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# France: more transparency – better governance

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COMPARED TO PREVIOUS YEARS, WHICH HAD SEEN THE IMPLEMENTATION OF SEVERAL EUROPEAN DIRECTIVES (MARKET ABUSE, PROSPECTUS, TRANSPARENCY AND TAKEOVER DIRECTIVES, MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)) AND THE CREATION OF A NEW SECURITIES MARKET IN PARIS, FEWER MEANINGFUL STATUTES OR MODIFICATIONS TO THE GENERAL REGULATION OF THE FRENCH SECURITIES REGULATOR, *AUTORITÉ DES MARCHÉS FINANCIERS* (AMF) TOOK PLACE IN 2010. A NOTABLE EXCEPTION TO THIS WAS THE OCTOBER 22, 2010 FINANCIAL AND BANKING REFORM STATUTE (FBRS), WHICH WAS TAKEN IN THE AFTERMATH OF THE FINANCIAL CRISIS AND WILL HAVE NOTABLE INFLUENCE OVER LISTED COMPANIES' AND CERTAIN CAPITAL MARKETS' ACTIVITIES. IN ADDITION, SOME ENFORCEMENT DECISIONS BY THE AMF ARE WORTH NOTING, AS THEY WILL HAVE AN IMPACT ON FUTURE EQUITY CAPITAL MARKETS (ECM) OR PUBLIC MERGERS AND ACQUISITIONS (M&A) ACTIVITY.

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The main reforms that have taken place since early 2010 have been focused on transparency, public M&A and corporate governance. Following the financial crisis, the legislator also chose to strengthen the regulator's enforcement powers.

## Transparency

### Safe harbour to mitigate insider trading risks

Executives and directors of public companies are increasingly at risk of trading securities at a time when they have knowledge of material non-public information. The AMF has recognised this and set up a working group which led to the publication on November 3, 2010 of guidelines that insiders may decide to follow to mitigate their risk: limitation to, and control of, the circulation of confidential price sensitive information, creation of



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negative windows during which trading by insiders is prohibited, etc. Although not mandatory, such guidelines will be considered as a safe harbour by the AMF. Most of the recommendations were considered as best practice and had already been adopted by most large issuers, but such safe harbour is welcome for small and mid-cap issuers which often have trouble navigating the intricacies of securities regulation.

A novelty of this safe harbour is the recommendation for investment management mandates or trading plans. It is recommended that executives and board members enter into mandates with independent professionals pursuant to which such professionals will manage their portfolio. Such mandates must be entered into at a time when the potential insider does not have any material non-public information. Also, in order to avoid such mandates being used to trade on the basis of privileged information, the AMF recommends that the mandate be implemented no earlier than three months after it is signed and that the executive refrain from exercising any influence over the management of their account, directly or indirectly. The AMF also recommends that the scope of the mandate be strictly defined, either through a formula, or by providing the number and price range of securities to be traded on a quarterly basis, which is an important limitation to the investment manager's role.

### Alternext

In order to facilitate small and medium size companies' access to stock markets, the AMF has revised its regulation to make it easier for the issuers listed on the main board (Euronext) to switch to Alternext, the junior market, where compliance costs are a fraction of what they are on Euronext.

Following the 2009 regulation simplifying such transfers, the AMF issued a recommendation on September 16, 2010 clarifying certain provisions. In particular, the recommendation addresses the important issue of transitioning from International Financial Reporting Standards (IFRS) to French Generally Accepted Accounting Principles (GAAP), as IFRS are not mandatory for companies listed on the junior market.

However, provisions relating to notifications of the crossing of certain shareholding thresholds applicable on the main market remain applicable to shareholders of Alternext issuers for a period of three years from the date of transfer.

The issue in this context remains finding the right balance between the cost of compliance, in particular for small issuers, and the level of security that is necessary to protect investors. Accordingly, the regulator has strengthened what it considers the most important protections for investors.

### Reporting of material shareholdings

Pursuant to applicable regulation, shareholders must report to the AMF whenever they cross, up or down, certain shareholding thresholds.

The sudden acquisition of over 17% of Hermès shares by competitor LVMH Moët Hennessy Louis Vuitton in October 2010 raised questions regarding French transparency regulation, in particular as it relates to the computation of shareholdings that have to be disclosed to the market. According to applicable regulation, cash settled options were excluded from the reporting obligation. A last minute amendment to such contracts, making them paper settled instead of cash settled, allowed LVMH to acquire such shares without violating the AMF reporting obligations.

This prompted a debate on whether it was necessary to reform such disclosure rules. As a matter of fact, the AMF had already decided to propose to include cash settled instruments in the scope of reporting obligations prior to the Hermès/LVMH case. Indeed, as part of the review process of the Transparency Directive, the European Commission issued a consultation paper including a question regarding the inclusion of cash settled options in the scope of the future Directive, to which both the French Treasury and the AMF responded positively, as did several other European countries, including the UK and Germany.

In addition, the Enforcement Committee of the AMF issued a decision in a similar case on December 13, 2010, where



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cash settled instruments were used in the creeping acquisition by Wendel of 17% of Saint-Gobain in 2007. The Enforcement Committee held that, even though no threshold notification rules had been violated in this case, Wendel had still breached two other disclosure obligations under the General Regulation of the AMF: first, the obligation to disclose its contemplated financial transaction on the securities of a listed issuer and second, its obligation to disclose this acquisition, which constituted price sensitive information for Wendel, as Wendel is itself a listed issuer.

### Reporting on short positions

The AMF noticed during the financial crisis that short positions could have an influence over market stability and that such positions were not adequately disclosed to the market. As a consequence, it has included a new article 223-37 in its General Regulation outlining a new disclosure regime for short positions. Pursuant to this article, any economic exposure to shares listed on Euronext or Alternext reflecting a net short position exceeding 0.2% of the issuer's share capital shall be disclosed to the AMF. Any further increase or decrease by 0.1% shall be disclosed as well. Whenever the net short position exceeds 0.5% of the issuer's share capital, the AMF shall inform the market. Exemptions from this rule are provided for liquidity providers, subject to the AMF's prior approval.

For the purposes of this rule, all transactions relating to the relevant stock must be taken into account, regardless of whether they take place in France or outside of France, on a regulated market or otherwise. However, net short positions on shares whose primary market is not in France do not fall within the scope of this obligation, even if the stock has a secondary listing in France.

### Pilot fishing

A press release from the AMF dated September 17, 2010 and a decision dated March 11, 2011 remind market participants that calls to selected investors to assess their potential interest in anticipation of a contemplated transaction (aka pilot fishing) should be handled with care and that violations of the regulation will not be tolerated. For instance, the AMF reminds market participants that the

investors' agreement to receive material non-public information and handle it as such should be sought and obtained prior to the communication of any information relating to such an issuer. The transfer of any information, regardless of whether it is price sensitive, prior to obtaining such agreement, shall be considered a violation of applicable regulation. According to the AMF, the materiality of the information should be taken into account merely to assess the penalty.

### Easier access to information on listed companies

Finally, a decree dated June 23, 2010 improved the conditions in which investors can gain access to information on listed companies. For instance, it becomes mandatory for listed companies to post certain regulated information, in particular relating to their shareholders' meetings (proposed resolutions, results of shareholders' votes, etc.), on their corporate websites.

## Public M&A

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### Mandatory tender offers

The Banking and Financial Regulation Statute published on October 22, 2010 has revised the percentage of shares or voting rights that triggers the obligation for its holder to launch a tender offer on 100% of the issuer's share capital. Whilst the main purpose of this evolution from one third to 30% of the shares or voting rights was to avoid creeping control, it reflects a broader integration of the European market as most member states including Germany, the UK, Spain, and Italy had adopted this 30% threshold.

The legislator and the regulator have introduced grandfather provisions, pursuant to which those who held, on January 1, 2010, between 30% (the new threshold) and a third (the former threshold) of the shares or voting rights, will only have to launch a tender offer if they cross the one-third threshold<sup>1</sup>; those who crossed the 30% threshold upwards between January 1, 2010 and February 1, 2011 will have to either sell the shares they have in excess of 30% by February 1, 2012 or launch a mandatory tender offer.

The legislator also revised the list of securities that must be taken into account to compute this threshold to include securities exchangeable for existing shares; this allows this calculation to be consistent with that prevailing to compute and disclose thresholds crossed by an investor. The AMF also revised its General Regulation to allow waivers to the obligation to launch a tender offer when the 30% threshold is crossed with no purpose to take control of the issuer, provided that such threshold is crossed for a period not exceeding six months and that the voting rights associated with the shares held in excess of the threshold are not voted during this period.

The standing market offer (*garantie de cours*), which was a simplified tender offer allowed in specific circumstances, has been abolished.

The circumstances in which a tender offer must be launched on shares listed on Alternext have been extended to include all crossings of the 50% threshold. Prior to the reform, only the crossing of such threshold following the acquisition of a block of shares required the launch of a tender offer.

Finally, this reform allows squeeze-outs of shares listed on Alternext.

### Corporate governance

Listed companies have prepared their shareholders' meetings with increasing care over the last two years, as many feared activists' reactions following the financial crisis.

### Proxies

An ordinance of December 9, 2010 and a decree of December 23, 2010 implemented the European directive on shareholders' rights into French law. Consequently, shareholders can now be represented at the shareholders' meeting, not only by another shareholder or their spouse, as was the case before, but by any person. This measure is expected to increase the weight of proxy advisors, who can seek proxies to ensure that their recommendations be followed by the boards of directors of public companies.

As several large French public companies complained of the lack of transparency of proxy advisors, the French

regulator recently issued a recommendation to improve communication between public companies and proxy advisors. Accordingly, proxy advisors are asked to explain the concepts they use and to publish, in December of the preceding year, the voting policies that they intend to apply for the next shareholders' meetings season, so that issuers may make informed decisions on the topics addressed in such policies. Finally, the AMF recommends that issuers be notified of – and be allowed to respond to – any communication from proxy advisors regarding their shareholders' meetings.

### Gender equality at board level

Shareholders have also paid significant attention to the composition of the boards over the past year and the legislator has echoed this concern.

A statute was passed on January 27, 2011 that mandates that, by 2014, women represent at least 20% of the directors of French listed companies and companies with more than 500 employees and revenues exceeding €50m. This ratio should increase to 40% by 2017. In 2009, 11.4% of directors at French blue chips (CAC 40 companies) were women and this percentage increased to 15% in 2010.

In the meantime, any company that does not have women directors may not appoint a male director before they appoint a female one, which will have a significant impact on the appointments proposed to the shareholders this year. Any appointment made in violation of this rule shall be null and void, but this will not have any impact on decisions made by the board itself.

### Enforcement

The maximum fines that can be imposed by the Enforcement Committee of the AMF have been increased 10 fold, from €10m to €100m, by the Financial and Banking Reform Statute. This applies only to market professionals who have violated their professional obligations. This gives the AMF meaningful means to enforce its regulation, reinforced by the newly-created ability for the AMF to settle out of court. However, many practitioners question the use of such an increase, in light of the fact that the prior ceiling had never been reached.

In addition, the rule now is that AMF decisions are made public, which increases the reputational risk for institutional investors and financial institutions in particular. The AMF can only decide not to publish its decisions if it creates a risk for the financial markets or if the damage created to the parties outweighs the benefit of such publication.

Finally, the AMF can appeal to the decisions of its Enforcement Committee (*commission des sanctions*), which was not the case before.

## Conclusion

Going forward, the market expects a reform targeted on small caps, to improve the balance between the need for reliable information and the cost of being admitted to trading. Reforms of the MiFID, the Market Abuse and the Transparency Directives at the European level are also expected and market participants and regulators have started to publicise their views, especially on the MiFID, which constitutes the framework of European capital markets.

Also, a new Directive modifying the Prospectus Directive (and, to some extent, the Transparency Directive) was adopted on November 24, 2010, largely to broaden the

scope of private placements and provide for a higher degree of harmonisation among European countries. The new Directive must be implemented into French law by July 1, 2012.

On corporate governance, an evolution in 'say on pay' is expected in the coming months. Over the past two years, shareholders have voted against several stock option plans at large public companies, demonstrating an interest in the remuneration of the groups' managements. France is one of a few large economies where the management's remuneration is not voted upon by the shareholders.

Finally, ECM activity is expected by many to be stronger in 2012-2013 than in the last few years. Renewed activity will no doubt raise new questions that the market and the regulator will address in due course.

### Note:

- 1 An investor who has crossed down the 30% threshold since January 1st, 2010 loses the benefit of the grandfather provisions.

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