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France Reverses Position on Transfer of Criminal Liability in Mergers

In light of a landmark decision from France's highest court, acquiring companies will have to give greater consideration to criminal risks potentially weighing on them as a result of the merger.

The *Cour de cassation* (the French Supreme Court) has found that in the context of a merger by absorption, the absorbing company may be held criminally liable for offences committed by the absorbed company prior to the operation. The landmark 25 November decision reverses the French Supreme Court's prior position.

The criminal division of the French Supreme Court has historically refused to admit that an absorbing company could be found liable for offences committed by the absorbed company prior to the merger,¹ pursuant to the principle of the personal nature of criminal offences and penalties as set forth in Article 121-1 of the French criminal code. This position was founded on a strict interpretation of the principle of the personal nature of offences and penalties. According to this principle, the dissolution of the absorbed company, following the merger by absorption, leads to the death of the legal person and to the extinction of any criminal proceedings against it.²

With its recent decision, the French Supreme Court is aligning its position with that of the Court of Justice of the European Union (CJEU)³ and the European Court of Human Rights (ECHR).⁴ These courts have recognized that an administrative fine imposed on the absorbed company for acts committed before the absorption constitutes a transferrable liability and that an "economic continuity" existed between the absorbing company and the absorbed company.

The French Supreme Court thus retains an interpretation of the principle of the personal nature of offences and penalties, according to which the dissolution of a legal entity cannot be assimilated to the death of a natural person. The French Supreme Court has specified that the scope of application of this new case law and its applicability over time differ depending on whether the merger by absorption was fraudulently undertaken such that the absorbed company may avoid its criminal liability.

Case summary

The case centered on claims brought against a company accused of involuntary destruction by fire. Following the allegations, the company was absorbed by another company and then dissolved prior to its hearing before the criminal court.

The criminal court had ordered additional investigations to determine whether the merger had been undertaken fraudulently, i.e., with the sole aim of avoiding the criminal conviction of the absorbed company. On appeal, the absorbing company's request for the nullity of the additional investigation ordered by the criminal court was dismissed.

Conditions for the application of the new jurisprudence

The new case law will apply if the following three cumulative conditions are met:

i. **The merger by absorption must have been concluded after 25 November 2020.**

Mindful of its break with prior case law, the French Supreme Court specified that this new interpretation will only apply to mergers concluded after 25 November 2020 pursuant to the principle of legal predictability stated in Article 7 of the European Convention on Human Rights.

ii. **The merger by absorption must concern public limited liability companies (*sociétés anonymes*, or SA) or simplified joint stock companies (*sociétés par actions simplifiées*, or SAS), and eventually partnerships limited by shares (SCAs)**

The French Supreme Court limits, at this stage, the scope of application of its new case law to mergers falling within the scope of Directive 78/855/EEC, i.e., to those involving public limited liability companies and, by extension, simplified joint stock companies (pursuant to Article L. 227-1 of the French Commercial code). However, the question of an extension to other corporate forms, particularly SCAs, may be raised.

iii. **Penalties transferrable to the absorbing company are limited to fines or confiscations.**

The French Supreme Court explains that penalties are restricted in this way because transfer of criminal liability following merger by absorption relies on the principle of total transfer of assets and liabilities from the absorbed company to the absorbing company. Thus, the non-pecuniary penalties listed in Article 131-39 of the French criminal code (such as placement under judicial supervision, exclusion from public markets, prohibition of receiving any public aid, prohibition of issuing cheques, etc.), do not fall within the scope of the transfer of criminal liability provided for in the 25 November decision.

The impact of fraudulent intent

The French Supreme Court, however, carves out an exception to these conditions for cases involving fraud. If the merger by absorption is undertaken such that the absorbed company may avoid criminal liability, the absorbing company can be held criminally liable regardless of the type of company or the date of the operation. Similarly, in such a case, all penalties listed in Article 131-39 of the French criminal code, including but not limited to fines or confiscations, may be or pronounced against the acquiring company.

Potential impact on mergers by absorption

In the context of merger operations, the decision means that absorbing companies should enhance their due diligence process to identify and assess future criminal risks to be transferred from the target company or an entity it previously absorbed prior to the transaction.

Absorbing companies will need to scrutinise target companies' past activities over the entire period not covered by criminal prescription. Prior to concluding the deal and subject to compliance with potential applicable securities, absorbing companies should systematically request documents related to internal investigations, customer complaints, disciplinary sanctions, and proceedings conducted by administrative and judicial authorities.

Particular attention should be paid to clauses such as "Representation and Warranties" in order to implement contractual guarantees regarding the absence of criminal offence committed by the target company and any ongoing legal proceedings or investigations against it.

Finally, additional care should be given to precisely documenting the financial and strategic purposes of the operation. Such documentation could provide additional safeguards should fraudulent intent be examined in the context of a lawsuit.

Emphasising the importance of this decision, the French Supreme Court published, along with an explanatory note, the following summary table summarizing the applicability of this landmark decision over time and depending on the existence of fraudulent purpose.

| | Merger by absorption prior to 25 November 2020 | | Merger by absorption after 25 November 2020 | |
|--|--|---|--|--|
| | Merger by absorption undertaken <u>with</u> fraudulent purpose | Merger by absorption undertaken <u>without</u> fraudulent purpose | Merger by absorption undertaken <u>with</u> fraudulent purpose | Merger by absorption undertaken <u>without</u> fraudulent purpose |
| Possibility of criminal prosecution and conviction of the absorbing society | Yes | No | Yes | Yes if within the scope of the directive 2017/1132 on the merger of public limited companies |
| Penalties likely to be imposed | Full criminal liability (all penalties incurred) | No | Full criminal liability (all penalties incurred) | Criminal liability for the purpose of imposing a fine and/or confiscation |

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Endnotes

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- ¹ Crim. 20 June 2000, No. 99-86742 ; Crim. 9 September 2009, No. 08-87312 ; Crim. 14 October 2003, No. 02-86376 ; Crim. 18 February 2014, No. 12-85807 ; Crim. 25 October 2016, No. 16-80366.
 - ² From a pure civil liability standpoint, the *Cour de cassation* had however already acknowledged that a court of appeal could — after having noted the extinction of criminal proceedings against a convicted legal entity due to its absorption — order the absorbing company, to pay damages to the civil claimants (Crim. 28 February 2017, No. 15-81469 P: D. 2017).
 - ³ CJEU, 5 March 2015, Modelo Continente Hipermercados SA vs. Autoridade para as Condições de Trabalho, C-343/13.
 - ⁴ ECHR, 24 October 2019, Carrefour France vs. France, No. 37858/14.