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Consequences of France's New PACTE Law (Action Plan for Business Growth and Transformation) on Corporate Governance

Client Advisories

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August 1, 2019 - In response to the new challenges of the global economy, France recently passed the PACTE Act no. 2019-486, which aims to remove obstacles to the growth and transformation of companies.

The law has six objectives:

- liberating companies, by removing constraints in setting up and selling companies;
- giving a long-term perspective to economic stakeholders;
- aligning the interests of all economic stakeholders, in particular employees;
- empowering stakeholders;
- creating an unshackled society, rather than one based on returns on investment; and
- building a state that is a strategic partner rather than a mere shareholder in companies in which the government has an ownership interest.

These six objectives have been developed in the following three themes:

1. **Liberating companies during all phases of their existence;**
2. **Enabling companies to be more innovative; and**
3. **Promoting fairer businesses.**

1. Liberating companies during all phases of their existence

The PACTE Act aims to liberate companies in all phases of their existence by simplifying business creation and company procedures, particularly with regard to workforce thresholds, and by facilitating business transfers.

In particular, the PACTE Act:

- simplifies the formalities for setting up companies;
- changes the role of **statutory auditors in companies** and raises the **qualifying thresholds** for their appointment;
- increases the efficiency of **simplified court-administered liquidation** by making such liquidation mandatory below certain thresholds, which should cover small and medium-sized companies, and accelerates the liquidation process;
- authorizes the government to reform the law on security interests by means of a government ordinance. The aim is to maintain a balance between the interests of creditors and debtors, while clarifying and making the law on security interests more user friendly.

2. Enabling companies to be more innovative

The PACTE Act also aims to improve and diversify financing, through the following measures:

- reforming savings products, facilitating access for companies to **financial markets** and diversifying sources of financing;
- lowering the threshold of the mandatory squeeze-out procedure to 10% to facilitate delisting;
- creating a standard agreement under French law for swap and derivative transactions;
- for financial securities issues of less than €8 million, which are not, in principle, subject to the obligation to issue a prospectus, introduction of the obligation to publish a summary document for public information purposes;
- relaxing the conditions for granting **current account advances**: Article 76 now removes the requirement to hold at least 5% of the capital;
- removing the requirement for clearing houses to be credit institutions;
- creating a sui generis legal framework for "initial coin offerings";
- regulating the activities of digital assets service providers (PSAN); this applies to both "tokens" and crypto-currencies; and
- overhauling the legal regime of preferred shares: in particular, unlisted limited companies may create preferred shares with multiple voting rights.

The law protects inventions by encouraging the filing of patents, and helps to derive value from them in particular by simplifying the filing process and introducing a procedure for patent oppositions to combat counterfeiting. Essential national interests are protected by tightening the controls on foreign investments in France, strengthening the powers of the Minister of Economy where a foreign investment that is subject to prior authorization has been made without such authorization, and by reinforcing the "golden share" held by the State in the capital of strategic companies, which allows sensitive assets to be controlled.

3. Promoting fairer businesses

In order to promote more responsible capitalism, the PACTE Act introduces a number of measures to promote greater social responsibility in businesses:

- consecrating the notion of corporate interest (*intérêt social*) in the new Article 1833 (2) of the French Civil Code, and allowing companies to set out their *raison d'être* in their by-laws;

- encouraging social responsibly business by creating "mission businesses" (*entreprises à mission*) which are commercial companies that have a *raison d'être* and are required to pursue social and environmental objectives;
- developing **employee savings schemes** by abolishing employer payroll charges (*forfait social*) for companies that have fewer than 50 employees on all amounts paid by the employer into an employee savings scheme (*dispositif d'épargne salariale*), as well as for companies having fewer than 250 employees on all amounts paid by the employer into an incentive scheme (*accord d'intéressement)*. The law also encourages employee share ownership by increasing the maximum discount allowed on company shares and providing the possibility of transferring capital gains by shareholders to employees. The law also creates new ways of promoting employee savings, such as a system of unilateral contributions by the employer to employee shareholding funds as part of an employee savings plan;
- increasing **employee representation** on the board of directors of *sociétés anonymes* and *sociétés en commandite par actions*, by requiring the appointment of at least two representatives when the board has more than eight members (instead of twelve previously), and a single representative for boards of eight or fewer members (instead of twelve previously);
- strengthening the representation of employee shareholders on the boards of directors or supervisory boards of *sociétés anonymes;*
- strengthening **gender parity** by requiring balanced representation in the management positions of *sociétés anonymes* and *sociétés en commandite par actions*;
- for listed *sociétés anonymes* and *sociétés en commandite par actions*, new corporate governance reporting requirements on executive pay;
- relaxing the rules on the representation of nonresident shareholders of French companies, and improving the identification of holders of bearer securities by listed issuing companies;
- regulating proxy advisors.

Successive alerts will focus on these topics in the coming weeks. The first alert is on the following theme:
Management of companies based on their interests and, potentially, their "raison d'être."

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Before the enactment of the PACTE Act, the French Civil Code provided only that "Every company must have a lawful purpose[1] and be incorporated in the common interest of the shareholders." The PACTE Act enshrines a principle that has been developed by case law by adding the following provision to article 1833 of the French Civil Code: "The company is managed in its corporate interest...." Further, the company must take into consideration "the social and environmental issues related to its activity."
Lastly, the amendment of Article 1835 of the French Civil Code allows companies to specify their *raison d'être* in their articles of association. According to parliamentary debates, this *raison d'être* is "comprised of the principles that the company adopts and will allocate resources to uphold in the conduct of its business."
These provisions came into effect the day after the Act was published in the Official Gazette of the French Republic, on May 24, 2019.

I. Management of the company in its corporate interest

Article 1833 of the French Civil Code: "Every company must have a lawful purpose and be incorporated in the common interest of the shareholders. The company is managed in its corporate interest, while taking into account the social and environmental issues related to its activity."

1. A qualified consecration of the notion of social interest

The PACTE Act enshrines the notion of “corporate interest”, which has been developed by case law. However, the law does not define this concept, as according to its recitals, “the notion’s application is based on its broad flexibility, which means it cannot be constrained by pre-established criteria.”

As for sanctions for failing to comply with the new provisions of Article 1833, amendments have been made to Articles 1844-10 of the French Civil Code and
L. 235-1 of the French Commercial Code to remove violations of the corporate interest as grounds for the company's nullity (L., Art. 169). Consequently, a management decision that breaches the company’s corporate interest cannot in any circumstances lead to the company’s charter being declared null and void.

However, the relevant decision may be invalidated insofar as it violates a mandatory provision, and an executive officer may be held liable on the basis of the rules traditionally applied before the PACTE Act was adopted:

- **liability towards the company and its shareholders**: a breach by an executive officer of the company’s corporate interest may lead to that officer being held liable for mismanagement. It could even lead to a "political sanction", in the form of the executive officer being dismissed, insofar as failure to comply with the provisions of Article 1833 (2) of the French Civil Code could be considered as grounds for dismissal;
- **liability towards third parties**: the Commercial Division of the French Supreme Court has traditionally held that no wrongdoing can result in the executive officer incurring civil liability, unless such wrongdoing is distinct from the exercise of such officer’s duties.

2. Taking account of social and environmental considerations

The wording of Article 1833 (2) of the French Civil Code provides that the company is managed in line with its corporate interest "while taking into consideration the social and environmental issues related to its activity". The legislator provides no definition of “social and environmental issues.” Insofar as these issues are to be considered within the context of the company’s activities, an in concreto analysis is required, explaining why no definition was included in the legislation.
No management decision should be made without first taking into account the relevant social and environmental considerations. However, it is not a question of subordinating the decision to such considerations: the PACTE law establishes an obligation to take social and environmental issues into account, not to prioritize them. A decision with negative social and environmental consequences may thus be validly adopted if it is in the interests of the company (Legislative Editions, Permanent Dictionary Business Law, Bulletin, June 2019).

II. The ability to specify the company's raison d’être in its by-laws

Article 1835 of the French Civil Code: "The by-laws must be established in writing. In addition to determining the contributions made by each shareholder, they set out the form, corporate purpose, name, registered office, share capital, and term of the company, and the rules governing how it functions.**The by-laws may specify a *raison d’être***, comprised of the principles that the company adopts and will allocate resources to uphold in the conduct of its business.”. The new Article 1835, applicable to all companies, introduces the notion of the *raison d’être* of a company. Changes specific to *sociétés anonymes* have also been made to require the board of directors or management board to take the company’s *raison d’être* into consideration
(Art. L. 225-35 and L. 225-64 of the French Commercial Code, as amended.).

1. Definition of *raison d’être*

As is the case for the notion of corporate interest, no definition of *raison d'être* has been provided by the legislation. "The *raison d'être* (is) the expression of what is essential to fulfil the company's corporate purpose" (Notat-Senard Report). The raison d'être is the statement of the values that the company intends to promote in the achievement of its corporate purpose.

2. The legal regime applicable to the *raison d'être*

- **non-mandatory**: The PACTE law does not oblige companies to insert a provision in their by-laws setting out their *raison d'être*. The *raison d'être*, if adopted, can be amended or removed. The Notat-Senard report gives the impression that a *raison d'être* necessarily involves the public interest, touching on the environment, social relations, consumer well-being and even humanity; but nothing prevents a company from "coming clean" and clearly stating that its *raison d'être* is, for example, the pursuit of profit (Editions Francis Lefebvre, BRDA 10/19). Since the adoption of the PACTE law, some companies have already included or intend to include a raison d'être in their by-laws[2].
- **where to insert the raison d'être**: Article 1835 of the French Civil Code advocates including the raison d'être in the company's by-laws, which will give the shareholders the opportunity to decide on any change in the policy or strategy of the company in which they have invested funds. In this case, the CSE (Comité économique et social), if one exists, must be informed and consulted, as the adoption of a raison d'être affects the company's strategic orientation (Article L. 2312-24 of the French Labor Code). The ability to insert a raison d'être in the by-laws goes hand in hand with the freedom to include it elsewhere. It is also conceivable to include the raison d'être in a shareholders agreement, thereby avoiding the publicity that would come with including it in the by-laws, or to limit it to the legal or economic documents, such as the Company Charter, the Reference Document (*document de reference*), statements made by managers, etc., that the company publishes. Indeed, the further the raison d'être is from
  the by-laws, the lower the risk of undesirable legal consequences.
- **the theoretical legal effects of the *raison d'être***: For the company, including a *raison d'être* in the by-laws imposes an obligation on the company to comply with that vision (EC Opinion Report, p. 39). As a result, if a third party suffers a loss as a consequence of any breach of the *raison d'être* the company could be liable to it. Such third party could also enforce the relevant provision in the by-laws against the company, in order for example to annul an act that affects that third party. (Comp. Cass. 3e civ., June 14, 2018, no. 16-28.672). On the other hand, the invalidity of corporate decisions and resolutions may not result from a violation of the *raison d'être* (Article 1844-10 of the French Civil Code and L. 235-1 of the French Commercial Code). Further, companies that offer their securities to the public run the risk of incurring administrative sanctions for issuing inaccurate information if the operation - such as a share capital increase or issuance of debt securities - is presented as intended to contribute to achieving the company's *raison d'être*, if in fact the aim of raising the funds is unrelated to that purpose. For **executive officers** and for ***sociétés anonymes*** it is expressly stated that the board of directors and management board are required to take the company's *raison d'être* into consideration if it is defined in the by-laws (Arts. 225-35 and L. 225-64 of the French Commercial Code). This can potentially lead to the executive officers being liable for any breaches of this provision.
- **the practical legal effects**: In the vast majority of cases, it is likely that the raison d'être will be expressed in general terms, without quantified or measurable objectives. In such cases, the legal risks arising from the *raison d'être* appear, in practical terms, to be more limited.
  On the other hand, if the *raison d'être* is expressed through quantified objectives (for example, a commitment to devote a certain percentage of profits to precisely defined humanitarian actions), there are real legal risks if the objective is not met.

[1] Or « Objects » in English law.

[2] Atos: "At Atos, our mission is to help shape the information space. With our skills and services, we support the development of knowledge, education and research through a multicultural approach and contribute to the development of scientific and technological excellence. All over the world, we enable our clients and employees, and more generally as many people as possible to live, work and progress sustainably and in confidence in the information space."
Carrefour: "To offer our customers quality services, products and food that are accessible to all through all distribution channels. Thanks to our employees' expertise, a responsible and multicultural approach, our local roots and our ability to adapt to production and consumption patterns, we aim to be the leader in food transition for all."

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