

**POISON PILLS IN A COMPARATIVE PERSPECTIVE**  
**TILL LEFRANC**

The purpose of this memorandum is to provide a brief overview of the main differences between the French and the American poison pill devices<sup>1</sup>. The French Commercial code was amended in 2006 in order to make poison pills possible in France. Only two months after these corporate law amendments, the general meeting of fifteen large companies gave its board authority to adopt such a poison pill device.

From a comparative point of view, it will be interesting to see how the poison pill device is used in the French system. Within this context, it is important to note the significant differences that exist between French and American poison pills<sup>2</sup>:

**1. A Statute was Necessary to Make Poison Pills Possible**

Independent of any takeover context, it was already possible for French shareholders to give their board authority to issue additional stock. However, *l'autorité des marchés financiers*, the French regulatory authority, refused to affirm the legality of a rights plan because of a general securities law principle under which a target company should not be allowed to unilaterally increase the offering price in the *Sanofi-Plafix* case in 2004.

Until the implementation of the new law, the validity of any poison pill device was uncertain because the French regulatory authority maintained that such a device would necessarily conflict with this securities law principle. In France therefore, unlike in the state of Delaware, Parliament had to intervene in order to make defensive rights plans possible.

Poison pill rights plans were introduced into the French legal system by a law passed on March 31, 2006, which implements the 2004 European takeover directive and creates a new article L233-32 in the French Commercial code. This new article provides that:

Besides any other lawful defensive measure, a special meeting of shareholders may, by a simple majority vote, decide to issue rights to purchase additional shares of the company at a discount. The quorum requirement is 20% of the shares, and there is not any quorum requirement for the second meeting if the 20% quorum requirement is not met in the first meeting. The free rights are awarded to anyone who is a shareholder when the takeover period ends.

A shareholder meeting may also give the board of directors authority to issue rights. The shareholder meeting then sets the maximum capital increase that will occur when the rights will be exercised, and also sets the maximum number of rights that the board is allowed to issue. The shareholders may also indicate under what precise circumstances the board would be obliged to issue the rights, and under what circumstances the board would not be entitled to

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<sup>1</sup> This memorandum summarizes and translates three different papers: "Judicial Review of Poison Pills", French Corporate Finance and Capital Markets Law Review, January 2007 (co-authored with Christophe Clerc, Shearman and Sterling, and Louis Oudot de Dainville); "When Can Courts Invalidate a Poison Pill Device?", French Business Law Review, September 2007 (co-authored with Christophe Clerc and Louis Oudot de Dainville); and my 80-page paper "Control of French Rights Plans in a Comparative Perspective" ([http://www.u-paris2.fr/mja/etudiants/memoires/2007/Till\\_Lefranc.pdf](http://www.u-paris2.fr/mja/etudiants/memoires/2007/Till_Lefranc.pdf)).

<sup>2</sup> About those differences, see "Implementation in France of the Takeover Directive and the New French Poison Pill", Shearman and Sterling, April 6, 2006.

issue the rights. The target company's decision to issue rights must be disclosed to the public before the offering period ends.

A shareholder meeting, or the board if it has been given authority to do so, decides what type of bids will trigger the rights, and defines all other characteristics of the rights, such as the way in which the exercise price will be assessed. The rights lapse when the main bid and any other competing bids are unsuccessful or are withdrawn.<sup>3</sup>

## **2. The French Parliament Chose to Create Only a Flip-In Device**

L233-32 enables a majority of stockholders to give their board authority to issue free rights to purchase shares of the target. It seems clear that the safe harbor created by the 2006 statute does not extend to flip-over devices.

## **3. Shareholder Approval is Required in Order to Put a Poison Pill in Place**

The rights can either be issued directly by the shareholders themselves, or by the board of directors but the board must have been given authority to do so by the shareholders. During the parliamentary debate, some representatives introduced a supermajority vote amendment<sup>4</sup>, but this amendment was ultimately rejected.

## **4. The Board Could Give Authority to the Chief Executive Officer to Decide Whether to Issue Rights or Not**

Legal scholars were initially unsure about whether the board could give authority to the CEO to decide to issue defensive rights<sup>5</sup>. In practice however, such a grant of authority

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<sup>3</sup> My translation. The original wording is:

Sans préjudice des autres mesures permises par la loi, l'assemblée générale extraordinaire de la société visée, statuant dans les conditions de quorum et de majorité prévues à l'article L. 225-98, peut décider l'émission de bons permettant de souscrire, à des conditions préférentielles, à des actions de ladite société, et leur attribution gratuite à tous les actionnaires de cette société ayant cette qualité avant l'expiration de la période d'offre publique.

L'assemblée générale peut déléguer cette compétence au conseil d'administration ou au directoire. Elle fixe le montant maximum de l'augmentation de capital pouvant résulter de l'exercice de ces bons ainsi que le nombre maximum de bons pouvant être émis.

La délégation peut également prévoir la fixation de conditions relatives à l'obligation ou à l'interdiction, pour le conseil d'administration ou le directoire, de procéder à l'émission et à l'attribution gratuite de ces bons, d'y surseoir ou d'y renoncer. La société visée porte à la connaissance du public, avant la clôture de l'offre, son intention d'émettre ces bons.

Les conditions d'exercice de ces bons, qui doivent être relatives aux termes de l'offre ou de toute offre concurrente éventuelle, ainsi que les autres caractéristiques de ces bons, dont le prix d'exercice ou les modalités de détermination de ce prix, sont fixées par l'assemblée générale ou, sur délégation de celle-ci, par le conseil d'administration ou le directoire. Ces bons deviennent caducs de plein droit dès que l'offre et toute offre concurrente éventuelle échouent, deviennent caduques ou sont retirées.

<sup>4</sup> Hervé Novelli, Assemblée Nationale, Deuxième séance du jeudi 16 mars 2006 : "I think that the normal voting rule in a special meeting (two thirds of the voting shares) would better protect minority shareholders."

<sup>5</sup> Mr. Le Nabasque argued that the board should not be allowed to give authority to the CEO to issue rights, because "the new law doesn't follow the normal capital increase rules about shareholders' grant of authority to the board" (those general rules allow the board to give authority to the CEO).

has been allowed by shareholders. For example, as the grant of authority given by Suez shareholders states:

The general meeting, in compliance with the Commercial Code quorum and majority requirements, and after reviewing the auditors' and the board's reports:

1. Gives the board authority to issue rights to purchase one or more shares of the company at a discount, and gives the board authority to decide what type of bids will trigger the rights, and to define all other characteristics of the rights. The rights should be awarded to anyone who is a shareholder at the time the takeover period ends. The aggregated nominal value of the additional shares that can be issued should not exceed 2.7 billion euros, and the maximum number of rights that may be issued should not exceed the number of shares outstanding when rights are issued.
2. Decides that this grant of authority can only be used if the company is facing a hostile takeover bid.
3. Decides that the board, in accordance with the law, has complete discretion in implementing this grant of authority. The board can also give the CEO authority to implement shareholders' grant of authority.<sup>6</sup>

## **5. Shareholders' Grant of Authority to the Board is Valid for a Maximum of Eighteen Months**

The 2004 takeover directive provides for a "neutrality rule". This rule states that a board faced with a hostile takeover bid has to "obtain prior authorization from the general meeting of shareholders before taking any action, other than seeking alternative bids, which may result in the frustration of the bid"<sup>7</sup>. This neutrality rule means that a board faced with a hostile takeover threat cannot normally issue rights, even if it was given authority to do so by the shareholders before the hostile bid. However, the board can ask shareholders to vote again during the bid in order to issue rights directly or to grant the board authority to issue rights.

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<sup>6</sup> My translation. The original wording is:

L'assemblée générale, statuant en la forme extraordinaire aux conditions de quorum et de majorité prévues à l'article L225-98 de Code de commerce, après avoir pris connaissance du rapport du Conseil d'administration et du rapport spécial des Commissaires aux comptes :

- Délègue au Conseil d'administration sa compétence pour procéder, en une ou plusieurs fois, à l'émission de bons soumis au régime des articles L233-32 II et L233-33 de Code de commerce permettant de souscrire, à des conditions préférentielles, à une ou plusieurs actions de la société et à leur attribution à tous les actionnaires de la société ayant cette qualité avant l'expiration de la période d'offre publique ainsi que de fixer les conditions d'exercice et les caractéristiques desdits bons. Le montant nominal maximal des actions ordinaires qui pourraient être ainsi émises ne pourra dépasser le plafond de 2,7 milliards d'euros et le nombre maximal de bons qui pourraient être émis ne pourra dépasser le nombre d'actions composant le capital social lors de l'émission des bons.
- Décide que la présente délégation ne pourra être utilisée qu'en cas d'offre publique visant la société.
- Décide que le Conseil d'administration, avec la faculté de subdélégation, aura tous pouvoirs pour mettre en œuvre, dans les conditions prévues par la loi, la présente délégation.

<sup>7</sup> Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.

This being said, the 2004 directive does provide for a "reciprocity exemption" from the general neutrality rule if the hostile bidder does not apply the same neutrality rule or if the hostile bidder is controlled by a company which does not apply the same neutrality rule. This reciprocity exemption allows a French board to issue rights if it was given authority to do so by the shareholders less than 18 months before the bid<sup>8</sup>.

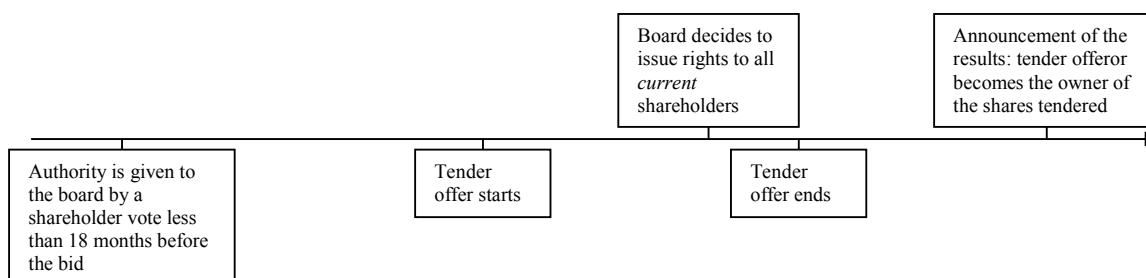
To sum up, there are only two situations in which poison pills can be put in place:

(1) The shareholder meeting takes place during the bid. In this context, it does not matter whether the reciprocity exemption applies or not, and shareholders can either give authority to the board to issue rights, or issue rights directly.

(2) The shareholder meeting takes place before the bid, and the shareholders give authority to the board to issue rights. This grant of authority is only valid for 18 months and can only be used if the reciprocity exemption applies.

## 6. The French Poison Pill is not Directly Discriminatory Against the Bidder

French poison pills are able to have a dilutive effect without discriminating against the hostile bidder because while the rights are announced during the bid, they are issued to all shareholders between the end of the tendering period and the settlement date. The amount of rights received by the bidder depends on the number of shares that he or she owns before the offering period ends, and does not depend on the number of shares tendered during the bid.



For example, assume that a company's stock is composed of 100 shares, each of them being worth \$1 on the market. A bidder owns 15% of the stock and makes a successful hostile bid to acquire 100%. The board decides to issue one right per share to purchase two additional shares for half of their price.

- In the United States, the bidder would have paid \$15 to acquire 15%. If the rights plan provided for a 15% threshold, the bidder's equity would get diluted when the shareholders exercise their rights. He would only own  $15 / ((85 \times 3) + 15) = 5,5\%$ . If, for the purpose of this example, we suppose that the market price remains the same after the rights are exercised, the bidder will have to pay \$255 to acquire 100% of the stock. If the \$85 paid by the other shareholders when exercising their rights remain invested in the target, the total cost of acquiring 100% will be  $15 + 255 - 85 = \$185$ .

<sup>8</sup> L233-33 of the Commercial Code.

- In France, the bidder pays \$100 to acquire 100 shares, but his equity holding gets diluted after this successful bid, and he in fact only owns  $((3 \times 15) + 85) / 300 = 43\%$ . He will have to pay \$170 more to acquire 100%. If the \$100 paid by the other shareholders to exercise their rights remain invested in the target, the total cost of acquiring 100% is  $100 + 170 - 100 = \$170$ . The \$15 difference with the United States example is due to the absence of discrimination in the French device.

## 7. Who is Going to Police the Use of Poison Pills?

The Commercial Code provision seems to allow the board of directors to make its company invulnerable to unfriendly takeovers by creating an almost impenetrable barrier to hostile bids. Corporate directors may have legitimate reasons for refusing an acquisition, such as finding time to obtain a higher price from a third party or protecting other constituencies like employees. However, company directors may also be acting out of self interest and use the poison pill to preserve their own positions to the detriment of shareholders willing to accept the hostile offer.

In such circumstances, a simple question emerges: who will regulate the poison pill device to prevent this type of conduct from happening? The *autorité des marchés financiers* would probably be the most appropriate institution to carry out this difficult task, but so far it has shown no interest in regulating the use of rights plans. Two other institutions could play such a role:

(1) The first institution could simply be company shareholders. In France, as we have seen, shareholder approval is specifically provided for by statute. The new poison pill always has to be approved by a general meeting of shareholders. Commercial code amendments give shareholders a significant amount of control over the poison pill device since it is the general meeting that determines the maximum number of rights that may be issued as well as the maximum amount of capital increase that will occur once the rights are exercised.

(2) Independent of shareholders, ordinary courts will also have to establish rules governing when company directors may use rights plans. Ordinary courts will have to regulate directors' conduct, and in doing so they will face the very same problems that have been dealt with by Delaware courts for more than twenty years.