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The impact of the reform of French contract law on M&A transactions

Introduced by Ordinance n°2016-131 of February 10, 2016, the French contract law reform has just entered into force. Even though much has already been said and written about it[1], the impact of the reform on M&A transactions remained to be studied.

Although not revolutionary (even if it codifies the theory of unforeseeability, long overlooked by the French legislator), this reform should be given credit for setting in stone principles mainly established by case-law, and for making French law more accessible, which non-legal professionals will undoubtedly highly appreciate.

This article is intended to highlight the provisions of Ordinance n°2016-131 of February 10, 2016 for the reform of contract law, the general regime of obligations and proof of obligations (the "Ordinance") that may affect M&A transactions.

1. Phase 1: Negotiations

1.1. Obligation to negotiate in good faith

New Article 1104 of the French Civil Code (the "FCC") stipulates that "*contracts must be negotiated* [...] *in good faith*". In the same vein, new Article 1112 of the FCC provides that "*the start, conduct [...] of pre-contractual negotiations [...] must imperatively meet the good faith requirement*".

Formerly limited to the contract performance phase[2], **the obligation to act in good faith now extends to the pre-contractual phase**. Yet, "good faith" is still not defined...

Still along the same lines, new Article 1112-1 of the FCC stipulates that "*the party who is aware of a piece of information which is decisive for the consent of the other party, shall inform such other party of the same insofar as the latter legitimately ignores such information or trusts its co-contracting party*", it being specified that:

- "*this duty to disclose information does not apply to information about the value of the services to be provided*",
- "*any information that has a direct and necessary link with the content of the contract or the status of the parties to the contract is critically important*",
- "*the parties to the contract are not permitted to limit or exclude this duty to disclose information*".

Any breach of this obligation is heavily sanctioned: "*in addition to imposing liability on the party who had the duty to inform, his failure to fulfil such duty may lead to cancellation of the contract*". If a complex transaction includes several sales, contributions and other corporate transactions, the unravelling can be quite risky…

In practice, in order to guard against the aforementioned risk, it would be advisable for the parties to **precisely define**, during the DD investigations that will be conducted upstream (as the case may be) and in the legal documentation that will be signed afterwards, **the information "*which is decisive*"**, in compliance with the above principles, as well as t**he terms and conditions governing the disclosure of such information**. Indeed, "*A person who claims that information was due to him has the burden of proving that the other party had the duty to provide it, and that other party has the burden of proving that he has provided it*"[3].

1.2. Duty of confidentiality

New Article 1112-2 of the FCC stipulates that "*a person who, without permission, makes use of or discloses confidential information obtained in the course of negotiations incurs liability under the conditions set out by the general law*".

This Article enshrines a well-established case-law and can be seen as the logical counterpart of the reinforced duty to disclose information referred to above.

The conclusion of a *NDA*[4] prior to entering into discussions should not, however, be excluded for, in practice, it will be also useful to **precisely define what is meant by "*confidential information obtained in the course of negotiations*", the terms and conditions governing the disclosure of such information, and the term of the duty of confidentiality**.

2. Phase 2: Offer, *pacte de préférence* (pre-emption agreement) and unilateral

promise

2.1. The Offer

Pursuant to new Article 1114 of the FCC, the offer must include "*the essential elements of the envisaged contract, and expresses the will of the offeror to be bound in case of acceptance. Failing this, there is only an invitation to enter into negotiation.*"

As such, **a mere non-binding indicative offer should not – subject to the terms and condition mentioned therein – be formally considered as an offer** and be governed by the new provisions applicable to offers.

New Articles 1115 and 1116 of the FCC further stipulate that the offer, as defined above, "*may be freely withdrawn as long as it has not reached the person to whom it was addressed*" and "*may not be withdrawn before the expiry of any period fixed by the offeror or, if no such period has been fixed, the end of a reasonable period*".

Here again, this is a codification of a settled case-law.

2.2. The pacte de préférence (pre-emption agreement)

Pursuant to Article 1123 of the FCC, "*where a contract has been concluded with a third-party in breach of a pre-emption agreement, the beneficiary of that agreement may obtain reparation of the loss he has suffered. Where the third-party was aware of the existence of the pre-emption agreement and of the beneficiary's intention to take advantage of it, the beneficiary may also bring an action for nullity or may ask the court to substitute him for the third-party in the contract that has been concluded.*"

Under the former legislation, the prevailing principle was the allocation of damages wherever the debtor failed to perform his obligation[5]. There was, however, a major exception to this rule: Since a famous ruling handed down on May 26, 2006 by the Mixed Chamber of the *Cour de Cassation* (French Supreme Court), the beneficiary of a pre-emption agreement had the right to require the nullification of a contract entered into with a third-party who was not aware of the beneficiary's rights and to be subrogated to the rights of the acquirer, provided, however, that at the time the contract in question was entered into, the third-party had knowledge (i) of the existence of the pre-emption agreement, and (ii) that the beneficiary of the pre-emption agreement intended to enforce his rights under such agreements.

This position is now confirmed. The innovation brought by the reform lies in the introduction of so-called **interrogatory actions** (*actions interrogatoires*) to the benefit of the third-party: Indeed, new Article 1123 of the FCC further stipulates that "*the third-party may give written notice to the beneficiary requiring him to confirm, within a period which the former fixes and which must be reasonable, the existence of a pre-emption agreement and whether he intends to take advantage of it. Such a written notice must state that if he does not reply within that period, the beneficiary of the pre-emption agreement will no longer have the right to claim*

either to be substituted in any contract concluded with the third party, or to bring an action for nullity of the contract."

2.3. The unilateral promise

Pursuant to new Article 1124 of the FCC, "*revocation of the promise during the period allowed to the beneficiary to exercise the option does not prevent the formation of the contract which was promised. A contract concluded in breach of a unilateral promise with a third-party who knew of its existence, is void*".

This text puts an end to conflicting views of French legal writers and scholars about the nullification of a promise during the option period, as it adopts a clear position that is contrary to that developed by French courts under a somewhat consistent case-law on that point[6]. Henceforth, **the revocation of the promise during the option period has no effect.**

3. Phase 3: Performance

3.1. Revision of the contract

New Article 1195 of the FCC stipulates that "*if a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party who had not accepted to assume the risk of such a change, that party may ask the other contracting party to renegotiate the contract.*"

While it was previously impossible as a result of the famous *Canal de Craponne* case[7], unless the parties had foreseen this possibility in a so-called MAC clause[8], **the occurrence of a significant event that is materially adverse to one of the parties between signing and closing can now be relied upon to request a rebalancing of the reciprocal services and commitments under the contract.**

Yet, MAC clauses should still have a bright future. Indeed, faced with such a vague text, it is clearly in the interests of contractual parties either (i) to define what is meant by "a *change of circumstances that was unforeseeable at the time of the conclusion of the contract [that] renders performance excessively onerous for a party*", or (ii) to expressly exclude the application of this provision.

3.2. Specific performance

Pursuant to new Article 1221 of the FCC "*the creditor of an obligation may, after having given formal notice to perform, seek specific performance unless performance is impossible or if there is a manifest disproportion between its cost to the debtor and its interest for the creditor*".

Under the former legislation, the *Cour de Cassation* sometimes admitted specific performance even where there was a manifest disproportion between its cost to the debtor and its interest for the creditor: In a specific case, the *Cour de Cassation* upheld the demolition and the reconstruction of a house, simply because of a delta

of 0.33 meter in the level of said house compared to the contractual specifications…[9] The French legislator adopted a pragmatic approach by limiting the use of specific performance as a remedy.

[1] Cf. in particular the article entitled "***French contract law reform: Consequences on contractual practices in distribution arrangements***" published in our July / August 2016 e-newsletter and the article entitled "***Reform of French contract law to take effect on October 1, 2016: Important changes that caught our attention***" published in our September 2016 e-newsletter.

[2] Former Article 1134 §3 of the FCC : "*they [i.e. agreements] must be performed in good faith*".

[3] New Article 1112-1 of the FCC.

[4] *Non-disclosure agreements*.

[5] Former Article 1142 of the FCC: "*any obligation to do or not to do results in damages, in case of non-performance on the part of the debtor*".

[6] Cf. in particular Third Civil Chamber of the *Cour de Cassation*, December 15, 1993, n°91-10.199: So long as the beneficiaries have not declared that they will acquire, the obligation of the promisor remains only an obligation to do, i.e. the exercise of the option after the withdrawal of the promisor, excludes any possible meeting of the parties' will.

[7] Civil Chamber of the *Cour de Cassation*, March 6, 1876, Gallifet vs. Cne de Pelissanne: The judicial judge may not amend the contract entered into between the parties because of a change of circumstances.

[8] *Material adverse change clause*.

[9] Third Civil Chamber of the *Cour de Cassation*, May 11, 2005, n°03-21.136.