

## DEVELOPMENTS IN FRENCH LAW ON DISCLOSURE AND TRADING OF SECURITIES

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### 1. Introduction

The Commission des Operations de Bourse (COB) is the regulatory agency of the French securities market. Two important characteristics of the Commission give it considerable flexibility in regulating the securities market. First, the COB is not subject to statutory or administrative limitations on the amount of time it may take to act upon applications. A delay of eighteen months in responding to an issue permit application has been held to be reasonable [1]. Second, the COB is not a legal person and thus, like the Commission de Contrôle des Banques [2], it cannot be held directly liable for its decisions. Instead, liability falls, if at all, on the state. The state, however, accepts liability for the acts of administrative agencies only in the event of serious offenses, that is, major offenses which a reasonable person would not have committed. The courts define such offenses very narrowly, and have upheld the COB even when that agency has reversed itself [3].

### 2. Disclosure required from companies

Recent EEC and French administrative decisions have encouraged corporations to disclose more fully their financial condition and securities activities by coordinating the publication of prospectuses, requiring disclosure of data on “the future of the company” and the regulation of all listed and unlisted securities, and encouraging the release of annual reports and information bulletins. Despite this trend toward greater disclosure, the French criminal code continues to prohibit dissemination of corporate “secrets” by corporate managers, agents, representatives, and employees.

On March 17, 1980, the Council of the EEC adopted a directive to coordinate prospectuses published for the purpose of registering securities on

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European stock exchange lists. As a result of this directive, French securities issuers must now reveal certain information in addition to that already required by the COB, for example, the aggregate amount of fees paid to financial agents and the interests (fees, benefits in kind, current loans, etc.) held by each category of managers in the company [4].

Domestically, the COB requires disclosure of "data on the future of the company". Companies must distinguish between (1) the orientation of the company's activity and its investment programs, for which detailed information is required, and (2) a forecast of future activity and results, for which the COB recommends a conservative, long-term approach. In its Annual Report, the COB commented:

The Commission considers that it should be up to the companies themselves to decide in what form they will present their prospects, and how often this should be done; but it emphasizes the fact that once they have made their decision, they must adhere to the two principles of consistency and coherence in the concepts used. It would, in fact, be regrettable, and doubtless against the company's own best interest in the end, if it were to confine its information to the favorable elements of the financial data [5].

When describing future prospects, managers must avoid any ambiguity in the terms used. For example, it is insufficient to refer to "improved results"; the disclosure statement must specify whether its projections address "operating results" or "gross results". The COB also requires statistical forecasts to be realistic [6].

The COB has recently emphasized the importance of having registered companies provide regular and usable reports to their shareholders. Although only the shareholders of a company have the legal right to demand an annual report, the COB recommends that a report be sent to anyone who asks for it, since the condition of registered companies is also of interest to potential shareholders [7]. In cases of repeated, negligent delays in publication of regular information bulletins, the COB does not hesitate to refer matters to the public prosecutor's department [8].

The COB is also concerned with the form and content of annual reports. For example, in 1977 the COB published a recommendation relating to the disclosure of information on the distribution of capital. It is worth noting that within two years, about one-half of the registered companies had integrated the recommendation into their annual reports [9]. The COB has emphasized the need for rapid and synchronized dissemination of information in order to preserve equal access to information [10].

The COB also hopes to institute a system that would permit companies to adjust accounts in times of price variation [11]. A similar system is used in English-speaking countries where, in addition to traditional balance sheets, appendices are published showing inflation-adjusted accounts.

Finally, as a result of the 1982 Finance Act, all listed and unlisted securities

– shares, debentures (other than bonds issued before the implementation of the Act and redeemable by drawings), and founder's shares, if any (irrespective of their form, whether personal or bearer) – must be registered in the records of the issuing company or of an authorized broker. The latter option is available only to listed companies and to those on the special register of unquoted companies [12]. This measure will come into force eighteen months after the publication of the decree implementing the Act.

The COB's attitude toward domestic commercial disclosure is balanced, however, by the French penal code's prohibitions on the transfer of certain commercial information by French citizens, residents, and businesses to foreign public authorities. If the information is deemed to endanger the sovereignty, security, public order, or essential economic interests of France, the informer could face two to six months in prison or a fine of 10,000–120,000 French francs.

### **3. Auditing**

If an auditor conducts his inquiry with insufficient care, the client and its associates are deprived of a statutory guarantee. Such auditing errors give rise to a cause of action for negligence which may result in a judgment of monetary damages [13]. In a recent case, the chairman of the board of directors of a limited company arranged to transfer to his personal account a sum of money deducted from a loan granted to the company. The company's auditor was found guilty of giving misleading information and failing to disclose criminal activities to the public prosecutor. The court reasoned that the auditor had caused a loss to the company, which had paid interest on the diverted sum, by confirming the false information [14]. The court ordered the auditor to pay the company a sum corresponding to the interest due on the money withdrawn by the chairman.

### **4. Marketing securities**

A recent COB study shows that the use of commissioned underwriters nearly doubles the cost/gross proceeds ratio of capital securities issues. The cost borne by private companies tapping the public for funds has averaged 2.6% of gross proceeds for capital increases without underwriting commissions, but escalates to 4.9% for those with underwriting commissions. The figures should be compared to the 3.6 and 4.3% average costs found in the study for traditional and convertible loans, respectively [15].

Two opinion polls, one involving the general public and the other involving company directors, were conducted in October 1979 at the request of the

stockbrokers' association (Compagnie des Agents de Change). The polls indicated that, if the general public had better information about the stock exchange, four out of ten Frenchmen might be interested in trading in securities. This would have doubled the number of Frenchmen then dealing on the stock exchange. On the whole, French investors considered investment on the stock exchange profitable, but they felt both ignorant of the exchange system and incapable of learning more about it. Eighty-five percent of the company managers supported opening capital investment in their companies to a larger segment of the public, although half of them feared that this would result in a loss of control. Nonetheless, the stock exchange remains a closed world; seven persons out of ten stated they had never been advised by their banks to invest savings in securities and that they had never tried to find out about the activities of the stock exchange [16].

The gross value of issued securities reached 131,700 million French francs in 1981 (106,900 for funds and 24,800 for shares) [17]. By the end of 1981, laws regulating 529 general purpose investment pools had been approved by the COB [18].

## 5. Insider trading

In 1979, the criminal court of Paris handed down two convictions for insider dealing. The COB referred four people to the public prosecutor on the same count [19].

## 6. The purchase of controlling interest

The COB is taking a greater interest in the means by which controlling interests are acquired. The COB had to apply stipulations regarding concurrent competitive takeover bids and counterbids four times during 1979. While a series of precedents is being established in this area, the COB refuses to formulate a detailed code which, it argues, would lack flexibility [20].

The tender offer has recently been introduced into French law and is being used with greater frequency. The COB hopes that, following the example of the United States and Great Britain, tender offers will allow a wider participation by individual shareholders, under procedures to be developed by the offeror and the stockbrokers' association [21].

Recent developments require notice to the public of the acquisition or transfer of controlling interests. Section 204 of the general rules of the stockbrokers' association requires that any transaction bearing on a controlling interest appear as a notice in the *Bulletin of Market Prices* for the day the transaction takes place. Notice must disclose the identity of the buyer and

seller, the date of the transaction, the price at which it was effected, and the number of shares involved. In order to insure equal treatment of shareholders by giving all shareholders the opportunity to sell shares at the same price as the major shareholders, notification must also show the period during which the buyer offers to purchase shares on the market, as well as the price at which the purchases will be made. This information usually is reprinted in newspapers and sent by banks to their customers without delay.

The rules of the stockbrokers' association were recently affirmed in a decision of the COB and an order by the Minister of the Economy. As a result, any legal entity, individual person, or corporation who comes to own, directly or indirectly, one-tenth, one-third, or one-half of the capital of a company whose securities are registered on the official list or on the unquoted companies special section, must give notice of his shareholding to the brokers' *Chambre Syndicale*, which informs the public [22].

The COB requests disclosure of two kinds of information from the purchaser of a controlling interest. First, concurrent with notification in the *Bulletin*, the purchaser of a controlling interest should publish a communiqué on his goals and his reasons for the transaction. Second, once the transaction is completed, the purchasee should make public the number of shares acquired during the period when he maintained his bidding price and the new distribution of capital after the operation [23].

In the case of a transfer of controlling interest involving an option (the seller being obliged within a period of one to three years to either return the cash payment or to demand the payment of any balance outstanding), the purchaser must maintain his bidding price for fifteen sittings of the stock exchange. The COB states that the bidding price requirement is tolled by the date of the signing of the contract, not by the date of completion of the transaction [24].

The COB also oversees the pricing of securities. The seller of a controlling interest grants the purchaser a guarantee as to liabilities. The COB has concluded that a thorough examination of the risks involved in implementing such a guarantee may justify a price difference [25]. However, the COB has decided that the commissions and fees paid to the intermediaries who bring together a seller and buyer for the purpose of creating a controlling interest may not be used to justify the offering of a lower price to minority shareholders [26].

## 7. Invitation to the public

It has recently been held that the printing of articles by a "société civile" in a paper promoting subscriptions published by an association of telecommunications users is an invitation to the public for funds, even though these subscriptions were open only to members of the association [27]. The court

noted that resorting to advertising was, in itself, indicative of the absence of personal contact between the company and the prospective subscribers. In addition, the court noted that the association had a large membership, with the only requirements for membership being use of public utilities and payment of a fee. The regulations on invitations to the public for funds apply to the issuance of securities and to the incorporation of a company, as well as to the resale of already issued and subscribed securities [28].

## **8. Companies trading in their own securities**

The conditions under which registered companies are allowed to purchase their own securities in order to regulate their price have been changed.

These companies must now:

1. register on the official list or on the unquoted companies section;
2. own not more than ten percent of the total of their own securities or more than ten percent of any specific class of securities [29].
3. possess reserves, in addition to the statutory reserves, amounting to at least the total value of the securities they own [30].

Additionally, the purchase of securities may not produce a reduction of the net assets to a level below that of the sum of the capital and the non-distributable reserves [31].

Prior authorization by the shareholders at their annual meeting is required to establish the details of the transaction (price, quantity, timing). In addition to the price ceiling determined by the shareholders, the maximum purchase price can in no case be more than “the average initial price quoted for the thirty previous stock exchange sessions on the futures market or the spot market, wherever the stock was traded. This price may be adjusted to take into account the coupons and rights which may have been detached during these thirty sessions or after the thirtieth” [32]. The resale price cannot be less than that determined by the shareholders, nor less than the average initial price of the thirty preceding stock sessions, this average being determined in the same way as the purchase price [33].

Securities acquired by the company in violation of the above stipulations must be sold within a year of their purchase; otherwise, they must be cancelled [34]. Furthermore, the chairman, directors, or managers (or the members of the management committee) who purchase or sell securities in the company’s name without abiding by the statutory stipulations, are subject to a fine of 2,000–60,000 French francs [35]. For the purpose of regulating security prices, companies must notify the COB of the transactions they plan to make and must provide an account of the purchases they have completed [36]. The Commission may require any explanation of evidence it deems necessary [37].

If these requirements are not complied with, or if the Commission notices irregularities in the company's transactions, it may request the brokers' *Chambre Syndicale* to take all necessary measures to prevent stock exchange orders received directly or indirectly from the company from being carried out [38].

## **9. Reissuing debentures**

A company which issues a debenture may alter the conditions of the issue by substituting another person for the original debtor. Procedurally, a ruling must be submitted to a special meeting of the bondholders and endorsed by the court (*Tribunal de grande instance*). In a recent case where the new debtor was a foreign company, the COB requested and was granted assurances that the original debtor would continue to guarantee the bond issue [39].

## Notes

- [1] Judgment of April 5, 1979, Trib. admin., Paris, 1980 Dalloz I.R. 389.
- [2] *Id.* See also Judgment of February 12, 1960, Conseil d'état, 1960 Lebon 107.
- [3] Judgment of April 5, 1979, Trib. admin., Paris, 1980 I.R. 389.
- [4] COB, Bulletin, April 1980, at 5.
- [5] COB, 1979 Annual Report.
- [6] COB, Bulletin, July 1980, at 4.
- [7] COB, 1979 Annual Report.
- [8] *Id.*
- [9] *Id.*
- [10] *Id.*
- [11] Symposium of December 2, 1980, *published in* COB, Bulletin No. 133, January 1981, at 3.
- [12] Section 94 of the 1982 Finance Act, December 30, 1981.
- [13] Judgment of November 15, 1979, Trib. gr. inst., Le Havre, 1980 Bulletin des Commissaires aux comptes at 44.
- [14] Judgment of January 14, 1980, Cour de Cassation, 1980 B.R.D.A. No. 12 at 17.
- [15] COB, Bulletin No. 143, December 1981, at 4.
- [16] *Banque*, January 1980, at 106.
- [17] COB, Bulletin, February 1982, at 12.
- [18] *Id.* at 15.
- [19] COB, 1979 Annual Report.
- [20] *Id.*
- [21] COB, Bulletin, October 1980, at 3.
- [22] Decision of the COB, March 17, 1981; Order of the Minister of Economy, April 1, 1981; COB, Bulletin No. 136, April 1981, at 33.
- [23] COB, Bulletin No. 127, June 1980, at 4.
- [24] COB, Bulletin, February 1980, at 5.
- [25] This rule does not apply in the case of a deferred payment to the seller of a controlling interest, for which specific provision are made by law.
- [26] COB, Bulletin, December 1980, at 6.
- [27] Judgment of July 3, 1980, Trib. corr., Paris, 1981 B.R.D.A. at 11.
- [28] Judgment of January 20, 1981, Trib. gr. inst., ST. Nazaire, COB., Bulletin No. 134, February 1981, at 3.
- [29] Law of July 24, 1966, art. 217-3 al.1.
- [30] *Id.* at art. 217-3 al.3.
- [31] *Id.* at art. 217-3 al.2.
- [32] *Id.* at art. 217-2 al.3.
- [33] *Id.* at art. 217-7.
- [34] *Id.* at art. 217-7.
- [35] *Id.* at art. 454-1 al.1.
- [36] *Id.* at art. 217-5 al.1.
- [37] *Id.* at art. 217-5 al.2.
- [38] *Id.* at art. 217-5 al.3.
- [39] COB, Bulletin, April 1980, at 9.