerors, who generally face difficulties in properly valuing their shares following a successful tender offer.

V. Concerted action

When two or more parties are found to be "acting in concert," they are jointly bound by the same legal and regulatory obligations.[47] This rule has repercussions in a tender offer context, as the shares of all parties acting in concert are deemed to be held jointly for purposes of regulatory requirements such as threshold-crossing notifications, mandatory withdrawal offers, or application of the reciprocity clause.

French law prior to the Act specified that two parties would be considered to be acting in concert if they had entered into an agreement to acquire or sell voting rights, or to exercise voting rights, with the purpose of accomplishing a common goal with respect to a company. Such an agreement is presumed to exist between (i) a company and its chairman, CEO, and managers; (ii) a company and the companies

[43] French Monetary and Financial Code, Art. L. 433-4(I). This provision also extends a squeeze-out to include shares that may be created by subscription, conversion, exchange or reimbursement.
[44] French Monetary and Financial Code, Art. L. 433-4(I), para. 2. As was the case prior to the Act, the AMF continues to have discretion to allow exceptions to this rule, for cases in which the value of the company is not adequately represented by previous prices paid, when a multi-criteria approach will be used to fix the price of the withdrawal offer. AMF General Regulations, Arts. 234-6.
[45] French Monetary and Financial Code, Art. L. 433-4(III).
[46] French Monetary and Financial Code, Art. L. 433-4(III).
[47] French Commercial Code, Art. L. 233-10.

that control it; (iii) a company and all other companies controlled by the same persons; and (iv) shareholders in a simplified share company (*société par actions simplifiée*) and the companies controlled by it.

The Act expands this definition to include those who "have entered into an agreement with the offeror in a tender offer bid in order to obtain control of the target company…[and those] who have entered into an agreement with the target company in order to make the offer fail."[48] This provision is important primarily for introducing the concept of "negative" concerted action. Parties that have agreed to cooperate in the success of an offer would have already been covered under the prior definition: the new rule explicitly includes agreements entered into as defensive measures.

VI. Declaration of intentions and information requirements

Prior to the Act, the AMF required that any person "preparing" a financial operation that "could have a significant impact on the price of a financial instrument or the situation and rights of bearers of such instrument" must inform the public of such an operation "as soon as possible."[49]

The Act reinforces this obligation by permitting the AMF to require any person believed to be preparing a tender offer to declare their intentions.[50] In particular, such a demand may be made when shares listed in France undergo significant price fluctuations.

The information supplied to the AMF in response to its request must be made public.[51] If a potential bidder declares that it intends to make a tender offer, then the AMF will establish a deadline for the filing of the offer.[52] If a potential bidder states that it does not intend to make an offer, then it will be barred from doing so for a period of six months, unless it can justify the change in its decision by important developments in the market environment or the situation of one of the parties concerned.[53] During this period, it must also refrain from placing itself in a position in which it would be required to make a mandatory tender offer.

These rules are modeled on provisions of the British Takeover Act. As in Britain, the Act does not automatically impose an obligation to disclose all preparations for an offer, but rather leaves a great deal of discretion to the AMF to determine the extent of information that must be disclosed.

The Act also modifies information disclosure rules for the offer itself.

[48] French Commercial Code, Art. L. 233-10-1.
[49] AMF General Regulations, Art. 227-7.
[50] French Monetary and Financial Code, Art. L. 433-15(V); AMF General Regulations, Art. 222-22.
[51] AMF General Regulations, Art. 222-22.
[52] AMF General Regulations, Art. 222-23.

The Act provides a definitive list of information that must be included in a company's annual report, "if it would have a significant impact in a tender offer context."[54] This information includes the capital structure of the company, restrictions imposed by the bylaws or by shareholder agreements on voting rights or share transfers, a list of shareholders having special control rights, a description of rules for the replacement of directors and modification of the bylaws, any golden parachute provisions for directors or employees, and any agreements that would be terminated upon a change of control.

The Act also provides that the employee shop committees of both the bidder and target companies must be informed of the launch of a tender offer. The bidder must provide both shop committees with a copy of its tender offer documents within three days following their publication.[55] The target's shop committee may pronounce the offer friendly or hostile and has the right to request a meeting with the bidder's management to discuss the industrial, financial, and strategic aspects of the bid, and the repercussions for employees.

VII. Conclusion

The modifications of French takeover rules resulting from the Act are significant. The role of shareholder assemblies in takeover contests has been reinforced, and their ability to delegate authority to the board of directors remains strictly limited, though less so in the case of bids by companies incorporated outside the EU. The prominence given by the Act to rights issuances as a defensive technique probably signals future development of this defense in contested offers.

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[53] AMF General Regulations, Art. 222-25.
[54] French Commercial Code, Art. L. 225-100-3.
[55] French Labor Code, Art. L. 432-1.

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