France

Negotiated M&A Guide

Corporate and M&A Law Committee

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1. INTRODUCTION

This section deals with the acquisition of private (non-listed) companies in France and outlines the main considerations, preliminary steps, documentation used and important points to bear in mind. It is assumed that the reader already has some knowledge of M&A in his or her own jurisdiction, and this Guide therefore focuses on the differences of approach and law that are likely to be of interest to someone who is not familiar with acquisitions of private companies in France. It is not designed to be a general explanation of the acquisition process, or a detailed summary of the standard provisions of an acquisition agreement.

An acquisition of a business in the form of a going-concern is a particular type of transaction under French law, to which a number of formal procedures apply, and is very different from the purchase of a company.

The general provisions of French civil and commercial law will apply to a company acquisition, and, in particular, the Civil Code and the Commercial Code.

2. STRUCTURE OF THE TRANSACTION

The structure for an acquisition of the shares of a private company is, in general, similar in form and substance to other main jurisdictions (notably the US and UK). A share purchase agreement is entered into setting out the main terms: the conditions, the price and payment mechanics, the representations and warranties, indemnification provisions and other standard clauses commonly found in such agreements. In an international context, such agreements are often entered into in English.

An acquisition of shares is the simplest and, generally, the quickest, form of transaction and is therefore preferred by the parties. Nevertheless, the disadvantage of such a transaction, like in other jurisdictions, is that the company is transferred to the purchaser with its liabilities. Therefore, when there is a requirement to carve out liabilities, or certain assets or contracts, it will be necessary to buy either the business or assets.

Tax and funds distribution issues will also be important in structuring an acquisition. If the business is sold, as opposed to the shares, then the proceeds will be paid to the company and may then need to be extracted by way of dividend, which could have negative tax consequences.

Registration duty will be another factor to consider in structuring a transaction: a transfer of shares of the SA or SAS form of company (described in more detail below) is subject to a rate of duty of 0.1%, subject to a minimum of €25 per transfer. A transfer of shares of the SARL form of company is subject to a rate of 3%. If the principal assets of the SAS or SA are real estate, higher rates of duty may be payable. In some cases, it may be appropriate to transform an SARL into an SAS prior to the sale, but care needs to be taken that such a transaction is not capable of being challenged by the tax authorities on the basis that it is motivated purely by a wish to reduce the amount of registration duty payable. A purchase of a going-concern business (*fonds de commerce*) is subject to registration duty at a rate of 3% for the portion of purchase price between €23,000 and €200,000 and 5% for the portion above €200,000. The duty is payable within one month from the sale.

The structure of a sale/acquisition of a going-concern business (*cession de fonds de commerce*) is very different. In particular, the form of the agreement is very regulated by French law, certain representations and warranties are mandatory, notice of the transfer is required to be given to creditors, the tax treatment is very different and details of the agreement are required to be filed at the Commercial Registry. As such transactions are considered cumbersome, lacking in flexibility, lengthy to complete and expensive from a tax perspective, they are often avoided by means of a prior transfer of assets into a newly-created company, followed by the sale of such company. Care needs to be taken, however, that such operations cannot be challenged by the tax authorities as having been structured primarily with a view to avoiding the higher registration duty rates that apply to business sales.

It should be noted that a transfer of a going-concern business generally entails the transfer of any lease of the premises (in principle, the landlord cannot prevent the transfer of the lease), certain insurance policies and the employment contracts of all employees working in the business.

3. PRELIMINARY CONSIDERATIONS

Different forms of company

There are many different types of company in France (both civil and commercial) and the form of the company will have an impact on the structure and terms of the acquisition. There have been a number of recent changes to the laws applicable to such companies, particularly regarding minimum capital and requirements to appoint auditors. The most common forms of commercial companies are:

- the *société par actions simplifiée* (SAS) (simplified joint stock company) which is now the most standard form of entity for private commercial companies. It is flexible to operate and can have only one shareholder. There is no longer any minimum share capital requirement. However, the very fact that there is a large degree of flexibility means that the by-laws of each SAS are likely to be different and need to be drafted/reviewed carefully. In particular, the management structure can vary from the simplest form: a President, who represents the company, to the more traditional board of directors, or equivalent. It should be noted that share certificates do not exist for the SAS and SA form of companies. Shareholdings have to be verified by an inspection of the shareholder accounts and share transfer books which are usually kept by the company itself. Transfers of shares are implemented by way of signature of a transfer form and recorded in such books.

- the *société anonyme* (SA) (joint stock company). This is the appropriate form for a public (*i.e.*, listed) company, and is required to have a minimum of two shareholders and a share capital of €37,000. The management form is restricted for this form of company (either a CEO with a board of directors or an executive committee with a supervisory board). The *société anonyme* provides more security for shareholders and foreign investors too because its operating and management rules are strictly defined in the French commercial code.

- the *société à responsabilité limitée* (SARL) (private limited liability company). This was traditionally the smaller form of company created by entrepreneurs. The shares of such a company are known as *parts sociales* (or interest shares). The identity of the shareholders is on the public record as their names are set out in the by-laws, which are required to be filed at the Commercial Registry. A change of shareholder therefore usually entails a change of by-laws. Transfers of shares to third parties are restricted and require the prior approval of the shareholders (*clause d'agrément*). In the case of sale or subscription of shares of an SARL by an individual, the consent of the spouse may be required, depending on the matrimonial regime.

In all cases, it is very important to review the by-laws of such companies, which can be obtained from the relevant Commercial Registry, and are sometimes available on-line. The most important provisions are those relating to the transfer of shares, the management of the company and any limitations imposed on the powers of the executive officers. By-laws of an SAS or an SA sometimes provide a requirement for transfers of shares to be approved by the board of directors (*clause d'agrément*) and may include pre-emption provisions. Equally, any shareholders' agreements should be checked for similar provisions, as well as any change of control or non-compete clauses, transfer restrictions, drag-along or tag-along requirements.

French company law does not allow financial assistance to be provided, directly or indirectly, for the purchase by a company of its own shares.

Foreign investments in France

Following a recent change in the law, only foreign investments made in sectors regarded as “sensitive”, such as those involving public order, public safety or national defence, are subject to a prior authorization of the French Treasury Department of the Ministry of Economy, and an administrative declaration.

Previously, many transactions proposed by a foreign entity, such as creation of a new undertaking or the acquisition of all or part of a business of a French company, were subject to a so-called “administrative declaration”.

Consequently, the sensitive sectors in respect of which prior authorization is required are the following:

- gambling
- private security services
- R&D in toxic products
- Security certification in IT sectors
- Businesses linked to national defence
- R&D, manufacturing and sale of weapons, ammunition, etc.

All foreign investments in the above sectors (whether made by an EU company or a non-EU company) are subject to the prior approval procedure, provided that they will result in:

- the acquisition of the control of an undertaking established in France, the notion of “control” being defined in Article L. 233-3 of the Commercial Code. It should be noted that the holding of more than 50% of the share capital or the voting rights of the company is not necessary to be deemed to control a company and that French corporate law takes into account the *de facto* control of a company;
- the direct or indirect acquisition of all or part of the business of an undertaking established in France.

The conditions are more drastic for non-EU foreign investors, as any transactions resulting in the foreign investor holding more than 33.33% of the share capital or voting rights of the company established in France are subject to the prior approval procedure.

The Treasury has two months from receipt of the application to notify its decision. Failure to reply within two months constitutes tacit approval on its part. The approval granted by the Treasury can be subject to conditions, such as the continuation of the activity of the business, the fulfilment of contractual obligations under agreements with the French State, or an undertaking not to sell the business to a third party.

Once completed, all foreign investments that have been authorised must be declared to the Ministry within two months. Failure to comply with this requirement can lead to the imposition of a fine.

A foreign investment made in contravention of the prior approval procedure will be null and void. In addition, any investor involved in such transaction would potentially be subject to severe sanctions such as fines, which may amount to twice the amount of the transaction, and to criminal sanctions.

In order to provide statistical data on foreign investments in France, some real estate transactions remain subject to an administrative declaration with the Bank of France. For example, the Bank of France must be informed of the realization of a foreign direct investment or the acquisition / assignment of real estate

properties abroad by residents and in France by non-residents, if the price exceeds €15 million. Failure to comply with this requirement can also result in the imposition of fines.

Employee protection

The vendor and purchaser of a company's shares, or of a business in the form of a going-concern, must also respect some labour law requirements.

The vendor and, possibly, also, the purchaser, are required to inform and consult the works council and in some cases the employees of the company concerned by the transaction. This obligation can sometimes complicate or slow down the sale process.

1. Consultation of the Works Council

One of the first questions to be asked in the sale process is whether there will be a requirement to inform and consult any works council in connection with the transaction, as this can be an onerous procedure.

A company with more than 50 employees is required to have a works council and the Labour Code requires an employer to inform and consult its works council on all issues relating to the organisation, management and running of the company.

Consultation of the works council is now only required in case of a company transfer, the acquisition or the transfer of its subsidiaries and also when the acquisition of shares in another company is envisaged by the employer.

Such obligation concerns not only the purchaser's works council, but also the works council of the target company. This requirement to inform and consult gives rise to two main practical concerns: confidentiality and timing. Parties are usually reluctant to inform the works council (particularly that of the target company) of a proposed acquisition until it is done and in the public domain; yet, the requirement is to inform and consult the works council before any binding agreement is entered into. This means the consultation has to be completed before signature of the acquisition agreement; works council consultation cannot be dealt with as a pre-closing condition. Nor is it a procedure that can be done overnight as it is necessary to convene the works council, provide it with relevant information and then give it time to reflect and ask any additional questions.

There is no requirement to give a copy of the acquisition agreement to the works council, or to reveal its terms. The works council is likely to be more interested in practical matters such as the timing of the transaction, its impact on employment within the relevant companies and proposed plans for the future. Obviously, much of this information can only be provided by the purchaser, who is not involved in the consultation of the target company's works council at this stage, but may agree to provide information, or even attend a meeting to answer questions.

It should be noted that the works council is not required to "approve" the transaction but only to consider it and render an "opinion" (*avis*), which can be positive or negative. The transaction cannot be signed until such opinion has been given. Until recently this meant that signature could potentially be significantly delayed if the opinion were not provided promptly. However, recent legislation provides that unless a different timetable has been expressly agreed (in such case it may not be shorter than 15 days), the works council shall be deemed to have given a negative opinion if it has not given its opinion within one month from the date of provision to it of the necessary information.

The timetable could be longer if the works council exercises the "alert procedure" (*droit d'alerte*) which entitles it to have an expert appointed to prepare a report on the situation of the company.

Moreover, if the works council considers that the information given by the employer is not sufficient, it may apply to the court in order to request the communication by the employer of missing information. The

court then has eight days to render its decision and, in case of difficulties, the court can decide to extend the deadline of the information-consultation process.

The works council's opinion must not be neglected. Even if a negative "opinion" cannot prevent completion of the contemplated transaction, it could have adverse consequences for the company's image and it could potentially result in a social crisis.

Finally, it should be noted that failure to comply with the obligations of information and consultation can give rise to criminal sanctions against the head of the company.

2. Information required to be given to the employees

A recent law has imposed an obligation on the employer to inform its employees in the case of certain business transfers or acquisitions.

The manager of the going-concern business which has a works council has to inform the employees of the intended sale of that business. The employees must be informed not later than the time when the works council is informed.

The purpose of this information is to allow the employees to make an offer to purchase the going concern business themselves.

In the case of a proposed sale of shares of a company, the employer has to inform the employees at least two months before the conclusion of the agreement.

Several exceptions to this information obligation exist: for example, the employer is not required to inform the employees when the transfer is proposed to be made to the owner's spouse, or certain family members.

Failure to comply with this obligation may result in the imposition of a fine of up to 2% of the sale price.

4. PRE-AGREEMENT

In more complex transactions it is common for the first steps to comprise the following preliminary agreements: confidentiality letter (often containing non-solicitation covenants with respect to employees and customers); exclusivity agreement; and letter of intent (also known as memorandum of understanding, term sheet or heads of agreement). These agreements can be separate or incorporated in one document. There is no rule with respect to the form of such agreements and sometimes they are presented as letters, rather than formal agreements.

As in other jurisdictions, the aim of the letter of intent is to summarise the main points that have been agreed upon in principle and set out the road map for the subsequent steps of the transaction. Only a limited number of provisions will be expressed as being legally binding: confidentiality, exclusivity, terms relating to payment of break fees, etc. However, there is generally a strong moral obligation not to deviate from the terms subsequently, so care needs to be taken in the drafting of such documents even at this early stage.

Confidentiality and exclusivity agreements will generally apply for a fixed period, failing which, they could be considered unenforceable. The confidentiality undertaking will usually apply for two to three years following termination of negotiations, or longer if the information disclosed is particularly sensitive and justifies a longer period.

Care also needs to be taken not to conclude a legally binding agreement inadvertently. The term "subject to contract", although understood, does not have legal significance in France. It is therefore important to use unambiguous language in the letter of intent to state which provisions are legally binding and which

are not. A letter of intent could be construed as a binding agreement under French law if it contains key terms such as parties, price and conditions precedent and if it is not clear that the parties do not intend to be legally bound by it. Accordingly, the parties should define the issues that they consider to be essential to the deal and on which no agreement has yet been reached.

Equally, certain conditions that are drafted in a subjective way and that depend on actions or views of one party only (*conditions purement potestatives*) may be considered void by the courts and so result in a non-conditional agreement having been reached. For example, a condition relating to "the results of the due diligence being considered satisfactory to the purchaser" could be considered void on this basis.

The Civil Code provides for an obligation to negotiate in good faith. A recent reform of the Civil Code confirms that this good faith requirement applies both in pre-contractual and contractual stages. From a practical point of view, this means that prudence is required when running auction processes, deciding what information to disclose to a purchaser and terminating negotiations. Liability can potentially be incurred for misleading a party into thinking that it is the only purchaser with whom negotiations are being conducted, thus leading it to incur expense in the acquisition process.

A party could also be required to compensate another where it pulls out of negotiations abruptly without giving reasons for doing so, or where the target is sold to a third party while negotiations were pending with another interested purchaser. The level of damages awarded for breach of the duty to negotiate in good faith is usually limited to those that are designed to put the party into the position that it would have been in had the negotiations not taken place (in other words, compensation for wasted costs and expenses, rather than damages for lost opportunity). This is why it is important to specify a break fee clause in a letter of intent in order to clarify what the parties expect in the event that the deal does not proceed in the way it was intended to, due mainly to the actions of one of the parties. (However, as a break fee constitutes a penalty provision, a judge would be entitled to reduce its amount should it be significantly higher than the real level of damage likely to be incurred.)

An application for an antitrust clearance can be submitted once a letter of intent has been signed.

5. DUE DILIGENCE PROCESS

Pre-acquisition due diligence is standard in the context of company acquisitions in France. Although the purchaser will want to protect itself through contractual representations, warranties and indemnification provisions, it will prefer to verify the state of the target even before committing to the purchase.

Due diligence procedures are similar to those in other jurisdictions and are likely to cover financial, legal, tax, operational, environmental and business issues.

From a legal perspective, one of the most important aspects will be identification of any change of control provisions in contracts entered into by the company. Another area where specialist advice will be required is employment and benefits. French employment law is notoriously complex and an extensive Labour Code sets out much of the law. Pensions, on the other hand, do not require as much attention as in other jurisdictions (for example, the UK) as private pension schemes are rare and most employees benefit from the State Scheme organised by the French social security system.

Ironically, the vendor will also want the purchaser to conduct extensive due diligence as this may enable it to limit the scope of the warranties required to be given. It is standard for a vendor to seek to exclude any information disclosed in the course of due diligence from the scope of the warranties, but this will be resisted by the purchaser. Thanks to virtual data rooms, due diligence can now be conducted more simply without the requirement to move large groups of professionals and consultants and without resulting in significant disturbance of management of the target.

Certain vendors, and particularly private equity funds, will significantly limit the level of warranty cover proposed to a purchaser in the sale agreement on the basis that (i) they were not involved in the

management of the company, and (ii) the purchaser has been given an opportunity to conduct full due diligence. This is a point that should be clarified at the outset in order to avoid wasted time and expense. It is rare, however, even for private equity vendors in France, to give no warranties, other than warranties as to capacity, incorporation of the target company and ownership of shares, as is sometimes the case in other jurisdictions (for example, the UK).

Provision of vendor due diligence reports is a fairly common practice in France in the context of private equity transactions, or where there is a requirement to conclude the sale rapidly. In this case, the purchaser should be sure to obtain a clear reliance letter from the firms who have conducted the due diligence enabling it to have recourse in the event of a claim.

Certain information relating to the target provided by the vendor should be checked against information obtainable from public agencies such as the Commercial Registry, the Land Charges Registry, the Patents and Trademarks Office. It is advisable to request a full search of the target company and any subsidiaries at the Commercial Registry, which will provide confirmation as to the current officers, auditors (if any), registered charges and liens, commencement of bankruptcy or administration proceedings, last filed accounts, etc.

If the target company owns significant real estate it would be advisable to instruct a Notary to investigate and/or certify the title. In France, Notaries are responsible for dealing with transfers of real estate and registration of mortgages over real estate. If the real estate is likely to be contaminated, it is standard practice to have a specialised firm conduct an environmental audit. Equally, where intellectual property is an important element of the target's business, it is usual to ask a specialised firm of patent and trademark agents to investigate and confirm registration and ownership.

The due diligence process can have an impact not only on the price negotiations, but also the terms of the representations, warranties and indemnities, particularly where the purchaser wishes to be specifically indemnified for risks identified in the course of the due diligence.

6. ANTITRUST

EU or French antitrust clearances may also be required.

If the transaction is deemed to have a Community dimension, it will be subject to Council Regulation (EC) No 139/2004 of January 20, 2004 on the control of concentrations between undertakings (the "EC Merger Regulation") and its implementing legislation. If, however, the transaction does not exceed the thresholds required for it to have a Community dimension, it may nevertheless need to be notified to the French Competition Authority (*Autorité de la Concurrence*).

If the thresholds specified in the relevant law (article L 430-1 et seq. of the Commercial Code) are met, there is an obligation to notify the transaction to the Competition Authority. The notification must be made before the transaction, which cannot be completed until it has been expressly or implicitly approved by the Competition Authority. As a result, any implementation of the transaction before clearance (gun-jumping) would expose the notifying parties to fines.

A notification will be required in France where a business concentration does not have a Community dimension as defined in the EC Merger Regulation and if the aggregate turnover in France for all of the participants exceeded €150 million in the previous fiscal year, provided that at least two of the participants individually have a turnover in France of more than €50 million. Lower thresholds apply in the retail sector as well as for a concentration having an impact in French overseas territories.

The notification is the responsibility of the purchaser, although the cooperation of the target (and the vendor) is required as significant amounts of information have to be provided with respect to the parties' activities and the relevant markets.

The Minister of Economy is still vested with intervention powers. At the end of a phase one decision, the Minister has 5 business days to ask the Competition Authority to undertake an in-depth investigation. At the end of a phase two decision, the Minister has 25 business days to take over the case and rule on general interest grounds either to clear a transaction that the Competition Authority has prohibited, or to subject the transaction to conditions or to prohibit it. Such intervention is not frequent but in all cases it extends the suspension period during which the transaction is not able to be implemented.

7. ACQUISITION AGREEMENT

As mentioned above, an agreement for the acquisition of a going-concern business will look quite different from an agreement for the acquisition of shares of a company. This section focuses on the latter only.

A share purchase agreement can be in French or in English where there is an international element to the transaction. In terms of style of agreement, for the larger corporate transactions, the agreement will resemble the kind of acquisition agreements with which US lawyers are familiar, although probably shorter in length.

The main elements of an agreement are as follows:

Parties/capacity

The agreement will set out full details of the parties, including, in the case of individual vendors, in many cases, residential address, nationality, date of birth and even matrimonial regime. This is important as in the case of a sale of shares of an SARL, the consent of the spouse may be required, dependent on the matrimonial regime.

In the case of French companies, it is standard to indicate the registration number which will show at which Commercial Registry the company is registered, its registered office address, share capital and name of authorised representative.

It is advisable to conduct a company search and check the capacity of the persons acting on behalf of a vendor. In general, an agreement for the sale of shares will be signed by the president (*Président*), managing director (*Directeur Général*) or manager (*Gérant*) of a vendor company, who are empowered by law to bind the company in all circumstances. Care should also be taken to ensure that there are no limitations on the capacity of such signatories, either in the by-laws or in the decision of appointment. In case of doubt, a certified copy of the by-laws and the decision of appointment and/or a decision of the board of directors or shareholders authorising the sale should be requested. It is quite rare for a legal opinion to be provided as to capacity in the context of a share sale.

Prudence is also required where there are multiple shareholders/vendors. Unlike in the case of public limited companies, no mechanism exists in a private limited company which can force the purchaser of a large shareholding to buy all of the shares of the company. Nor can a purchaser force the minority shareholders to sell it their shares (“squeeze-out”) unless there are specific provisions which equate to this in the by-laws or a shareholders’ agreement that has been signed by all the shareholders (known as “drag-along” or “tag along” provisions.

In certain circumstances, the minority shareholders may have a claim against the majority shareholders where a decision has been taken for the sole advantage of the majority shareholders, to the detriment of the minority and against the interests of the company.

Definitions clause

It is becoming more standard for agreements to set out lengthy definitions, following the style of UK/US agreements, although French lawyers prefer to refer to relevant definitions in the codes if possible.

Recitals

The Recitals are often quite detailed, setting out the context of the acquisition and indicating for example whether extensive due diligence has been conducted. The purpose of such clauses is often to try to reduce the scope for a claim in the event of breach of warranty.

Price and payment

The consideration can be satisfied in cash, or by the issue of shares, or constitute the assumption of liabilities. It can be paid in instalments or be subject to adjustment mechanisms which depend on verification of items such as working capital, profits or net debt. Earn-out clauses are also fairly common. However, where the price is subject to adjustment or an earn-out formula, it is vital that the mechanism for calculation of the adjustment or additional consideration is clear.

The agreement should therefore set out the procedure in detail and provide that if there is any dispute between the parties, the matter will be submitted to an independent third party expert for final determination.

Failure to ensure that the price is determined, or determinable, would result in a risk of nullity of the agreement due to the lack of one of the fundamental elements under French contract law – cause. The other required elements being agreement of the parties, object and capacity.

Depending on the negotiations, part of the price can be paid into an escrow account on closing, or even retained, as security for warranty or other claims that may be made against the vendor after closing.

Signature and closing

In simple transactions, and where possible, it is preferable to provide for signing and closing to occur simultaneously. Where this is not possible because there are conditions precedent to be fulfilled (third party or regulatory consents to be obtained, financing conditions, etc) and closing must take place at a later date, it is standard to provide for covenants requiring the business of the target company to be run in the normal and ordinary course and restricting the actions that can be taken between signature and closing. The purchaser will also wish to provide that it can walk away from the deal if there is a “material adverse change” in the company’s position between signature and closing, although the precise definition of such term is likely to give rise to some interesting negotiations, particularly in view of the lack of French case law on the point.

A deadline for fulfilment of the conditions is usually stipulated and if they have not been complied with by the relevant date, either the parties are able to walk away from the deal without liability or, in certain circumstances, a “break fee” may become payable by the party “at fault”.

It is also standard to provide that the representations and warranties are deemed repeated on closing. In this case, the vendor will want to be able to update its disclosures against the warranties and the impact and consequence of such additional disclosure is often the subject of considerable negotiation.

Documents commonly executed and produced at closing include the following:

- Share transfer forms for the SAS or SA form of company (*ordre de mouvement*); or share transfer deeds in the case of the SARL
- Forms required for registration duty purposes (*formulaire “cerfa”*)
- Any corporate authorities that may be necessary from the vendor, purchaser or target company
- Resignation letters from the officers of the target

- Closing board minutes or shareholder resolutions for the target (for example, adopting new by-laws, appointing the purchaser's representatives as officers, etc)

- Bank draft for payment of the price (or wire transfer instructions)

- Bank guarantees, escrow agreements or other documents relating to any deferred consideration or potential warranty liability

- Statutory books of the target (share transfer register, register of shareholders, minute books, attendance registers, depending on the form of the company)

- Any documents or agreements relating to the financing of the transaction that may be required.

In the case of the SA or SAS, the transfer is recorded immediately on closing in the target company's share transfer books. In the case of the SARL, the procedure is more complex, requiring notification of the transfer on the company and registration of the updated by-laws at the Commercial Registry.

Although there is no requirement in principle for signature or closing to take place within France, there is no longer any advantage to be gained from arranging for the closing to take place abroad. Registration duty payable on share transfers is due in the case of a company incorporated in France, regardless of where the documents are executed. There is no requirement to sign or close share purchase agreements before a Notary. A Notary will only be required where real estate is required to be transferred as part of the closing arrangements, or a mortgage deed entered into, or in some cases, where a charge over a business has to be released.

Representations and warranties / disclosure

It has become standard practice to include a wide range of warranties in the acquisition agreement, although the length and detail of the warranties is more limited than in UK or US agreements.

Warranties are given by the vendor to the purchaser but there are also likely to be some limited warranties by the purchaser to the vendor. The warranties will usually cover all aspects of the business, status, accounts, assets and operation of the company, as in a UK or US agreement. Warranties relating to employment matters are likely to be more detailed and cover additional aspects such as compliance with obligations relating to collective bargaining agreements, working hours legislation and works council consultation. French acquisition agreements do not provide for a separate deed of indemnity relating to tax matters.

There may be some discussion as to whether the warranties shall be limited so as to protect the purchaser against undisclosed liabilities only (*garantie de passif*), or to confirm the existence and value of assets on the balance sheet (*garantie d'actif*), or a combination of both. A purchaser will obviously want to have both.

The warranties are given subject to matters that are disclosed against them. In general, the disclosures are contained in exhibits to the agreements that refer to the warranty in respect of which disclosure is being made, and may take the form of specific disclosures drafted to explain the circumstances and reasons why they constitute an exception to the warranty, or documents, or a combination of both. The disclosure letter that is used in the context of UK transactions is not common in France, particularly as the general disclosures of matters that are in the public domain, or which should have been discovered by a prudent purchaser, are generally resisted by the purchaser's lawyers. In the same way, a purchaser will be reluctant to accept deemed disclosure of all facts, matters and information that are capable of being reviewed in a data room.

Indemnification

One of the most important - and heavily negotiated - clauses in an acquisition agreement is the indemnification clause that provides that the vendor will indemnify and hold the purchaser harmless for claims, losses and damages resulting from any breach or inaccuracy of the representations and warranties.

The extent and nature of damages recoverable is often defined in the agreement and usually includes any financial loss that may be caused to the purchaser and/or to the company, consisting of the expenses, debts, taxes, liabilities, claims or losses that may result from a breach of any of the contractual obligations of the vendor in the agreement and/or from any misrepresentation, inaccuracy or breach of the representations and warranties, or from a third-party claim relating to events prior to closing.

The clause usually provides that any amounts payable by the vendor will be payable to the purchaser or the company, at the discretion of the purchaser, and that if paid to the purchaser, will be treated as a reduction of the price.

The indemnification provisions usually require a claim to take into account any available insurance coverage that relates to the matter giving rise to the claim and any tax savings the target company may have as a result of the additional liability.

In the interest of the vendor, the obligation to mitigate losses suffered should be expressly set out as French law does not provide for an automatic mitigation obligation.

A vendor will seek to limit the indemnification obligation in a number of ways. Principally, this will amount to limits in terms of amount and duration of the obligation. There may also be thresholds or deductible amounts designed to discourage frivolous claims or to ensure that the purchaser has a common interest in reducing the loss. It is standard to have a *de minimis* (or, per claim threshold) as well as a global minimum threshold. The levels of these amounts will depend on the purchase price and negotiation between the parties. The question of limitation of the maximum amount will depend on the negotiating strengths of the parties. The limits can range from the full amount of the purchase price, down to a relatively small fraction of the purchase price.

As far as time limits are concerned, the parties often agree that the applicable legal statute of limitations will apply to claims relating to title to shares, tax and social security, while a period of between one to three years is the norm for other types of claims. Claims relating to environmental matters may be capable of being brought for a longer period.

It is standard for the purchaser to require some form of security to be provided for warranty claims, particularly where the vendor is an individual or a small company. The most common forms of security provided for warranty claims are first-demand bank guarantees, an escrow account, or retention of part of the price.

Under French law rescission would only be available to a party as a remedy where the failure of the other party was fundamental (such as where the vendor has intentionally caused an error on the part of the purchaser by misrepresentation).

Non-compete clause

It is standard for the vendor to give a non-compete undertaking on the sale of the business for a period of up to three years, depending on the circumstances. Care should be taken to ensure that the non-compete does not constitute an unreasonable restraint of trade. It should be reasonable in terms of geographic and business scope and duration, failing which, it may be considered as void. The purchaser will usually want to specify a sum of damages that will be payable in the event of a breach of the non-compete.

Dispute resolution

In the context of company acquisitions, disputes are usually submitted to the French courts for resolution unless there are compelling reasons to elect for arbitration. The dispute resolution clause in the agreement should ideally identify the court clearly to avoid jurisdictional disputes. (For example: “Disputes arising in connection with this Agreement shall be submitted to the Commercial courts of Paris”). If no jurisdiction is stated, the plaintiff would have to commence proceedings in the courts having jurisdiction over the place where the registered office (or residence) of the defendant is located.

It is also common for parties to agree to negotiate in good faith for a period of time determined in the agreement to try to resolve their differences amicably before turning to judicial resolution or arbitration. Mediation also exists in France, but it is not usual for parties to a share purchase agreement to provide for mediation as a preliminary step.

If parties are concerned about confidentiality, the ability of the judges to consider certain technical issues, or other aspects of court proceedings, they may select the alternative of arbitration. It is fairly common for parties to share purchase agreements to elect for ICC arbitration or, alternatively, for *ad hoc* arbitration (which avoids the requirement of payment of fees to the arbitration institution which has established the applicable rules), in which case, the main terms of the arbitration procedure will be set out in the agreement.

The rules on French civil procedure are contained in *Nouveau Code de Procédure Civile*.

French court proceedings can be conducted relatively quickly and are inexpensive compared to US or UK court proceedings. There is no system of “discovery” and much of the procedure takes the form of submission of documentary pleadings and evidence. Awards of “costs” against a losing party are generally nominal and limited to expenses and only a fraction of the lawyers’ fees incurred.

There is no longer any distinction between “solicitors” and “barristers” in France and therefore the lawyer who negotiated the agreements can also appear before the courts to plead in the event of a dispute, provided he or she has the necessary experience. Court hearings are generally short, especially before the Commercial court, and oral testimony of the parties is not generally required. However, the judges in the Commercial courts are not qualified lawyers and this in itself sometimes leads parties to opt for arbitration. Resolution of disputes by arbitration is confidential and usually quicker, but likely to be more expensive than court proceedings.

Signature formalities

The procedures relating to signature of documents under French law are still relatively formal. Although there is no requirement for signature of a share purchase agreement before a Notary, it is still standard practice for the parties to meet and all sign the same documents, with one original being distributed to each signatory (and additional originals are sometimes required for registration purposes). Agreements are not signed in counterpart in France. Moreover, it is usual for the parties to initial each page of the agreements and exhibits where these are not bound by a way of a system that prevents the documents from being unbound. This requirement to initial can sometimes be an onerous and time-consuming procedure.

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