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BRIEFING

The Takeover Directive: implementation in France

Summary

A draft bill to implement the Takeover Directive has recently been published in France and is expected to come into force during 2006. As thought, France will opt in to Article 9 of the Directive and allow reciprocity. It is opting out of most of the provisions of Article 11 but French companies will be able to apply these provisions voluntarily. The draft bill will also introduce other changes to French takeover rules, in particular a 'put-up or shut-up' obligation. Changes will also be made to compulsory offers and squeeze-out offers.

A draft bill to transpose Directive 2004/25/EC on takeover bids (known as the Takeover Directive) was approved by the French Senate at the end of October 2005. The current text is subject to approval by the lower chamber of the French parliament, which is expected before the end of the year. The draft bill, which was first published in September 2005, will then come into force in May 2006.

The draft bill has attracted a lot of attention in France. In June, an influential working group led by Jean-François Lepetit (former chairman of the French Takeover Panel) published its recommendations on the approach France should take to the optional articles of the Takeover Directive, and in mid-October the highly respected Senate Finance Commission published a full report on the draft bill.

After rumours of a possible hostile bid by PepsiCo for Danone over the summer, the draft bill is being seen as an opportunity to re-establish France's credentials as an investor-friendly country, at the same time as giving French companies the power to defend themselves on an equal footing against foreign 'predators'. The proposed implementation of articles 9, 11 and 12 of the Takeover Directive in French law shows how difficult these two objectives are to reconcile in practice. The draft bill will also bring about a number of other changes to how public takeovers are conducted in France.

Restrictions on frustrating action (Article 9 of the Takeover Directive)

The draft bill adopts the provisions of Article 9 of the Takeover Directive in virtually identical terms. These

provisions, requiring the board of a target company to obtain shareholder approval before taking frustrating action during an offer period, are similar to the current restrictions under French law.

In line with the Takeover Directive, the draft bill places target shareholders at the centre of the debate by requiring their approval or confirmation of any non-ordinary course action by the target company that may result in the frustration of a bid. On the face of it at least, this represents a change to the current position in France where the market authority (Autorité des marchés financiers – AMF) acts as the independent arbiter of whether defence tactics that have not been approved by shareholders amount to frustrating action. In addition, unlike directors, shareholders will not have to take into account other stakeholders' interests in deciding whether to approve defensive measures.

However, this shift in power away from the AMF does not mean that target shareholders will be unrestricted in the frustrating action they may approve. First, the defensive measures subject to shareholder approval will have to be proposed by the target board, which will be limited by its obligation to act in the general corporate interest (*intérêt social*).

In addition, it is more than likely that any proposal, even if approved by shareholders, would have to comply with the AMF's general regulations, including the fundamental principle of free competition between bidders. In practice, this is likely to result in the AMF continuing to block any frustrating action it considers too restrictive, even if that action is subject to approval by target

shareholders. If a situation similar to the Aventis defence of Sanofi's hostile bid (during which the AMF issued a statement condemning a proposal to be put to Aventis shareholders to approve the issue of warrants) were to arise once the draft bill has been implemented, the outcome would probably be the same, notwithstanding the additional power given to shareholders.

Finally, the restrictions on frustrating action apply during an offer period. Under French takeover regulations, an offer period only starts when an offer is formally filed with the AMF, and is not triggered by an announcement of a decision to make a bid, or that a bidder is considering doing so. Therefore the restrictions on a target board taking frustrating action start later in France than in certain other countries (such as the UK).

Reciprocity (Article 12(3) of the Takeover Directive)

In line with the recommendations of the Lepetit report, the draft bill provides that the restrictions on frustrating action do not apply to a target company where the offer has been launched 'by entities which do not, or whose parent companies or concert parties do not, apply the French restrictions on frustrating action or equivalent restrictions'. This is the so-called principle of reciprocity set out in Article 12 of the Takeover Directive. The draft bill addresses a number of the issues highlighted during the consultation phase concerning how this will work in practice, in particular in a situation of competing bids or concert parties.

Following a recommendation of the Senate Finance Commission, the draft bill has been amended to apply reciprocity to competing bidders and concert parties in the same way. In each case, if one of the bidders or concert parties does not apply prohibitions on frustrating action, this is enough to enable the target company to take frustrating action against all the bidders (and concert parties) without shareholder approval during an offer period.

To prevent the target company from entering into an arrangement with a 'friendly' bidder that does not apply the restriction on frustrating action to benefit 'unfairly' from the provisions on reciprocity, the draft bill excludes reciprocity where the only entity not applying the

restriction on frustrating action is acting in concert with the target company. However, there is a degree of uncertainty as to whether such an arrangement would amount to a concert party in the absence of other arrangements between the parties, and there would obviously be issues involved in trying to prove the existence of any such agreement.

The notion of reciprocity under the draft bill is very broad. For example, if a bidder applies only part of the French restrictions on taking frustrating action, the target company will be released from the prohibition on taking any frustrating action. In addition, reciprocity will apply regardless of the reasons for the bidder not applying the prohibition on frustrating action (eg unlisted bidders will be deemed not to apply the prohibition on frustrating action because they cannot be subject to a takeover bid). Finally, foreign (including non-EEA) companies are subject to reciprocity and the use of the term 'entities' in the draft bill indicates that foreign partnerships, trusts and similar organisations will also be subject to reciprocity.

For foreign entities, the draft bill recognises prohibitions on frustrating action that are 'equivalent' to the French rules. Any dispute as to what is meant by equivalent restrictions will be resolved by the AMF, whose decision may be challenged in the Paris Court of Appeal within 10 days. Litigation against AMF decisions during a public takeover generally lasts between four and six months and so a dispute over equivalence is likely to add to the overall offer timetable. A target company may even consider challenging an AMF decision on equivalence as part of its overall defence strategy.

In the event that reciprocity applies to lift the prohibition on frustrating action, any such frustrating action must nevertheless have been authorised by the target company's shareholders in the 18 months prior to the offer. This will mean that unless a target company has existing shareholder approval, it will still be restricted in the action it may take during an offer period, even if it benefits from the provisions of reciprocity (for example, a 'pacman' defence would require shareholder approval under the draft bill). This is likely to result in companies including resolutions to approve 'standard' defences at their annual general meetings as a matter of course. It is not yet clear whether institutional and minority shareholder groups will support such resolutions.

Breakthrough (Article 11 of the Takeover Directive)

Although, as widely expected, France has decided to opt out of Article 11, the draft bill does implement two provisions of Article 11 that were already AMF policy and gives French companies the ability to adopt the other provisions on a voluntary basis. Any company deciding to apply the voluntary provisions would have to amend its by-laws and inform the AMF of the decision, which the AMF will subsequently publish.

The draft bill has also been amended to provide for reciprocity in respect of the voluntary provisions of Article 11 of the Takeover Directive (along the same lines as the prohibition on frustrating action). However, the draft bill does not provide for any compensation mechanism for the shareholders of companies electing to apply Article 11 of the Takeover Directive on a voluntary basis.

The provisions of Article 11 relating to the suspension of multiple voting rights during and immediately following an offer period have not been adopted by the draft bill. French companies can provide for double-voting rights in their by-laws for shareholders who have held shares in registered form for a minimum of two years. French-style double-voting rights do not qualify as multiple voting rights as defined in the Takeover Directive and so these provisions of the Takeover Directive were not considered relevant under French law.

The draft bill provides that a bidder shall not be subject to restrictions on the transfer of shares provided for in a company's by-laws during an offer period. This is the position currently under the general regulation of the AMF. The draft bill also allows companies to adopt a similar position for contractual transfer restrictions entered into after 21 April 2004, albeit on a voluntary basis.

In addition, the draft bill confirms the AMF's existing policy of requiring that any cap on voting rights provided for in a company's by-laws does not apply at the first shareholders' meeting following an offer if the bidder holds more than a certain percentage of the target company's share capital. The general regulation of the AMF will fix the relevant percentage shareholding level, which is expected to be two-thirds.

A French company may voluntarily adopt the provisions of Article 11 of the Takeover Directive relating to the suspension of restrictions on voting rights during an offer period (whether included in a company's by-laws or a contract entered into after 21 April 2004). Contractual restrictions on voting rights are currently subject to strict disclosure obligations under French law and these will remain unaffected by the draft bill.

The draft bill also enables French companies to suspend restrictions on voting rights (either contractual or provided for in the company's by-laws) or enhanced appointment or removal rights for board members (provided for in the company's by-laws) at the first shareholders' meeting following an offer if the bidder holds more than a certain percentage of the target company's share capital. This threshold is expected to be set by the AMF at a simple majority.

Other provisions

The draft bill introduces a number of other changes to French takeover regulations.

- 'Put-up or shut-up' orders. Following prolonged market speculation of an imminent bid by PepsiCo for Danone over the summer, the draft bill grants the AMF the power to require a person who it reasonably believes is preparing a public takeover, to make its intentions known to the AMF, which will then make the information public. The AMF will also be given the power to block an offer that is filed by a person within a defined period following a statement by that person that it did not intend to launch an offer.
- Squeeze-out offers. The draft bill introduces a new category of squeeze-out procedure (*retrait obligatoire* – RO) that may be made within three months of the end of the offer period at the offer price, if the offeror holds at least 95 per cent of the capital and voting rights of the target. Unlike the existing squeeze-out procedure, this follow-on squeeze-out would not have to be preceded by a buy-out offer (*offre publique de retrait* – OPR). In addition, if the main offer included a share element, the bidder may offer securities in a squeeze-out (with a full cash alternative). As expected, the Senate Finance Commission proposed to reduce the threshold to 90 per cent of

- the voting share capital that was the subject of the offer, but this was rejected by the Senate.
- **Mandatory offers.** The draft bill introduces a requirement for a mandatory offer to be launched at a price at least equal to the highest price paid for the same securities by the offeror during the 12 months before the launch of the offer. Under French takeover regulations, the AMF is required to approve the terms of public offers, so it currently reviews the price of all public takeovers, including mandatory bids, on the basis of a well-established multi-criteria valuation methodology. The other provisions of French law relating to mandatory offers (including exemptions) remain unchanged.
 - **Concert party.** The definition of concert party under French law will be extended by the draft bill to include any agreement relating to the acquisition of control or the taking of frustrating action. Rather than being a new category of concert party, the new definition is treated as being part of the existing concept, which requires an agreement to implement a common policy regarding the company. This limits the scope of this change and for example, despite the new definition, financial advisers would not be treated as acting in concert with a bidder.
 - **Increased employee information rights.** The draft bill places an obligation on the offeror to send a copy of its offer document to its own workers' council and convene a meeting of its workers' council (the existing obligations only relate to the workers' council of the target company). It also provides for direct contact with employees in the absence of a workers' council.
 - **Disclosure obligations for listed companies.** Listed companies will be subject to an obligation to disclose annually in the management report certain information that is likely to affect the outcome of a public offer. This information includes material contracts with change of control provisions and golden parachute provisions in directors' and employees' employment arrangements.

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