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Perspectives

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RECENT REFORMS AND TRENDS IN THE FRENCH PUBLIC M&A MARKET

The French public mergers and acquisitions (M&A) market has been affected both by new regulations implemented this year following laws passed in 2010 and new market trends influenced by U.S. standards. This article describes some of the major reforms and changes that have occurred recently in the French public M&A market.

FRENCH TAKEOVER BID - RECENT REFORMS

The Amendment to the French Financial Market Authority General Regulation (AMF General Regulation), by an order dated January 31, 2011, completes last year's legislative changes on the banking and financial regulation law n° 2010-1249 (BFRL), dated October 22, 2010. This Amendment reforms takeover bids in several ways, including the following changes.

Mandatory bid threshold lowered to 30%

The stock exchange market transparency and safety law formerly imposed the filing of a mandatory offer in two situations: (i) where a person becomes the holder of more than one third of the capital or voting rights of a listed company; and (ii) where a person holding between one third and one half of the capital or voting rights of a listed company increases such holding by at least 2% of the outstanding capital or voting rights of such listed company in less than 12 months, also referred to as a "speed-limit acquisition." The January 2011 amendment decreased the threshold for mandatory offers to 30% of the capital or voting rights of a listed company in each of these situations.

Calculation method of the mandatory offer thresholds

In determining whether this 30% threshold of capital or voting rights is triggered, a person should be careful to include all holdings of securities, including derivatives (e.g., swaps and credit default swaps), required by the applicable rules. For simplification, the AMF General Regulation provides that the same rules apply when determining market transparency thresholds (5%, 10%, 15%, 20%, 25%, 30%, 33.33%, 50%, 66.6% 90% and 95% of the capital or voting rights) as apply to mandatory offer thresholds (30% of capital or voting rights and speed-limit acquisition). These rules require, among other things, that debt instruments providing rights to outstanding equity, forward contracts, and options partially or totally deliverable in the form of equity (whether exercisable immediately or at maturity irrespective of the exercise price) be taken into account in determining whether the 30% threshold has been reached. Agreements with cash-only settlements are not currently taken into account in calculating the 30% threshold, but in reaction to recent transactions (Saint Gobain and Hermès), an amendment to the law for more transparency of the market has been presented to the senate to require the inclusion of such cash-only settlements in calculating the market transparency thresholds. The legislature might also reconsider the question of whether economic exposure should be taken into account in calculating the mandatory offer thresholds.

Grandfather clause

The January 2011 amendment includes a grandfather clause applicable to persons who held between 30% and one-third of the capital or voting rights of a listed company as of January 1, 2010. Such persons are subject to the old mandatory offer rules and, thus, are only required to file a mandatory offer if their holdings exceed the old one-third thresholds.

Reorganization of derogations to the mandatory offer

Prior to the January 2011 amendment, the AMF General Regulation had different articles, one relating to a direct crossing of the threshold and another relating to the indirect crossing of the threshold (*i.e.,* in connection with the acquisition of control of a parent company holding a 30% stake in a listed subsidiary on a French or European regulated market, where the subsidiary represents an essential part of the assets of the parent company). These provisions have been reorganized and modified, giving rise to new derogations cases, but without significant modification of the substance of the regulations.

FRENCH TAKEOVER BID - RECENT TRENDS

The development of tender offer and merger agreements

When a listed company is controlled by a shareholder or a group of shareholders, a shareholder who wants to acquire control first enters into a share purchase agreement with respect to the controlling interests then files an offer for 100% of the shares of the target company. These purchase agreements comply with international standards, with boilerplate conditions precedent and seller representations and warranties. Sometimes, significant shareholders desire to maintain maneuvering flexibility in the event of a third party competing offer. In such cases, the significant shareholders may only agree to sign an undertaking to tender their shares in the offer.

When a company is not fully controlled and the purchaser does not want to effect a transaction without warranties, in addition to the purchase agreement or the tender and support agreement, it may preliminarily obtain approval of the transaction by the target company's management and board of directors before filing the offer. In this situation, the French practice used to be that the chairmen of both boards would reach a mutual understanding, and then the offeror would file the offer. This gentleman's practice is now less common, with an increasing number of offerors requiring contractually binding commitments from the target prior to filing the offer. This trend has led to the development of "tender offer agreements" or "merger agreements," which protect the offeror from having to launch a transaction unless the necessary target approvals are obtained. A recent example of such a transaction was the offer filed by Solvay for the non-controlled company Rhodia, which was subject to a binding agreement signed between the two companies. This approach was also utilized in the "competing" offer of Honeywell for Sperian Protection following the announcement of Cinven's buy-out attempt.

Compared to a U.S.-styled merger agreement, the provisions in these tender offer or merger agreements are flexible and not yet standardized. The target company verifies the intentions of the offeror and ensures that it has a positive opinion from its board of directors regarding the offer, and may accept a soft "no shop clause" in order to provide offeror protection against the target's potential implementing of deal-defeating defenses. Some typical U.S.-styled merger agreement provisions are still nonexistent in their French equivalents, as in the case of "top-up options," which provide that if the offer does not reach, but is close to, the statutory ownership thresholds required for a back-end squeeze-out of the remaining minority interests (typically 90% to 95% ownership is required*)* the target can effect a capital increase to enable the offeror to reach the required squeeze-out ownership threshold. Although such capital increases require both the approval of the target company's board of directors and shareholders at an extraordinary general meeting, we believe such provisions will eventually be adopted in France, perhaps via a different method.

The uncommon break-up fees

Where an offeror cannot purchase the shares of significant shareholders before filing an offer, the offeror may want significant shareholders to agree to pay a significant "break-up" fee if those shareholders back out of the deal.

Such break-up fees in tender offer and merger agreements are practically nonexistent in France. The few examples of French transactions that were subject to negotiated break-up fees include the transaction contemplated among Alcan, Pechiney and Alusuisse, SAP's offer for Business Objects in 2007, and Honeywell's offer for Sperian Protection in 2010.

In France, the duties and responsibilities of the board of directors require that the interests of all stakeholders, including, most importantly, employees, be taken into account in considering any offer. As a result, most directors refuse substantial restrictions in their freedom to analyze an offer and appropriately defend the target against a change in control. Thus, there has not been a judicial or legislative need to strictly prohibit deal protection measures and break-up fees in a tender offer, unlike what has occurred recently with our English neighbors.

The increasingly important use of the "debt push down"

The resurgence of the debt markets has allowed offerors to once again utilize leverage in most buyouts. Thus, a target company's debt capacity has increasingly become an important consideration for financing transactions.

More and more target companies now pay dividends or distribute reserves after receiving an offer. We believe these practices will continue in the future, particularly in light of the anticipated amendment of the European directive implemented in the late 1990's that prohibited financial assistance. Nevertheless, potential changes in the development capacity of a target in the future and protection of its corporate interests will remain a major issue in the French market. Currently, the return of high debt ratios similar to the boom years of 2006-2007 does not seem to inhibit deal-making.

In transactions with "debt push down," there has also been a trend of capital decreases through buy-back offers, which are often used to offer cash to shareholders who seek liquidity on part of their holdings at a price generally well above the market price. Here, we actually see the use of debt to restore the value of equity. These transactions allow investors to achieve their desired internal rate of return in difficult economic periods. It should be noted that the French Financial Market Authority (AMF), in order to allow these transactions to proceed, will sometimes grant derogations when, as a result of not participating in the capital decrease, significant shareholders cross a mandatory bid threshold (in particular the 30% capital or voting rights threshold).

A mandatory threshold success of 50.01% for offers under the normal proceeding

It should be noted that in light of recent cases, particularly the tender offer by AS online for Seloger.com in 2010, there is currently some discussion of amending the stock exchange regulations. Some bids at a weak price have resulted in the offeror holding less than 50% of the capital of the target company after the offer. In order not to deprive shareholders of such offers, the AMF is considering imposing a mandatory success threshold of 50.01% for certain tender offers (*i.e.*, where AMF control of the offer price is limited).

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