

# Client Alert

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## Recent Capital Market and Corporate Legal Developments in France

The French Parliament adopted on 22 October 2010 a Law for banking and financial regulation (the Banking and Financial Regulation Law or the New Law) designed to regulate financial activities further to the G20 recommendations on the matter, and to bolster the French economy during the financial and economic crisis. Only the second purpose of the New Law shall be dealt with in this *Client Alert*. It was prepared by the French Ministry of the Economy with the objective to modernize the French stock exchange procedures and to reinforce the financial soundness of small and mid-sized businesses.

***The reform of stock exchange procedures translated into several concrete measures aimed at improving shareholders' protection and market transparency, especially in relation to tender offers.*** The Banking and Financial Regulation Law was also intended to make the MTFs (Alternext Paris)<sup>1</sup>, which are traditionally favored by small and mid-cap companies seeking to raise capital, more attractive to investors. This goal was proposed to be achieved by extending to MTFs the rules applicable to regulated markets (Euronext Paris) in connection with mandatory tender offers, public buy-out offers and squeeze-out.

Besides these main reforms, the French Parliament also strengthens the power of the *Autorité des Marchés Financiers* (AMF), the French

Financial Markets Authority. The latter has recently amended its General Regulation to implement the different reforms mentioned above. The new provisions were adopted by the French Regulator further to several public consultations.

### I. Amendment of Rules on Tender Offers

The Banking and Financial Regulation Law brings substantial changes in the legal regimes of mandatory tender offers on securities traded on regulated markets (Euronext Paris) and on tender offers rules applicable to securities traded on MTFs (Alternext Paris). It also supplements the legal definition of "acting in concert".

#### A. Mandatory Tender Offers on Regulated Markets

The New Law modifies substantially the conditions in which an investor taking shares in a listed company is required to make a tender offer to purchase all the outstanding shares of such company. The New Law mainly lowers the triggering threshold of this obligation and amends its calculation method. It also introduces a new temporary exemption to the obligation to launch an offer. These provisions, as well as the amended provisions of the AMF General Regulation in connection thereto, entered into force on 1 February 2011.

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## 1. The Reduction of the Triggering Threshold

***The Banking and Financial Regulation Law lowers from one third of the share capital or voting rights to 30% the holding threshold triggering the obligation for a shareholder to make a tender offer for all the shares of a company listed on a regulated stock exchange (Euronext Paris).***

This change was promoted by the AMF, which pointed out that in practice, given the low participation of shareholders at shareholders' meetings, an investor is *de facto* able to retain control over a listed company by holding a portion of its voting rights approaching 30%. This 30% threshold is also the one applicable in most of other European countries (United Kingdom, Germany, Austria, Spain Italy, Netherlands, Belgium, Ireland and Sweden).

Before the reform, in addition to the crossing of the one third threshold, a shareholder who held, directly or indirectly, between one third and the half of the shares or voting rights of a company, and increased its shareholding by at least 2% of the shares or voting rights of such company within a 12-month period had also to file a mandatory tender offer. According to the New Law, the one third threshold has also been lowered to 30% in this second case.

***A grandfather clause has been adopted by the AMF so that the former one third threshold shall continue to address temporary situations before and after the entering into force of the new provisions on mandatory tender offers, on 1 February 2011.***

It governs the following situations:<sup>2</sup>

- Regarding (i) investors holding, on 1 January 2010, a portion of a company's shares or voting rights comprised between 30% and one third, and (ii) investors holding, after 1 January 2010 and before 1 February 2011, between 30% and one third of a company's shares or voting rights as a result of a commitment undertaken before 1 January 2010, ***the triggering threshold applicable shall remain***

***one third of share capital and voting rights as long as their holding remains between these thresholds.***

- Investors who cannot benefit from the grandfather clause and hold, as from 1 February 2011, between 30% and one third of a company's shares or voting rights must reduce their holding below the 30% threshold before 1 February 2012 or file a tender offer for all the shares of the company. This one-year delay has been granted by the AMF to take account of the market constraints for selling the relevant shares.
- Any shareholder concerned by the grandfather clause, or having to reduce its shareholding before 1 February 2012, must disclose to the AMF without delay, the portion of the company's shares and voting rights it holds. The AMF shall publish a list of the investors having made such statement.

## 2. Calculation Method

***The 30% threshold is henceforth determined in accordance with the rules governing the reporting of major shareholding by investors, which results in the alignment of the two sets of rules.***

In particular, the following shares must be taken into account for the purpose of calculating holding thresholds in both regulations:<sup>3</sup>

- Shares or voting rights held by other persons for the account of the person concerned
- Shares or voting rights held by companies controlled by the person concerned within the meaning of Article L. 233-3 of the French Commercial Code
- Shares or voting rights held by a third party acting in concert with the person concerned
- Shares already issued or voting rights that the person is entitled to purchase, at its sole discretion, pursuant to an (i) agreement<sup>4</sup> or (ii) financial instruments.

According to the New Law, the AMF has specified that for the purpose of the mandatory offer, the financial

instruments to be taken into account include bonds exchangeable in shares, forward contracts and all types of options that can be exercised immediately or in the future as well as barrier options when the barrier is reached. Regarding the agreements concerned, the Equity swap and CFD must be taken into account for the purpose of calculation only if they are physically settled, automatically or at the investor's initiative. In case of agreements entitling an investor to shares once a given listed price is reached, the shares concerned by such agreements must be taken into account only once the agreed listed price is reached.<sup>5</sup>

- Shares held in usufruct, shares or voting rights held by a third party pursuant to a temporary shares sale agreement entered into with the person concerned (*i.e.*, options securities loans, repurchase agreements)
- Shares held in trust by the person concerned provided that said person may exercise the voting rights attached to such shares at his/her sole discretion
- Voting rights that the person concerned may exercise at its discretion pursuant to a power of attorney

### 3. Exemption Provisions

In connection with the new mandatory bid threshold, the AMF may grant investors a temporary exemption to the obligation to launch a tender offer.<sup>6</sup> Exemption may only be granted where the crossing of the 30% threshold is not part of a plan by the shareholder to obtain or increase its control over the company and to the extent that it is remedied within a 6-month period. During that selling time period the concerned shareholders shall undertake not to exercise the corresponding voting rights. This exemption has been introduced in counterpart for the new calculation method of the 30% threshold which includes, for the purpose of this regulation, the underlying shares of financial instruments or financial agreements in the shareholding of

investors. This provision may be used by the AMF to avoid the disproportionate and unjustified consequences of this new calculation rule.

Besides this specific exemption provision, the AMF may still grant exemptions from the mandatory filing of a takeover bid in other certain limited circumstances<sup>7</sup> in case of the crossing of the new 30% threshold.

### 4. Mandatory Bid Price Calculation

The reference period for the calculation of the minimum price of mandatory tender offers has been modified by the Banking and Financial Regulation Law to prevent price manipulation by the bidder.

In accordance with the EU Directive on takeover bids, French Law provided for a fair bid price in case of mandatory bid which had to be at least equal to the highest price paid by the bidder, for the same shares, in the twelve months preceding the "**filing of the offer**".<sup>8</sup> This provision has been slightly modified by changing the starting date of the 12-month period, which is now the "**triggering event of the obligation to file an offer**". This amendment is intended to prevent the bidder from postponing the launch date of the offer where this could artificially lower its mandatory bid price.

### B. Removal of the Procedure for Standing Market Offers on Both Euronext and Alternext and Introduction of Mandatory Tender Offers on Alternext

***The Banking and Financial Regulation Law abolishes the procedure for "standing market offers" (garantie de cours), both in regulated markets (Euronext Paris) and on MTFs (Alternext Paris).***

That offer introduced in France in 1973 before the creation of rules on mandatory tender offer in 1989 obliged a buyer who acquired a block of shares conferring more than 50% of a company's share capital or voting rights, to offer to acquire all the shares tendered during a minimum period of 10 trading days at the price equal to the price of the block of shares granting the

control over the target company. This price could however be different from the fair price required according to the EU Directive on takeover bids. Besides, the procedure for standing market offers had been rarely used on regulated markets (Euronext Paris) for the last five years. The AMF generally applied the procedure of the mandatory tender offer which is more efficient, offers more guarantees to minority shareholders and complies with the EU Directive.

The procedure for standing market offers has also been abolished on MTFs (Alternext Paris) by the New Law for the same reasons. In such markets however, this removal could only be enacted to the extent that minority shareholder protection was guaranteed otherwise, which resulted in the introduction, on MTFs, of a procedure of mandatory tender offer with a triggering holding threshold of 50% of the shares or voting rights of the target company.

Both the abolition of the procedure for standing market offers and the introduction of mandatory tender offers on MTFs are effective since 1 February 2011.

### C. Public Buy-Out Offers and Squeeze-Out on MTFs

***The Banking and Financial Regulation Law extends the rules applicable to buy-out offers and squeeze-out to the companies listed on an MTF (Alternext Paris) under the conditions and modalities provided for by the AMF.***

In order to implement the provisions of the New Law in this area the AMF has amended its General Regulation in such a way as to bring, to the extent possible, the procedures applicable to MTFs (Alternext Paris) into line with these already applicable on regulated markets (Euronext Paris). This alignment favored the broadening of the scope of public buy-out offers and squeeze-out on MTFs. As an example, we noted that these legal tools have been made applicable to both the outstanding shares and the authorized capital of companies listed on an MTF (Alternext Paris).

Buy-out offers may thus be implemented on MTFs (Alternext Paris) by (i) majority shareholders holding at least 95% of the voting rights of an issuer or (ii) at the request of minority shareholders holding less than 5% of voting rights, upon AMF approval. However, the cases of buy-out offers applicable to companies whose shares are traded on a Regulated Market in the following situations:<sup>9</sup>

- A listed limited company (*Société Anonyme*) is transformed into a partnership limited by shares (*Société en Commandite par Actions*), or
- In case of major modification of the company by-laws affecting shareholders' rights or in case of modification of the business of the company, *i.e.* where the controlling shareholder intends to (i) ask an extraordinary general meeting of shareholders to approve significant amendments to the company's by-laws or decides to (ii) proceed with the merger of that company into the company that controls it, (iii) sell or contribute all or most of the company's assets to another company, (iv) reorient the corporate purpose or (v) suspend dividends for a period of several financial years.

are not available for companies whose shares are traded on Alternext.

As far as squeeze-out is concerned, this procedure may now be implemented by majority shareholders holding at least 95% of share capital and voting rights of an issuer listed either on Euronext Paris or on Alternext Paris.

### D. Definition of Persons Acting in Concert

The Banking and Financial Regulation Law also confirmed the recent case law relating to the concept of "persons acting in concert". Indeed, the French Supreme Court ruled in a so-called *Gecina* case, decided on 27 October 2009, that two persons could be regarded as acting in concert towards a company not only when acquiring or selling voting rights with a view to jointly determine the management or commercial strategy of the company, but also where the acquisition or sale

of voting rights is decided in order to gain control over the company. In order to protect the French stock market from creeping takeovers, the New Law extends the definition of persons acting in concert as follows: "*Persons who have entered into an agreement with a view to buying or selling voting rights or with a view to exercising voting rights to implement a common policy in relation to a company or to gain control over such company are deemed to be acting in concert*".<sup>10</sup>

## II. Disclosure of Temporary Transfers of Shares and Short Positions

In line with the report of the AMF working group on major shareholdings' reporting, the Banking and Financial Regulation Law promotes transparency regarding temporary transfers of shares listed on a Regulated market, (*i.e.* transfers giving the right or requiring to resell the shares to the seller). While it is widely acknowledged that securities loans and other temporary transfers of shares contribute to market liquidity, the AMF working group focuses on the risk that such transactions be used by shareholders to carry out punctual actions towards listed companies at shareholders' meetings. ***Thus, according to the new statutory provisions, any person who holds as a result of a temporary transfer, alone or in concert, more than 0,5% of the voting rights of an issuer must disclose such information to the AMF and to the company at the latest within three days prior to a company general meeting*** (which is the legal record date for attending a shareholders' meetings).

The disclosure must include the nature of the transaction and the number of shares temporarily transferred, the identity of the parties, the term of the transfer agreement, the reference of the securities concerned and — as the case may be — the voting agreement entered into in connection with the transaction. Should shareholders fail to do so, the shares held on a temporary basis shall cease to carry any voting rights for any shareholders meeting held until the

resale of the shares. The AMF shall publish the information on its website one business day following its reception at the latest.<sup>11</sup> Financial intermediaries benefit from an exemption to these rules, provided that their shareholding remains inferior to a portion of the company's share capital or voting rights to be determined by the AMF and that they do not influence the management of the issuer through the exercise of their voting rights.<sup>12</sup>

***In November 2010, the AMF introduced in its General Regulation a new comprehensive transparency regime for net short positions in equities traded on a French regulated market or MTF. This General Regulation has become effective on 1 February 2011. The measures taken by the AMF in 2008 to prohibit short selling on specified financial stocks no longer apply.*** Under the new regime, market participant must daily report to the AMF any net short position that crosses upward or downward the thresholds of 0.2, 0.3, 0.4, 0.5%, and any further 0.1% increment of the share capital of issuers the shares of which are listed on a French Regulated market (Euronext Paris) or a French organized MTF (Alternext Paris) and for which the French market is the main market. A "negative list" is posted on the AMF website (on the issuer area/ short selling) and updated on a regular basis. The crossing of the 0.5% threshold and any further 0.1% shall be published on the AMF website. Shares listed on other French MTF (*Marché Libre* or *Alternativa*) are not concerned by the disclosure requirements.

For the calculation of the net short position, neither convertible bonds, nor warrants, or underwriting commitment are to be taken into account. However, securities giving access to shares already issued are included. The calculation is made on the basis of the amount of the issued share capital as published by the issuer.<sup>13</sup> Exposure through holding of financial instrument is calculated on a delta-adjusted basis.

Under the new regime, statutory "investment service providers" acting as market-makers, liquidity providers and block trade positioners and financial

intermediaries acting as the investors' counterparties are exempted from the reporting requirement, provided that they obtain a prior approval from the AMF in accordance with the AMF Instruction N° 2010-08 of November 2010 on reporting short position to the AMF.

### III. Strengthening of the AMF Powers

#### A. Monitoring of Rating Agencies

The AMF is entrusted with the task to register and monitor the activity of rating agencies. In that respect, in accordance with the European Regulation N°10600/2009 of 16 September 2009 on credit rating agencies, the AMF granted certification, in February 2011, to the Japan Credit Rating Agency and signed a cooperation agreement with the Japan Financial services Authority. Therefore the ratings made by this agency may be used for regulatory purposes within European Union without the agency having a physical presence in Europe.

The Banking and Financial Regulation Law also provides for a new liability regime for rating agencies towards clients and third parties<sup>14</sup> and prohibits the contractual provisions with the purpose of waiving such responsibility. In addition, further to the New Law and the EU Regulation, credit rating is now defined under French Law as an ancillary investment service.

#### B. Power of Sanction

***The maximum amount of the penalties which may be imposed by the AMF to financial intermediaries for the violation of their professional duties as provided for by Law and the AMF General Regulation has been increased*** by the Banking and Financial Regulation Law.<sup>15</sup> The highest fine the AMF can impose to most of the financial intermediaries and service providers under its supervision (including investment services providers, clearing institutions, market undertakings, custodians of undertakings for collective

investment) has been increased tenfold to €100 million. The same maximum fine may be imposed to any person who committed in France or abroad any market abuse as well as any attempt thereof.

In addition, the penalty applicable to the individuals working for financial intermediaries and service providers has been increased tenfold to €15 million where these persons committed market abuse.

In the event of profits, the maximum fine amount applicable may still be equal to 10 times the amount of the profits earned by the responsible person, or five times such profits as far as employees of financial intermediaries are concerned.

The New Law also grants the Chairman of the AMF, upon approval of its Board, the power to appeal the decisions taken or the sentences imposed by the AMF Enforcement committee (*Commission des sanctions*)<sup>16</sup> which is independent from the other AMF divisions (e.g. investigation and market surveillance division, legal affairs, corporate finance division...) This power has been mainly requested in connection with a recent case where the AMF Enforcement Committee decided to not engage in a penalty process against the managers of the European group EADS following to the AMF investigation for insider trading.

#### C. Power of Settlement

***Once specific implementation provisions will have been adopted by Decree (Décret), the AMF shall be entitled to engage in settlement discussions*** (composition administrative) with certain financial intermediaries which are under investigation for a breach of their professional duties as required under AMF regulation. The new procedure shall however not be available in case such professionals are suspected of market abuse, i.e. insider trading, dissemination of false information or market manipulation.

The Board of the AMF decides on a case by case basis and in its sole discretion whether the new settlement

procedure (*composition administrative*) is opportune. In such case, the Board sends to the relevant person a statement of complaint accompanied by an offer of settlement. The agreement reached by the General Secretary of the AMF and the financial intermediary must then be approved by the AMF Board and certified by the AMF's Enforcement committee (*Comité des sanctions*) to become binding over the parties. Every approved agreement is then made publicly available.

Any person to whom a settlement has been proposed undertakes to pay a sum to the Treasury not exceeding the maximum fines applicable pursuant to the Monetary and Financial code. The decisions taken by the AMF Board and the Enforcement Committee are however subject to appeal.

#### **D. Cooperation With Other Regulatory Authorities Regarding CO<sub>2</sub> Emissions Markets**

The Banking and Financial Regulation Law entrusts the AMF, in cooperation with the French Energy Regulation Commission, with the task of supervising and monitoring the CO<sub>2</sub> emissions markets, which thus become regulated markets. Both agencies announced on 10 December 2010 that they entered into an information-sharing agreement which covers the supervision of greenhouse gas emission allowances, electricity, natural gas and their derivatives.

This agreement allows the two regulators to share their respective information and expertise to identify the risks factors on these markets. In particular, the Energy Regulation Commission will be in a position to help the AMF analyze the coherence of the transactions carried out in greenhouse gas emission allowances with the economic and technical factors peculiar to energy markets. Thanks to this agreement, France is the first European country to anticipate the provisions of the draft European Regulation on energy market integrity proposed by the European Commission on 8 December 2010.

#### **Endnotes**

- <sup>1</sup> Alternext Paris is the French Alternative investment market dedicated to small and mid capitalizations.
- <sup>2</sup> Article 234-11 of the AMF General Regulation.
- <sup>3</sup> In article 233-9 of the French Commercial code.
- <sup>4</sup> In its consultative document dated 3 December 2010 on the update of its General Regulation in respect of tender offers, the AMF considered that the "agreements" in question are highly diversified OTC agreements which must therefore be assessed by analogy with the criteria set forth regarding financial instruments.
- <sup>5</sup> Article 234-1 of the AMF's General Regulation, as amended on 1 February 2011.
- <sup>6</sup> Article 234-4 of the AMF's General Regulation.
- <sup>7</sup> *E.g.* the subscription to a capital increase by a company in recognized financial difficulty, subject to the approval of a general meeting of its shareholders, the resale or other comparable disposal of equity securities or voting rights between companies or persons belonging to the same group, or the merger or asset contribution subject to the approval of a general meeting of shareholders.
- <sup>8</sup> Article L. 433-3 of the French Monetary and financial code.
- <sup>9</sup> Articles 236-5 and 236-6 of the AMF General Regulation.
- <sup>10</sup> Article L. 233-10 of the Commercial Code.
- <sup>11</sup> *See*: Article 223-38 of the AMF General Regulation and the implementing AMF Instruction n°2011-04 of 2 February 2011.
- <sup>12</sup> Article 233-7, II, 3° of the Monetary and financial code.
- <sup>13</sup> AMF position n° 2011-03 of 2 February 2011, list of questions-answers on the implementation of the short selling disclosure regime as of 1 February 2011.
- <sup>14</sup> Article L. 544-6 of the Monetary and financial code.
- <sup>15</sup> Article L. 621-15 of the Monetary and financial code.
- <sup>16</sup> The Enforcement committee is the AMF body in charge of imposing penalties in case of a breach of its General Regulation or another financial rule.

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

**Marie-Chrystel Dang Tran**  
+33.1.40.62.21.30  
marie-chrystel.dangtran@lw.com  
Paris

**Olivier du Mottay**  
+33.1.40.62.23.39  
olivier.dumottay@lw.com  
Paris

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