FRENCH PERSPECTIVES

Pierre BÉZARD
Président honoraire de la Chambre commerciale de la Cour de cassation

et Jean-Jacques CAUSSAIN
Avocat au Barreau de Paris, membre du Conseil de l'Ordre,
Associé de Clifford Chance

Pierre Bézard.– French company law has considerably developed over the last few years, and this development is in fact accelerating. The Law of 24 July 1966, applicable to the formation and running of commercial companies, aims to ensure a fair balance between the protection of the company's shareholders and creditors, as well as the dynamism of these companies. In reality, this text establishes a very voluminous, detailed and rigorous regulatory framework, breaches of which are often sanctioned by criminal provisions. Drafted mainly by lawyers, it only places limited confidence in entrepreneurs and, through the number of precautions established, is the echo of past difficulties and scandals.

This text has been strengthened by ensuring the protection of the interests of shareholders and third parties as a result of the transposition of European Directives taken in application of Article 54-(3)-(*g*) of the Treaty of Rome.

These regulations are applicable to all commercial companies regardless of their importance and whether they are closed or make public offerings by listing their securities.

Stock market regulations also apply to these listed companies, but at present, they have limited scope.

Although most French directors were cautious about regulations which appeared to them to be strict, formalistic and expensive, it did not seem to them that the question was a priority, at a time when the country was benefiting from great economic development and full employment. Their attitude changed profoundly when the recession appeared, hitting hard the economies of different countries, in particular France, and when international competition became very strong. Once litigation started, the criminal aspect of the regulations came to the fore, and appeared threatening.The public authorities took at least partial consideration of these wishes, and a series of limited reforms followed with the aim of relaxing certain rules relating to the formation and running of companies, as well as forestalling their difficulties.

Likewise, two new types of companies were created : a *société à responsabilité limitée unipersonnelle* (EURL) in order to take into account the fact that numerous small companies are directed only by a single person, as well as a *société par actions simplifiée* with a relaxed legal status, reserved solely for important companies.

However, above all, the public authorities tried to develop the stock market. It appeared to them that thanks to the stock market, companies would be able to find funds by placing their securities in order to face their difficulties and to develop. To this end, fundamental structural and operational amendments were made to the stock market.

The public authorities also undertook very strong action to lead individual investors to invest their savings in the financial markets. To encourage them, they granted them – at least in the beginning – significant tax incentives. This action was crowned with success. Millions of investors made their way to the stock market, either directly or through the intermediary of collective investment undertakings.

However, it appeared necessary to ensure the protection of these investors. Regulations with an ever greater scope were therefore drawn up by the Ministry of Finance in conjunction with the stock market authorities and the *Commission des Opérations de Bourse* (COB), the latter being in charge of protecting savings investments.

The protection of holders of listed securities is henceforth essentially ensured by stock market regulations. Company law only presents a subsidiary interest for them. Moreover, they behave like investors who are liable to withdraw very quickly. Their status as shareholders, able to express themselves in General Meetings, barely motivates them, if at all.

Hence, the distinction between closed companies and open companies, *i.e.* those whose shares are traded on a regulated market, appears very clear in practice and more and more so in the regulatory framework. It is on the basis of this distinction that the following comments will be presented.

Closed companies : towards the « contractualisation » of the applicable law

Closed companies are usually small or medium sized companies, but they may also be important companies whose capital is held by a few shareholders. All these companies have one thing in common : they do not have shares listed on the stock market and they do not make public offerings.

These companies are subject to the Law of 24 July 1966 whose restrictive nature has already been highlighted, but which has been reformed on numerous occasions, as we have pointed out. Although these reforms moved towards a relaxation of the regulations, they were occasional and had a limited scope.

The great company law reform awaited by all the economic actors remains to be established, in order to ensure the « contractualisation » of law, its modernity and its decriminalisation. The public authorities committed themselves in this direction. To this effect, the Ministry of Justice set up a commission a few years ago composed of lawyers and practitioners which drew up a reform project after a broad consultation within the economic and financial sectors. This text has subsequently been improved. But it has still not been submitted to Parliament, since the Government considered that other projects should be given priority. At present, there is question of it being submitted at the beginning of the year 2000.

It should be pointed out that, at the same time, an important study on company law reform was carried out by Senator Marini.

Having waited for this reform for many years and disappointed at not seeing it take place, practitioners were all the more deeply, but pleasantly surprised – even if the method used did not seem to them to be the best – to see a text with revolutionary effect discretely adopted in July 1999.

Jean-Jacques Caussain.– Up until the law of 12 July 1999 which Mr. Bézard has just referred to, the only forms of private limited companies available to a private business were :

- the *société anonyme* (SA) which is subject to very cumbersome regulations leaving very little room for contractual provisions and

- the *société à responsabilité limitée* (SARL) which is subject to various statutory provisions most of them being similar to those applicable to the SA.

- The *société par actions simplifiée* (SAS) which has only existed since the Law of 3 January 1994, but was not widely available because it was restricted to corporate entities, having a minimum share capital of 1,500,000 F, or to state-owned institutions.

The Law of 12 July 1999 has lifted this restriction. As a result anyone, whether an individual or a legal entity, can now be a shareholder of an SAS whose main characteristics are the following:

- The SAS is a company limited by shares (*société par actions*) ; it can be set up by one or more shareholders, each being liable only to the extent of the contribution made. Its share capital is at least 250,000FRF (half of which must be paid upon formation of the company). It must also have a statutory auditor (*commissaire aux comptes*).

- The SAS is a private company. Thus, it may not issue securities to the public, and its shares must be registered under the name of their owner.

- The SAS is formed by « contract ». Thus its articles of association enjoy great freedom in the organisation of powers within the company and the conditions under which shares are transferred.

As regards the organisation of the SAS, the law contains several provisions regarding the shareholders' decisions and the management. Fundamental decisions must be taken collectively by the shareholders, namely operations relating to: share capital (increase or decrease), merger, hive-off, liquidation, appointment of auditors, approval of annual accounts, allocation of dividends, and change to the corporate form and any amendment to clauses relating to transfer of shares.

Apart from these statutory provisions, parties enjoy almost total freedom in setting out the rules applicable to collective decisions. The articles of association of an SAS may provide, for instance, that:

- a meeting may be called by notice at any time by one or more shareholders or even by a third party (a banker, or a lawyer...);

- the meeting may be held by telephone conference call, video conference or written consultation;

- any shareholder may place a draft resolution on the agenda;

- the quorum may be reduced or removed and that the majority may vary depending on the type of decision;

- the voting rights may be reduced or increased (by introducing classes of shares with multiple voting rights or a right of veto in favour of a particular shareholder).

The above examples may seem obvious to a UK audience, but this degree of flexibility does not exist in the SA or SARL.

As regards to the management of the company, the articles are equally flexible. The only statutory office under law is that of the President (*Président*) who is vested with the widest powers to act in all circumstances on behalf of the company (within the ambit of the objects clause of the company) and any limitation on such authority is not binding against a third party. In addition, the shareholders have the possibility, if they wish, of appointing managers (*dirigeants*). Together, the President and the managers may constitute a single decision making body acting collectively (supervisory board, management board, committee, etc.) or else be organised differently. As with the collective decisions of shareholders, the decision-making process of such boards or committees may be freely determined under the articles of association, in particular with respect to the quorum, representation, majority and the procedural validity of meetings.

The final feature of the SAS relates to the clauses pertaining to the transfer of shares. The legal provisions governing the SAS favours the insertion of any shareholders' agreement into the articles of association and strengthens the legal effect of such agreement. The articles of association may in particular contain the following clauses:

- standstill clause prohibiting the transfer of shares by the shareholders for a fixed period with a maximum of 10 years;

- that transfers to third parties or between shareholders must have prior approval by the President, a board or a shareholder.

Any sale of shares completed in breach of such clauses will be null and void.

The articles may also provide for the exclusion of a shareholder under certain conditions.

Since it is now accessible to anyone, the SAS, because of its flexibility, should become very popular in the near future and should be the ideal vehicle for the setting up of closed companies. One can assume that it will replace progressively the SA and the SARL and become the French equivalent of a UK private limited company.

Pierre Bézard.– The SAS has led French law to take a decisive step towards « contractualisation ». Nevertheless the reform of the law of commercial companies has not lost its importance and its urgency. This development towards « contractualisation » should be permitted for all types of companies.

Closed companies should be subject to more relaxed and flexible regulations enabling their founding members and shareholders to determine for themselves the solutions applicable to their running in the Articles of Association.

The criminal framework should be greatly relaxed : only several provisions should be retained, concerning particularly serious offences.

Moreover, one may also consider that the solutions to be established by the Fifth European Directive relating to the structure of public limited companies – the establishment of which is still being awaited – could constitute the only mandatory rules to be retained in domestic regulations. Reflections relating to a European company may also be very useful in the elaboration of domestic law.

The establishment of a contractual company law would make the Courts' role essential. They would be led to construct this company law, on the basis of disputes submitted to them as well as in view of the practice and in light of legal authorities. The Courts would do so by reference to the great principles of contractual compliance, loyalty, transparency and equality of treatment. Moreover, for several years, French case-law has initiated this development by making ever more frequent references to these concepts which are too often hidden by the complexity and volume of the regulations currently applicable. Indeed, simple formal compliance with texts does not necessarily establish that their underlying fundamental principles have been observed.

Companies whose securities are listed : strengthening of the applicable law

The situation of companies whose securities are listed is developing in a fundamentally different manner from that of closed companies. This is because they bring numerous investors together, either directly or through the intermediary of collective investment vehicles and because their protection should be ensured. This is also because they may be the subject of severe stock market battles during public offers and it is a question of ensuring that they take place correctly.

It is true that listed companies are subject to the Law of 24 July 1966 in that they have the status of *sociétés anonymes*, they therefore benefit from the development which will relax this text. But in reality, the regulatory framework applicable to them, whether through stock market regulations or company law, is being strengthened.

As regards issues and transactions concerning them, listed companies fall mainly within stock market regulations. But company law has been the echo of these regulations and this development, and has provided it with a legal basis. This applies to the determination of securities, information on the acquisition of significant shareholdings, the definition of the concept of control etc...

The regulations applicable to listed securities aim to treat them like savings products and to ensure the protection of investors by only allowing them to be offered quality products, *i.e.* those likely to be easily traded and profitable. These regulations also aim to ensure full and rapid information for investors as soon as an important event likely to affect the value of securities occurs. They also lay down a strict penalty for directors and other people referred to in the text in the event of insider trading, price manipulation or misleading information. These regulations also establish provisions, moreover often amended, in the field of public offers, but also enabling or obliging public repurchase offers for minority shareholders in certain specific cases.

These regulations are drawn up by the Minister in charge of the Economy and Finance in close co-operation with the *Conseil des Marchés Financiers* (CMF) and the *Commission des Opérations de Bourse*. These two institutions carefully supervise their application. Furthermore, their role is not only to sanction breaches but also to prevent them.

The very important role played by the Court of Appeal of Paris, the only Court having jurisdiction, and the Commercial Chamber of the *Cour de Cassation* (Supreme Civil Court) upon appeal, should also be emphasized. A number of important proceedings have been submitted to them regarding disputes brought by the stock market authorities. On these occasions, without hindering the essential, beneficial action of these authorities, these jurisdictions have ensured that not only the rules of procedure have been complied with, in particular concerning compliance with the adversarial principle (*contradictoire*) – but also those concerning the legal merits.

It is also very important to stress that over and above the securities and transactions related thereto, the stock market authorities are ever more interested in the issuers themselves, more specifically the status of their directors. This is without doubt a source of development of company law at the initiative of the stock market. The example of corporate governance which we shall deal with shortly is significant.

Therefore, an undeniable reinforcement of the texts and controls may be noted in relation to the regulations applicable to listed companies. This solution is justified by the protection of investors and their equal treatment in stock market battles.

However, these regulations should not develop into an excessive formalism and should not distance French solutions from a European and worldwide movement towards unification. It does not seem that this last concern is justified as we shall now explain.

Jean-Jacques Caussain.– The starting point of corporate governance in the United Kingdom was the report issued in 1992 by the Cadbury committee which recommended that all quoted companies should comply with a Code of Best Practice and publish in their annual report the extent of their compliance with the Code during the year. It was followed, in 1995, by a report of another committee chaired by Sir Richard Greenbury on directors' remuneration. In 1998, the Hampel Committee put together a combined code taking into account these two reports and making its own recommendations. This code has been appended by the Stock Exchange to the Listing Rules. More recently, the Turnbull report on Risk Management has provided directors with guidance on the combined code.

France also has been, and is still, concerned by the issue of Corporate Governance which we call "*le gouvernement d'entreprise*". The privatisation of numerous companies and the globalisation of financial markets has made it necessary for listed companies to adapt to this new environment. Today more than 40% of the capitalisation of the CAC 40 are held by foreign investors who expect the principles of Corporate Governance to be applied in France. This issue has been the subject of two important reports.

VIÉNOT REPORT I

The first report was issued in July 1995 by a committee that was set up by the CNPF (former name of the MEDEF) and the AFEP and which was chaired by Mr. Marc Viénot, chairman of the Société Générale at that time. This report contained various recommendations (which are certainly familiar to you) regarding the board of listed companies and more particularly:

- The setting up of specialised committees:
  - audit committee
  - remuneration committee
  - appointment committee

- The new status of directors providing for:
  - limitation of the number of positions as director held by the same individual
  - restrictions on reciprocal directorships
  - appointment of independent directors
  - limitation of the number of executive directors on the same board

- Directors' charter which contains various requirements

A few years after the delivery of this first report, it appeared that three-fourths of the companies listed of the CAC 40 had put into place an audit committee and a remuneration committee, but according to some observers these committees had not always been sufficiently efficient, and there were not enough independent directors sitting on the boards of French listed companies.

VIÉNOT REPORT II

Taking into account these criticisms, and also being inspired by the propositions set out in the various reports published in the UK, a second Viénot report on *Le gouvernement d'entreprise* was published in July 1999. It is rich in a number of recommendations:

1. Separation of the offices of Chairman and Chief Executive officer

This was one of the main recommendations of the Cadbury Report and is now included in the combined code and is followed by the companies listed in the United Kingdom.

Under French law, the positions of Chairman (*président*) and Chief Executive Officer (*directeur général*) are statutorily linked together and must be exercised by the same person (the "Pdg"). The second Viénot Report is in favour of an amendment to the law on commercial companies which would permit this separation, but the system would remain optional and left to the board's discretion. A draft bill has been prepared by the Ministry of Justice along these lines.

It must also be mentioned that French law already offers an alternative with the dualist system of *directoire* (management committee) and *conseil de surveillance* (supervisory board) which is the French equivalent of the German system of *Vorstand* and *Aufsichstrat*. This structure provides for a clear distinction between executive directors who sit in the *directoire* and non executive directors who sit in the *conseil de surveillance*. Almost 25% of the companies of the CAC 40 have now adopted the two-tier structure.

2. Disclosure of the remuneration granted to corporate officers and directors

In the UK, since the publication of the Greenbury Report, such information must be now contained in the annual report of listed companies. The second Viénot Report also recommends

that the annual reports of listed companies should include a chapter on such remuneration. In contrast with the UK, such disclosure should only relate to the aggregate amount of remuneration of all kinds paid to such corporate officers and should not apply to the individual remuneration of each officer. Actually, the Viénot committee considers individual remuneration to be a private matter, and expressed the view that investors are only interested in the ratio between the management global remuneration and the results of the company.

3. Disclosure of share option schemes

The information on such schemes should be detailed and contained in the annual report, but it should not give details on each beneficiary of such options.

4. Details on directors

The annual report of listed companies should give more details on their directors : biographical notice, number of shares held, directorships in other listed companies, memberships of committees, etc.

5. Operation of the board of directors

At least one-third of the members of the board should be independent directors and identified as such in the annual report. Proper and sufficient information should be given to the members of the board, and directors would be bound to request appropriate information. Moreover, the directors' attendance at board meetings should be mentioned in the annual report.

6. Operation of the committees

- Independent directors should represent:
  - at least one-third of the members of the audit committee and of the appointment committee
  - at least half of the members of the remuneration committee.
- The audit committee should submit a report to the board of directors every year.

7. Financial disclosure

- Listed companies should publish as soon as available annual accounts (ex., one month to publish provisional accounts)

Finally, it should be stressed that the recommendations made in the two Viénot Reports are not compulsory. Thus, there are no sanctions in case of non compliance by a listed company with any of these recommendations. Contrary to the UK where the Combined Code is annexed to the Listing Rules, such recommendations are not yet annexed to the *règlement général* of the *Conseil des Marchés Financiers* (CMF) which is the professional authority of the French Stock Exchange. However, the Viénot committee has considered it necessary for listed companies to

specify clearly in their annual report compliance with the recommendations of the two Viénot reports, and if applicable, reasons for non compliance.

Pierre Bézard.– In conclusion, it may firstly be emphasised that under French law an ever clearer distinction is appearing between the law applicable to closed companies and that relating to companies with listed securities. The law applicable to closed companies is becoming ever more contractual. The freedom of the founder members and shareholders is hence increasing : they will be subject to less restrictions and their commercial and industrial approach will be facilitated. On the contrary, the law applicable to companies whose securities are listed is being reinforced and the control to which they are subject is stricter. This solution is justified by the protection of investors.

It may next be noted that French law, subject to various sources leading to a certain level of unification, is drawing nearer to the laws of other western countries in particular those of England and Wales. As far as closed companies are concerned, the relaxation of written law brings to light the ethical principles expected of directors, as it is the case in Common Law countries which are moving towards written law through the application of Directives.

Despite the delays incurred in the adoption of important texts and reasons, European law is also a powerful unifying element. As for closed companies, unification is clearly progressing rapidly.

Finally, it may be said that under French law, decisions of the Courts will play an ever more essential role. Hence, as regards closed companies, when confronted with the diminishing importance of texts, it will fall to case-law to facilitate the adoption of coherent solutions adapted to the reality. For listed companies, case-law will continue to keep a watchful eye on the application of regulations by the stock market authorities and will thus constitute a true stock market law.

On the eve of the year 2000, may we take this opportunity to express the wish that all countries will have high quality regulations applicable to companies. High quality means that they take into consideration interests which should be protected, but flexibly, without unjustified restrictions. Undertakings must be able to fully dispose of dynamism capable of creating wealth to be fairly distributed. Without strong undertakings, there are no prosperous economies and no efficient State policies.

A final wish : may these States have an efficient Justice system which is aware of what is at stake and which, by a shared confident approach of not only Judges but also all lawyers : practitioners, advisors and teachers, establishes efficient decisions adapted to economic realities.