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February 19, 2002

Legal issues arising from recent celebrated shareholders rights battles in France

by

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Historically, minority shareholders in French companies have had difficulty asserting rights against a hostile majority or board of directors. This situation has changed significantly in recent years, as a result of both jurisprudence and new legislation.

The rights of shareholders in French companies are now generally considered to be as strong in France as in any other Continental European country. Nevertheless, there remain many unsettled questions, and advocates of increased shareholders' rights argue that protections of minority rights need to be strengthened.

1. Basic rights of shareholders in France relating to corporate governance

The basic rights of shareholders in a French *société anonyme* (the form of company used most widely by large- and medium-size companies in France<sup>2</sup>) relating to

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<sup>2</sup> French companies whose shares are publicly traded must take the form of either a *société anonyme* or a *société à commandite par actions* (which is similar to a limited partnership, having one or more members

corporate governance include the right to vote at shareholders meetings, including the annual shareholders meeting (where annual accounts are approved and directors are elected); the right to receive information in connection with any proposal to be voted on at a shareholders meeting; and the right to receive answers at a shareholders meeting to questions submitted in writing in advance to the board of directors.<sup>3</sup>

Minority shareholders are protected to a limited extent by the requirement of a two-thirds majority for any change in the company's by-laws<sup>4</sup> and unanimity for certain changes (change in nationality, subject to treaty; adoption of certain company forms and increase of par value of shares). In addition, an individual shareholder can file a legal action based on improper actions taken by management, either for damages suffered personally by the shareholder as well as a derivative action (*action sociale*) on behalf of the company.<sup>5</sup>

In addition, although generally only the board can convene a shareholders meeting, in case of "urgency" (and upon a showing of good cause) any shareholder (or other interested party) can request a court to name an individual empowered to convene a shareholders meeting, and in case of change of control (via tender offer or sale of a control block of shares) a majority of shareholders can convene a meeting without court action.<sup>6</sup>

Further rights are provided under French law to shareholders whose holdings reach a minimum threshold, expressed as a percentage of the company's capital. These rights can be exercised by one or more shareholders representing at least 5% of capital. In addition, in the case of listed companies, rights can be exercised by formal associations of minority shareholders (*associations de défense des actionnaires*), representing shareholders who have held their shares in their own name for at least two years and who register with the company and the French securities regulatory body (the *Commission des opérations de bourse* or "COB") and meet the following thresholds of minimum holdings in the company (the "Association Threshold"): 1% if capital exceeds 15,244,902 euros, 2% if capital exceeds 7,622,451 euros, 3% if capital exceeds

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known as *commandités* with unlimited liability and shareholders with limited liability). This paper discusses rights of shareholders in a French *société anonyme*. Other forms of business organizations in France sometimes used for medium- or large-sized commercial enterprises are the following: *société par actions simplifiée* (SAS), *société à responsabilité limitée* (SARL), *société en nom commercial* (SNC) and *société à commandite simple* (SCS).

3 There are three possible systems of management of a French *société anonyme*. In the traditional form, the company is managed by a chief executive, the President-Director General, who cumulates the functions of chairman of the board of directors and chief operating officer. In an alternative form, permitted by recent legislation, the functions of President (chairman of the board) and Director General (chief operating officer) are held by different individuals. In a third form of management, the *société anonyme* is managed by a directorate of directors general, headed by a president, and supervised by a supervisory board (*conseil de surveillance*).

4 See Commercial Code ("C. Com.") art. L.225-96. The minimum quorum for an extraordinary shareholders meeting is one-third of voting shares on the first convocation and one-fourth if the meeting is reconvened after failure to reach a quorum at the first convocation.

5 C. Com. arts. 225-251 and 225-252 and Decree no. 67-236 of March 23, 1967, art. 199.

6 C. Com. L.225-103 II.

4,573,345 euros, 4% if capital exceeds 762,245 euros and 5% if capital does not exceed 762,245 euros.<sup>7</sup>

Shareholders and associations with these minimum holdings have the right to do the following:

- file a court action to designate a person authorized to convene a shareholders meeting (C. Com. L.225-103 II);
- present resolutions to shareholders meeting (C. Com. L.225-105);
- file a court action to replace statutory auditors in case of error, incapacity or other “good reason” such as lack of impartiality or independence (C. Com. L.225-230 and L.225-233);
- require a written response to questions about specific aspects of the management of the company and, in the absence of a “satisfactory” response within a month, request court appointment of an expert (who may be paid by the company) to prepare a report answering the questions posed (C. Com. L.225-231);
- ask questions of the board of directors up to twice each year on “any fact of a sort which may compromise the continuity of the business” (C. Com. L.225-232);
- file, as a group, a derivative action (*action sociale*) against directors and managers for breach of fiduciary duties (C. Com. L.225-252).<sup>8</sup>

Additional rights granted to minorities include the right of shareholders with at least 5% of shares to request liquidation of the company after dissolution (C. Com. L.237-14 II) and for shareholders with at least 10% of shares, to require consolidated accounts to be prepared even if the company is part of a larger group preparing consolidated accounts (C. Com. L.233-17).

One measure used to discourage change of control is double voting rights. French law permits a company’s by-laws to provide for double voting rights for shareholders who have held shares in their own name for at least two years (this minimum period can be longer in some cases).<sup>9</sup> The double voting rights can be restricted to shareholders from the European Economic Area (the European Union plus

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<sup>7</sup> C. Com. L.225-120.

<sup>8</sup> The thresholds for collective action not brought by a shareholders association are defined by a sliding scale set out in Decree no. 67-236 of March 23, 1967, art. 200. Note that a similar type of collective action can be filed by associations representing investors in securities or financial products issued by a French entity. See Code monétaire et financier, articles L.452-1 et seq.

<sup>9</sup> C. Com. L.225-123.

Norway, Liechtenstein and Iceland). A further measure used to discourage change of control is to limit the maximum number of votes which any shareholder can exercise.<sup>10</sup>

Legislation adopted in 2001<sup>11</sup> made a number of changes designed to increase accountability of management, including modification of some of the rules described above and addition of a requirement that the annual report of the board of directors state the remuneration and benefits of top management received from the company and entities it controls (C. Com. L.225-102-1).

There has been little jurisprudence in past years regarding contested fights for control of publicly listed companies. However, use of the courts in contested fights is expected to increase, because of the expansion of shareholder rights and the new opportunities for shareholder associations to assert such rights. Two recent cases illustrate this trend.

## 2. Groupe André

This takeover battle raised two important issues: what criteria are to be used to determine when shareholders are acting “in concert” for purposes of application of rules relating to mandatory tender offers and what actions management may take to combat a takeover attempt.

Groupe André is a manufacturer and retailer of shoes and clothing, with a number of well known trademarks, including André (low-priced shoes), Halle aux Chaussures, Marina, Orcade, Kookai and Creeks, and with large real-estate holdings occupied by its retail outlets.

Significant shareholdings in Groupe André were acquired by two investment groups: NR Atticus, an investment fund managed by Nathaniel Rothschild and others (“Atticus”); and Guy Wyser Pratte (“GWP”). Management faced the prospect of a battle for control of the company at the annual shareholders meeting, which by law was to have been held at the latest on February 29, 2000 (six months after closing of the company’s fiscal year).

Management of Groupe André took two steps in the face of this threat. First, it applied to the court for permission to delay the shareholders meeting until April. Second, it sought to sell the block of 7.88% of the company’s shares owned by the company itself (the “Treasury Shares”); sale to a friendly purchaser would allow those shares to be voted in favor of management, whereas the shares could not be voted as long as they were owned or controlled by Groupe André.

Although Atticus apparently had been given the opportunity to acquire this block of shares, it declined to do so, since that would have put its shareholdings over the

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10 C. Com. L.225-125.

11 Law no. 2001-420 of May 15, 2001, entitled “Loi sur la nouvelle réglementation économique”.

threshold of 33<sup>1/3</sup>% of capital which would trigger an obligation to make a tender offer. Instead, Atticus sought to prevent the sale of the Treasury Shares.

On February 22, 2000, Atticus filed summary proceedings (*action en référé*) with the Commercial Court to block the sale of the Treasury Shares. The next day, the Court authorized management to delay the shareholders meeting. On March 1, 2000, the Commercial Court rejected Atticus' request and authorized sale of the Treasury Shares.

The Paris Court of Appeal on March 15, 2000 affirmed the lower-court decision allowing sale of the Treasury Shares. The court held that the mere existence of a dispute between the parties did not justify the escrow of the shares, and that there was no showing that management would use the sale to advance their personal goals or favor one shareholder over another, rather than acting in the best interests of the company. The court mentioned that damages would be available to sanction any improper action by management.

In the end, management did not find a buyer for the Treasury Shares, and Atticus with support from GWP prevailed at the shareholders meeting held in April 2000, winning a majority of seats on the supervisory board and replaced the Director General of the company.<sup>12</sup> Since then, the company has adopted a new name, "Vivarte".

With respect to the issue of when parties are deemed to be acting in concert, the standard now set out in French law refers to persons having "concluded an agreement with a view to acquire or sell voting rights or to use voting rights to implement a common policy regarding the company".<sup>13</sup> In the Groupe André case, Atticus and GWP did not have such an agreement and took differing positions on some points, and for this reason were not considered to be acting in concert. Suggestions have been made that the definition of "acting in concert" be expanded, although there does not seem to be widespread support for such a legislative change.

With respect to the issue of what action management can take to combat a takeover attempt, past jurisprudence indicated that management could contest takeover attempts if they had a basis for claiming that their actions were in the best interests of the company.<sup>14</sup> In the Groupe André decision, the Court of Appeal reiterated that basic standard, but did not add any detail. The Court's opinion did include a statement, with a nice "free-market" ring, that in the context of disputes between management and minority shareholders the evaluation of the legitimacy and the sincerity of the objectives of management's position is to be made by "the shareholders as a whole and participants in the securities market" under the supervision of competent authorities and courts.

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12 At the time of the meeting, shareholdings (excluding Treasury Shares) were 32.99% for Atticus, 9.07% for GWP, 25.47% for the Groupe André management, 5.46% for Unijet, a company allied with Groupe André management, 1.5% for employees and 25.51% for the public.

13 C. Com L. 233-10.

14 See the decision of the Paris Court of Appeal of June 17, 1999 upholding the standing of Paribas to contest the decision of the Conseil des Marchés Financiers allowing a tender offer in the Société Générale/BNP takeover fight.

This describes the backdrop, but does not provide much of a clue as to how future battles will be resolved.

### 3. Legrand

The specific shareholders-rights issue involved in this battle related to valuation of minority shareholding. More generally, however, this case raised the question of court review of decisions of securities regulators.

The stage was set when in early 2001 Schneider, a large French multinational in the electrical industry, announced a friendly tender offer for Legrand, another large French multinational with a similar business. The Schneider bid was approved by the *Conseil des Marchés Financiers* (“CMF”) on January 24, 2001.

However, an association of minority shareholders, the *Association de Défense des Actionnaires Minoritaires* (ADAM), challenged the amount offered for non-voting preferred shares. On May 3, 2001, the Paris Court of Appeal ruled that the price should be revised, because the documents presented to the CMF for the purposes of its decision were incomplete and because the reasoning stated by the CMF to support its decision was insufficiently articulated. A modified tender offer was quickly proposed and approved, and over 98% of shares were tendered.

However, the transaction took a turn unexpected by management when, in October 2001 it was rejected by European competition authorities, notwithstanding measures proposed by the parties to lessen its anti-competitive effects.

With respect to shareholders-rights issues, the Paris Court of Appeal decision of May 3, 2001, is considered very significant because of the willingness displayed by the court to hold up the decision of securities regulators to scrutiny, which has rarely occurred in the past. How this scrutiny will be exercised in future cases remains to be seen.

### 4. Key unsettled questions

The cases described above show that shareholders seeking to assert rights against majority shareholders or entrenched management have a number of tools they can use. The detailed rules for use of those tools remain to be defined.

Among the questions to be resolved are the following:

- What will be the standard for responses to be given by management to questions posed by minority shareholders about specific aspects of the management of the company?
- How receptive will the courts be to appointing an expert to prepare a report answering such questions, in the absence of a “satisfactory” response by management?

- How receptive will the courts be to derivative actions against directors and managers for breach of fiduciary duties?
- What sanctions will be imposed for breaches of the standards governing management or majority-shareholder behavior?

There will probably be a fair amount of jurisprudence on these issues in the coming years, which will help define the context for management behavior and the general atmosphere for corporate governance in France.

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