C/M/S/ Bureau Francis Lefebvre

# Mergers & Acquisitions 3

NEWSLETTER

December 2009

## Contents



## Editorial

The LAROSIERE Report had identified business governance shortcomings as one of the causes of the financial crisis. In truth, the criticism related rather to governance of financial organisations. Nonetheless, improvement of the quality of governance now seems to be a widely accepted aim for all entities: listed companies, medium-sized businesses, mutual insurance groups and not-for-profit bodies are paying heed to this issue, as various indicators show.

Governance quality is not without its impact on mergers and acquisitions. By promoting shareholder loyalty, it helps against take-over bids. In many instances where there is transfer of control the issue arises of modern governance complying with standards that may be either compulsorily introduced or freely accepted. Mergers, particularly big ones, traditionally produce culture conflicts which can be resolved by implementing intelligent governance. These varied factors led us to choose the theme of business governance for the central issue in this letter, all the more as the lawyers in our firm have noted an ever-growing stream of questions put to them on the topic.

For obvious reasons, one of our team objectives in this second quarter of 2009 is to provide our clients with help in setting up governance procedures complying with the standards set by AFEP-MEDEF [Association Française des Entreprises Privées-Mouvement des Entreprises de France = French private-sector association - French business council]. Nonetheless, in an economic environment seemingly on the mend it remains a key aim to hold our position among the best M&A teams.

The CMS Bureau Francis Lefebvre corporate team

**SPECIAL REPORT:**
Business Governance

# Heads-Up

## The guarantor's position in the event of merger of a creditor company: a turn-around?

A reversal of the case-law with respect to the treatment of guarantees in the event of merger by absorption of the creditor company appears to have been established as a precedent by a judgment handed down by the commercial division of the Cour de cassation on 30 June 2009.

It will be recalled that merger through absorption of a debtor company by a company not involved in the guarantee operation terminates the guarantor's liability with respect to future obligations, except where it is expressly desired to guarantee future debts of the acquiring company.[1] For a long time that principle has prevailed where there is merger of the creditor company.

However, a judgment handed down in 2005 by the *Cour de cassation*[2] suggested that it was abandoning the analysis. In that case the managers of a company had given a joint and several guarantee with respect to a finance lease agreement to the leasing company. After the lessee company had been compulsorily wound up, the company that had acquired the lessor called upon the guarantors to pay the unpaid instalments.

The Cour de cassation had heard the acquiring company's claim on the basis of article L. 236-3 of the Commercial Code, under which any take-over entails full transfer to the acquiring company of the assets and liabilities of the acquired company. Thereupon, unless otherwise agreed, the guarantee of instalment payments must automatically transfer to the acquiring company in the event of merger through absorption of the company owning the leased building.

The outcome had seemed to establish survival of a guarantee after the merger of the creditor company. The underlying concept was a double one: full transfer of assets and liabilities and the irrelevance of a creditor's personal identity to the position of guarantors.

However, a recent judgment has now overturned that decision[3]. In this instance the manager of a general partnership had stood joint and several guarantor for payment of sums of money which might be owed to a bank by the company under a completion bond with respect to road works. The bank had then been acquired by another bank which, after the general partnership went bankrupt, had sought recourse against the guarantor.

The Cour de cassation quashed the appeal judgment ordering the guarantor to make payment, after observing that *"in the event of merger by absorption of one company by another, the liability of the guarantor giving a guarantee to the acquired company only remains on foot for the purpose of guaranteeing debts arising after the merger in the event of an expressly stated intention on the guarantor's part to give a guarantee to the acquiring company".*

The Cour de cassation at all events has no intention of making the distinction and attaches the same effects to a merger whether it involves creditor or debtor companies or guarantors. Hence the parties to any merger must take care to demand as far as possible that guarantors refresh their prior obligations.

1 CA Paris, 5 January 1987, BRDA 1987, n° 7, p. 12.
2 Cass. Com., 8 November 2005, RTD com., 2006. 145, obs. P. Le Cannu.
3 Cass. Com., 30 June 2009, BRDA 17/09, inf. 3.

# > SPECIAL REPORT
## "Business Governance"

Corporate governance has for several years now become a dominant theme in ruminations about corporate life.

It evolved into a managerial style from its beginnings as a subject of discussion.

It is nowadays a reality at the core of company operations, especially for companies whose shares are listed in a regulated market. More and more, it disciplines group operations. It is also a governance method involving medium-sized businesses, which cannot avoid a general evolution influencing everyone's thinking, judges in particular. Originally, of course, corporate governance was principally a means of regulating the operations of listed companies: its aim was to protect shareholders against managers' tendency to maximise their own perceived usefulness. The crisis we are now going through has exposed the limitations of the shareholder-as-king model and shareholder value. Business governance now shows itself in a more objective light: first and foremost it involves jettisoning conflicts of interest which weaken outcomes in the business's overall interests. That elimination of conflict of interest requires the appointment of independent directors to boards, setting up independent committees to audit general management, and a balance of power mechanism.

*"Corporate governance"* more generally implies permanent consideration of how power is organised in companies and groups of companies. Business legal departments in practice spend a great deal of time resolving governance issues and what we are dealing with is something very far removed indeed from a phenomenon which some had viewed as merely a *"flash in the pan"*.

Business governance is of course not such a new idea as is sometimes claimed. Some business governance requirements were already met by statute before we began to talk of *"corporate governance" (I)*. This phenomenon later more or less took up the front of the stage and resulted in standards coming from a variety of sources *(II)*. This variety of rules is now problematic and the consistency of this area of the law is fairly hypothetical *(III)*.

### I – Business governance before the advent of corporate governance

French law made allowance for business governance requirements well before people spoke of corporate governance. Bearing in mind that the aim of business governance is mostly to eliminate the influence of conflict of interest on the management of companies, the mechanisms for getting rid of such conflicts are in some cases already well advanced in age. Thus our Commercial Code contains a number of rules taking away the voting rights of a member or director where there is a conflict of interest: an in-kind contributor, a beneficiary of waiver of preferential subscription rights, or a director entering into an agreement with the company. Our law, like that of most of our neighbours, has no general rule prohibiting voting in a conflict of interest situation: the case-by-case method continues to be applied on the principle that each such case is interpreted restrictively.

Of course, the major example is that of regulated agreements. The procedure is well known to all practitioners but the issue has always raised the same questions, which even specialists are doubtful about answering: the procedure does not catch ordinary agreements entered into in normal circumstances. In fact, it could be thought that there is no conflict of interest in that case. But what is an ordinary agreement? It may well fall within the company objects. But those objects are often so broad that few transactions fall quite without their ambit. Accordingly, prior practice is evoked, harking back to the customary nature of the agreement in the company's usual activities. Yet surely the magnitude of the operation makes the procedure essential even in this context.

Even more open to debate is the notion of an agreement's normality. What is normal at group level? There are few decided cases and the majority of them turn on pathological situations where the need for the procedure is beyond dispute. Legal department managers daily debate risk assessment with their lawyers, for want of evidence conclusive enough to obviate dispute.

Moreover, the precise area of application of regulated agreements is very uncertain, particularly in the light of paragraph 2 of article L. 225-38 of the Commercial Code. "The position is similar for agreements in which one of the persons referred to in the preceding paragraph has an indirect interest". Indirect interest opens vistas which are hard to place a limit on. If it be used systematically the procedure nonetheless loses its significance and we cannot allow it to be employed solely as a precaution. On each occasion a real or potential conflict of interest must be analysed before deciding upon its application.

## II – Specific *"corporate governance"* standards

Corporate governance rules initially spread into financial circles by a process of imitation. Listed companies whose shareholders were largely American or English, made it their business to establish working rules corresponding to the expectations of those investors. In France genuine standards appeared a little later.

Viewed through the prevailing company law philosophy a paradigm shift occurred. Legal doctrine and the profession had more or less perfected their theory involving the interest of the business seeking to satisfy a corporate interest combining the interests of all participating parties. The first foundation of corporate governance was obviating conflict of interest as between shareholders and managers and the quest for appropriate methods for resolving conflicts. But there is a smaller gulf than might appear between these two logical approaches striving for a better rationalisation of power protected against the pressure of categorical interests. Even if the initial aim of corporate governance to satisfy the interests of shareholders alone tended to place the two logical approaches in opposition, the weakening of that objective, particularly under the pressure of the crisis, meant that business governance standards nowadays work as tools for the satisfaction of the interests of the business. These standards are found in statutes and private codes.

The corporate governance phenomenon has barely touched the law. As a matter of fact, that is fairly logical inasmuch as self-regulation seems better adapted to business governance than do mandatory statutory rules. Nevertheless, the provisions of the Commercial Code attest to some desire on the part of public authorities to lay down rules in this area. Hence the NRE [*Nouvelles Régulations Economiques* = New Economic Regulations] Act of 15 May 2001 introduced the separation of the position of chairman from that of general manager.

In fact, that separation, which at the time was represented as being very normal in Anglo-American circles, has not been enforced. However, companies' articles and memoranda of association have had to be amended to empower boards of directors to choose between the traditional position (Chairman and Managing Director) and the new one (separate chairmanship).

The 2003 Financial Security Act has served to introduce the Chairman's Report, the purpose of which is to provide information about the manner in which accounts have been prepared. The report essentially focuses on internal auditing and falls within a business governance perspective.

More recently, audit committees have been brought into our Commercial Code .That was done less for reasons of policy than for the need to adopt a European directive. The adoption was effected via an order dated 8 December 2008. Audit committees act exclusively under the authority of the members of the board of directors. They remain amorphous in form and the law relates solely to companies whose shares are listed in a regulated market.

These rules and in particular those contributed by the TEPA [*Travail, Emploi, Pouvoir d'Achat* = work and purchasing power] Act regarding deferred compensation (golden parachutes, top-up retirement plans, etc.) answer a desire for better governance with respect to compensation and remuneration and raise innumerable questions for practitioners, to which lawyers are applying their best know-how.

Besides statutes, governance rules principally figure in private codes. Business governance philosophy seeks rather to solicit players' acceptance than to impose very strict standards on them. The core provisions appear in business governance Codes throughout Europe. The European Union did not wish to add a new Code, observing that most of the codifications already in existence contained more or less the same rules.

In France, the AFEP-MEDEF Code is the most highly visible business governance Code for companies whose shares are listed in a regulated market, but is in reality more widely applicable. The Code states that *"It is also desirable and recommended that other companies partly or wholly apply these recommendations by adapting them to their specific circumstances"*, and in fact a number of unlisted companies have spontaneously elected to comply with this Code.

Likewise, the IFA (*Institut Français des Administrateurs* = association of French directors) Director's Charter is a significant document from the business governance viewpoint, but its status seems to be somewhat different. For the IFA, the same comment applies with respect to synthesis of recommendations as to boards' role and type of action.

On the other hand, in my view there is another genuine Code, namely the *Code de gouvernement d'entreprise de l'Association française de la gestion financière* [the French financial management association business governance Code]. Finally, it should be possible to refer to a European Code, such as the Belgian business governance Code.

## III – The complex interplay of business governance standards

The co-existence of legally imposed standards and those arising from self-regulation in the field of business governance is increasingly observed. These standards complement each other at times and contribute to a degree of consistency in legal rules. Those standards also contradict each other at times, which can cause tricky situations in practice.

• To begin with in some cases standards are calculated to complement each other, which is exactly what the Act of 3 July 2008 requires. Article 26 of that act (article L. 225-37 of the Commercial Code) provides that: *"for companies whose financial securities are tradeable on a regulated market, the chairman of the board of directors shall give an account in a report annexed to the report referred to in articles L. 225-100, L 225-102, L. 225-102-1 and L. 233-26 concerning the content, preparation terms and organisation of the board's work, as well as the internal monitoring and risk management processes established by the company, giving details in particular of those processes which relate to preparation and processing of accounting and financial information for the company accounts and where relevant the consolidated accounts. Without prejudice to the provisions of article L. 225-56, the said report furthermore stating any restrictions that the board of directors may place on the managing director's powers."*

Where a company voluntarily refers to a business governance code developed by organisations representing businesses, the report provided for herein shall likewise specify the provisions which have not been adopted and the reasons for which they have not been followed. Further, the place at which the code may be viewed shall be specified.

Should a company not advert to such a business governance code, the said report shall set out the rules adopted to supplement the requirements of the Act and explain the reasons for which the company has decided not to apply any of the provisions of the said business governance code. *"The report provided for in this article shall likewise specify the particular procedures for participation of shareholders in a General Meeting or shall refer to the provisions of the articles and memorandum of association which provide for the said procedures".*

It would appear that this statute gives considerable strength to business governance codes, since the rules embodied in theses codes become mandatory by force of law. But this is only true in reality if the company adopts the Code in its entirety. In the contrary event one rule or another will not be applicable.

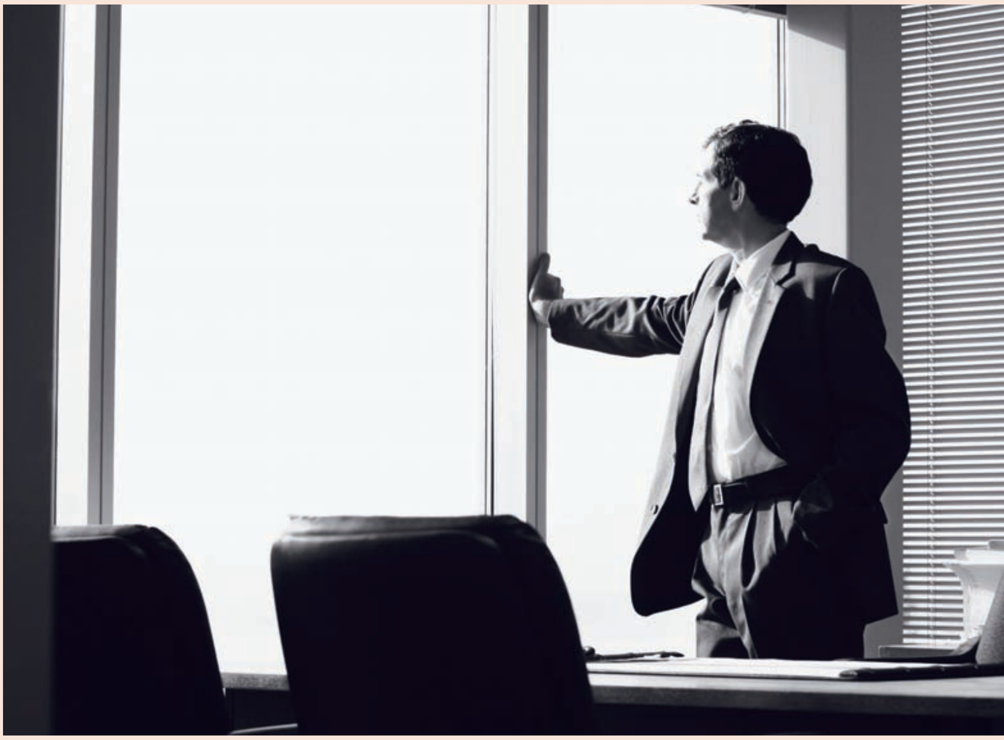
Either the rule has expressly not been adopted so that an explanation must be forthcoming ("comply or explain") and the reason will be more or less hard to supply or else the company does not accept any Code and rules must be adopted to supplement statutorily imposed rules which can be less restrictive than rules in the Code.

It is beyond all doubt that the interplay between the AFEP-MEDEF Code and the law can be effective with respect to managers' remuneration. Here there is no conflict between standards: the Commercial Code does mandate compliance with particular procedures but does not impose restrictive standards with respect to the amount of various remuneration packages.

• However, in many cases the interplay between law and Private Code results in rules contradicting each other more often than complementing one another. Thus the law may be deemed to be prima facie inadequate inasmuch as it may appropriately be made complete using provisions from Private Codes, the supplementation invalidating the statutory rule. A very good example comes from audit committees, made mandatory in some companies by the Order of 8 December 2008.

For example, as far as membership is concerned, consider article L. 823-19 of the Commercial Code, second paragraph, arising from the Order of December 2008:

*"The composition of the said committee shall be established where appropriate by the body responsible for administration or monitoring. The committee may only comprise members of the body responsible for administration or monitoring for the company, to the exclusion of those performing management duties. At least one member of the Committee must have special financial or accounting skills and be independent in accordance with criteria specified and made public by the body responsible for administration or monitoring".*



Now let us turn to the AFEP-MEDEF Code

*"14.1. Composition*
*The proportion of independent directors in the accounts committee must be at least two thirds and the committee cannot include any company management officer".*

The statutory requirements are much more modest than those in the AFEP-MEDEF Code. The statute pre-dates the standard in the Code and seems less rigorous. Hence once a company bases itself on the AFEP-MEDEF Code, should it merely apply statutory requirements it will have to explain why it has fewer independent directors in the audit committee than the number required by the Code.

But another source of conflict appears in the position of audit committees. The audit committee as prescribed in the Commercial Code is merely a product of the board of directors without independence with respect to it. Now, the codes' philosophy is rather to contemplate a source of authority independent of the power hierarchy. The board of directors is indeed a supervisory body but is also a player in the power process. One business or another may be tempted to envisage an organisational flowchart in which the audit committee will better mark out its independence. In this instance it is not necessarily the case that the law will prevail over business governance philosophy.

A further conflict lies in the issue of combining an employment agreement with appointment as a director, which is regulated in the Commercial Code and subject to precise rules. For its part, the AFEP-MEDEF Code has condemned the practice. The application of the Commercial Code leads to failure to recognise the private Code standard. Once again, in the event of failure to observe the AFEP-MEDEF Code, it will be appropriate to offer an explanation of the reasons for that non-recognition. Such an explication is quite possible, as reasons linked to organization of the company or the group may justify such a combination.

• Naturally, the foregoing leads to consideration of possible sanctions for such non-observance. It would seem that at this point things are fairly vague. Several hypotheses are open to us.

In one scenario the company has made a commitment to adhere to a Code while in reality that is revealed not to be the case. Is it open to us to form a view that the market has been given misleading information, and to draw conclusions therefrom?

Or perhaps the company may decide not to base itself on any Code at all but then explains why it has decided not to apply any provisions and sets out the rules adopted to supplement legal requirements. That last expression is vague: *"rules adopted to supplement legal requirements…"*. Must each legal provision be supplemented? The answer is undoubtedly in the negative.

Who will judge the quality and appositeness of the explanations put forward? The shareholders no doubt will be able to ask questions on that score. But is it conceivable that responses will go further and that actual penalties can be ordered?

It seems that the only relevant standpoint could be to raise the question of management's liability. They may be liable for breach of the law or the articles of association, or for management failure. Will the possibility of infringement against the law be open in some cases? And if there be an infringement what loss or damage can be proven by the claimant?

In the end, much sound and fury signifying nothing?

Probably not. For many businesses nowadays, life is not like that. There is a culture of voluntary commitment to standards outside of any real punishment mechanism. Bodies representing businesses have called on the necessary collective discipline to avoid the threat of legal intervention.

AMF has published reports on attested practices that emphasize shortcomings; such reports are calculated to revive the law-making itch which is still active: recently a bill to improve business governance was presented, showing that the risk of legislators taking up the cudgels again has not gone away.

# New Developments

## Shareholders' agreements

A *Cour de cassation* commercial division judgment dated 5 May 2009 has worried many lawyers and distribution network managers among others. The judgment held that although the expert appointed under article 1843-4[4] may well take a lead from methods of calculating the value of shares which have been agreed in the articles and memorandum of association. but is never bound by those calculation methods. This issue would have caused little concern if reliance on this article of the Act did not appear to be customary in many shareholders' agreements or contracts. The parties have agreed to have the share value struck by an expert appointed under article 1843-4 in the event of a party seeking a share transfer. Why rely on an article which clearly only relates to legal issues ? The reason is that the expert appointed under the said article is obliged to thoroughly pursue his reference and cannot stop short, unlike an expert appointed under article 1592[5] of the Civil Code.

Now the burning question relates to the ambit of the judgment: the matter was brought to the Court with regard to performance of an articles of association provision. Would the same finding apply to an expert appointed in an agreement outside the articles of association ? We could consider the answer to be *"no"*, and a Versailles Court of Appeal judgment dated 10 September 2009 seems to follow that line. But the question remains up in the air and continuing to use article 1843-4 in shareholder agreements involves an obvious risk.

Appointment of a third party valuer must be done under article 1592 of the Civil Code. In that context there is little doubt that instructions as to price calculation given to the expert can apply.

4 Article 1843-4: *"in all cases in which there is contemplated a transfer of a member's company ownership rights, or a buyback of the same by the company, in the event of dispute the value of the rights shall be determined by an expert appointed by the parties or where the same cannot agree by summary order of the presiding judge without appeal"*.

5 Article 1592: *"However, it (the consideration) may be submitted to a third party for arbitration; if the third party cannot or does not wish to perform the valuation there shall be no sale"*.


## Simplification of Merger and Demerger Rules

The rules governing mergers or demergers have been simplified by Directive No. n° 2009/109 dated 16 September 2009. Member States can be freed from some obligations where a new company is formed via merger or demerger: exemption from prior reports and some advertising requirements. The European authorities are aiming at progressive elimination of information requirements which can be seen as obsolete or excessive. These simplifications are part of a wider plan seeking to reduce administrative burdens on companies by 25% between now and 2012. The directive will be incorporated into French law by 30 June at the latest.

# In Brief

## SASAC Reception

Recently the firm hosted a Chinese delegation from SASAC (State-owned Assets Supervision and Administration Commission of the State Council), which was keen to obtain information about Private Equity practice in France. SASAC is an extremely high-level body which reports directly to the central power in China, whose role it is to supervise and manage State businesses.

Over several training sessions our firm's lawyers were able to describe the state of play for Private Equity in France in 2009, present assessment techniques and demonstrate the legal techniques generally used for capital investments.

# CMS Bureau Francis Lefebvre's corporate activity

**CMS Bureau Francis Lefebvre's corporate team handles all questions regarding transactional and restructuring operations for both listed and unlisted companies, whether French or international, backed by colleagues from various disciplines within the firm (taxation, corporate, competition, etc.) and in firms that are members of the CMS network (2400 lawyers acting in 28 countries).**

**Our Practice Areas:**

- Drafting of contractual and other documents
- Negotiation Support
- Acquisitions, divestments, joint ventures
- Shareholders' agreements
- Restructurings (mergers, asset transfers, etc.)
- Arranging and structuring finance (equity, MBOs, MBIs)
- Investment Capital
- Legal audits
- Data room
- IPOs
- Stock exchange law

**Contacts:**

**Philippe Rosenpick: T: + 33 1 47 38 41 98 – philippe.rosenpick@cms-bfl.com**
Christophe Blondeau: T: + 33 1 47 38 41 98 – christophe.blondeau@cms-bfl.com
Isabelle Buffard-Bastide: T: + 33 1 47 38 40 20 – isabelle.buffard-bastide@cms-bfl.com
Jean-Eric Cros: T: +33 1 47 38 40 41 – jean-eric.cros@cms-bfl.com
Jacques Isnard: T: + 33 1 47 38 41 16 – jacques.isnard@cms-bfl.com
Christophe Lefaillet: T: + 33 1 47 38 40 20 – christophe.lefaillet@cms-bfl.com
Bruno Peillon: T: + 33 1 47 38 40 82 – bruno.peillon@cms-bfl.com

**CMS Bureau Francis Lefebvre, 1-3 villa Emile Bergerat, 92522 Neuilly-sur-Seine Cedex, France**
**T +33 1 47 38 55 00 - F +33 1 47 38 55 55 - info@cms-bfl.com - www.cms-bfl.com**

**CMS Bureau Francis Lefebvre** is a member of CMS, the organisation of 9 major independent European law firms providing businesses with legal and tax services across Europe and beyond. Operating in 47 business centres around the world, CMS has over 600 partners, more than 2,400 legal and tax advisers and a total complement of over 4,600 staff.

**CMS member firms:** CMS Adonnino Ascoli & Cavasola Scamoni (Italy); CMS Albiñana & Suárez de Lezo S.L.P. (Spain); CMS Bureau Francis Lefebvre (France); CMS Cameron McKenna LLP (UK); CMS DeBacker (Belgium); CMS Derks Star Busmann (Netherlands); CMS von Erlach Henrici Ltd. (Switzerland); CMS Hasche Sigle (Germany) and CMS Reich-Rohrwig Hainz Rechtsanwälte GmbH (Austria).

**CMS member firms' offices and associated offices worldwide: Amsterdam, Berlin, Brussels, London, Madrid, Paris, Rome, Vienna, Zurich,** Aberdeen, Algiers, Antwerp, Arnhem, Beijing, Belgrade, Bratislava, Bristol, Bucharest, Budapest, Buenos Aires, Casablanca, Cologne, Dresden, Dusseldorf, Edinburgh, Frankfurt, Hamburg, Kyiv, Leipzig, Ljubljana, Lyon, Marbella, Milan, Montevideo, Moscow, Munich, Prague, São Paulo, Sarajevo, Seville, Shanghai, Sofia, Strasbourg, Stuttgart, Utrecht, Warsaw and Zagreb.

The members of CMS are in association with The Levant Lawyers with offices in Beirut, Abu Dhabi, Dubai and Kuwait City.


Mandatory deposit on publication. ISSN: pending