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Related Party Transactions in France - A Critical Assessment

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Abstract

In France, the regulation of related party transactions (RPTs) involves three steps following the notification to the board of an RPT. First, the board gives its prior authorisation to the transaction. Those who are self-interested do not take part in the vote. Secondly, auditors prepare a report on RPTs. Thirdly, a general meeting of shareholders approves or rejects it. If the shareholders do not endorse the transaction, any adverse consequences will be borne by the interested insiders. The RPT can only be avoided if it was not approved by the board and is harmful to the company. This longstanding procedure has been designed to prevent company officers and substantial shareholders from using their power to influence a contract with the company on terms less advantageous than those that the company would have obtained from a third party in a fair and balanced negotiation. This rather burdensome procedure often proved artificial and ineffective. Anti-tunnelling laws may have been unproductive because demand for them and shareholder protection more generally had traditionally been low in a culture where top management was a closed club. However, the addition of AMF recommendations in 2012 and legislative modifications in 2014 have increased the quality and quantity of information passed on to auditors and shareholders. The implementation of the 2017 Directive on Shareholders' Rights may be the occasion to introduce further useful adjustments, such as a legislative clarification of the scope of French RPT law.

Keywords: related party transactions, corporate governance, France, tunnelling, conflict of interest

JEL Classifications: K22, G34

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INTRODUCTION

French law has long had a mechanism for scrutinising related party transactions (RPTs). The mechanism, known as *conventions réglementées* ("regulated conventions"), has been in place since 1863, with periodical amendments of which the most recent were introduced in 2014. It is enshrined in articles L. 225-38 to L. 225-43 of the Commercial Code, which apply to both listed and non-listed companies,[2] and is also supplemented by soft law provisions, including, for listed

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[2] These provisions relate to public limited companies (*sociétés anonymes* or "SA"). Similar provisions exist for other corporate forms, such as limited partnerships with share capital (*sociétés en commandite par action*) (article L. 226-10 of the Commercial Code) and private limited liability companies (*sociétés à responsabilité limitée* or "SARL") (article L. 223-19 of the Commercial Code). This chapter will focus on public limited companies, which can be organised under a one-tier model (board of directors) or a two-tier model

companies, recommendations of the French Market Authority, the *Autorité des Marchés financiers* (AMF). [3]

It should, however, be emphasised at the outset that in French law, transactions "within the ordinary course of business" are exempted from regulation, even where they would otherwise be considered as "related party" transactions. In this chapter, the expression "RPT" is confined to transactions that fall within the scope of the French regulatory framework.[4]

At present, there is no consensus on the effectiveness of French RPT law. Advocates of shareholders' rights argue that the law is ineffective to prevent abuse, and that criminal sanctions are not frequently imposed. Meanwhile, business associations argue in favour of less burdensome reporting requirements, requesting for instance a materiality threshold.[5]

The fact that French ratings are not particularly high in the World Bank's *Doing Business* report signals that RPT law has had limited efficacy. The 2017 report ranked France 32nd according to the investor protection index. France was ranked at the same level as Spain and Austria but far below the UK (6th), Northern European jurisdictions such as Sweden and Denmark (19th), Slovenia (9th), Ireland and Bulgaria (13th), and Cyprus and Croatia (27th). Nevertheless, this has not deterred institutional investors, including investors from the UK and the US, from buying shares in French listed companies: approximately 40% of the shares of the 40 largest listed French companies are held by foreign institutional investors.[6] Of course, these purchases may have been made at a discount, which limits the conclusions that could be drawn about the attractiveness of French companies for investors.

Regardless of the reason for investment, there has been international pressure on France to improve its RPT law. In 2012, a report by the OECD on *Related Party Transactions and Minority Shareholder Rights* compared several common law and civil law jurisdictions and pointed to

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(managing board and supervisory board). Rules applying only to listed companies will be introduced as such.

[3] These advisory recommendations, together with instructions and position memoranda, form part of the regulatory authority's "*doctrine*", which provides firms with guidelines on how to comply successfully with law and regulation. See a recent memo published by the AMF relating to the role and publication of its doctrine, available at http://www.amf-france.org/Reglementation/Doctrine/Principes-de-doctrine.

[4] Though executive compensations and deferred benefits are RPTs – along with the payement of a subsidiary's environmnental debt - they also follow additional specific rules and will not be covered in the Chapter.

[5] For an article discussing the ambivalent assessments of the regulation in place, see Pierre-Henri Conac, 'German-French Symposium on Company Law and Capital Market Law, July 3-4, 2014, Max Planck institute for comparative and international private law, Hamburg - Related Party Transactions in French Company Law' (2014) Revue Trimestrielle de Droit Financier n°3 26, 26.

[6] Alain Pietrancosta, Paul-Henri Dubois and Romain Garçon, 'Corporate Boards in France', in Paul Davies, Klaus J. Hopt, Richard Nowak and Gerard van Solinge (eds), *Corporate Boards in Law and Practice* (OUP 2013) 175, 179.

weaknesses in the French system.[7] The AMF also set up a working group which issued, in February 2012, a publication known as the *Poupart-Lafarge* Report on Shareholders' *General Meetings*,[8] suggesting various improvements to the rules related to self-interested transactions. The report directly inspired a recommendation on general meetings in listed companies that the AMF issued shortly thereafter.[9] Most notably, the recommendation included a definition of "indirectly interested parties", a concept that is not defined in the Commercial Code and has not been clarified by case law. In 2014, French legislature adopted some of the AMF's proposals, amending several articles of the Commercial Code relating to RPT law.[10]

This chapter emphasises the improvements that have been made to French RPT law as a result of the debates and reforms that took place in the early 2010s. In particular, the new requirement that the board must not only vote, but must justify its vote, has the potential to improve the quality of decision-making, as well as increasing transparency for shareholders, and facilitating enforcement against the board. In addition, the reduction of the scope of RPT law by omitting contracts with wholly owned subsidiaries is a welcome simplification that will make reports on RPTs more readable.

Beyond that, the evolution of RPT law reflects a deep change in French corporate culture. The foundation of modern corporate culture in France can be traced to the Viénot and Bouton reports in the early 2000s. Under the pressure of international scrutiny exemplified by the World Bank Group's *Doing Business* reports and OECD reviews, as well as structural evolutions such as the feminisation and internationalisation of boards, the increasing number of independent directors,[11] and the growing role of proxy advisors and activist bodies, French corporate governance is progressively breaking free from the deeply entrenched "club" culture

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[7] See Chapter 3 in OECD, *Related Party Transactions and Minority Shareholder Rights*, OECD Publishing, 2012, 61-74. The report is available at: www.oecd.org/ dataoecd/28/29/50089215.pdf.

[8] See P.-H. Conac, *Rapport du groupe de travail sur les assemblées générales d'actionnaires de sociétés cotées Groupe de travail présidé par Olivier Poupart-Lafarge, Membre du Collège de l'AMF*, 7 February 2012, Revue des sociétés 2012, p. 258.

[9] AMF Recommendation n° 2012-05 of July 2, 2012 commented and updated on February 11, 2015 and October 24, 2017. Latest version available at http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list/Doctrine?docId=workspace%3A%2F%2FSpacesStore%2F8d4c30c1-ea1d-445b-a2ba-e0ed3eab16bc&category=I+-+Emetteurs+et+information+financière.

[10] Ordinance n°2014-863 of 31 July 2014 relating to company law, adopted in application of article 3 of the law n°2014-1 of 2 January 2014 authorising the Government to simplify and secure the life of businesses, Official Journal 2 August 2014, p. 12820; Report to the President of the Republic regarding the Ordinance n°2014-863 of 31 July 2014 relating to company law, adopted in application of article 3 of the law n°2014-1 of 2 January 2014 authorizing the Government to simplify and secure the life of businesses, Official Journal 2 August 2014, p. 12814.

[11] For recent figures on the composition of listed companies' board, see 2017 report of Haut Comité de Gouvernement d'entreprise, 37-47. Available at http://www.medef.com/fr/content/rapports-dactivites-du-haut-comite-de-gouvernement-dentreprise-1.

that once characterized the top management of most French companies, and is, as a result, becoming more professional. In particular, conflicts of interest and tunnelling have now been recognized as issues that must be addressed.

Nevertheless, French RPT law still sometimes promises more than it can deliver for two main reasons. First, France has so far made little use of the "trusteeship" strategy.[12] The importance of independent third parties remains limited: involvement of independent experts, independent board members, and a more active role of auditors would directly improve the effectiveness of RPT law. Scepticism towards independent third parties may reflect a remaining trace of the traditional "club" culture in business. Secondly, the scope of the law lacks clarity. In particular, the regulations use the expressions "indirect interest" and "ordinary course of business" without defining them or providing guidance as to their limits. As a consequence, parties err on the side of error, which is not efficient.

The first part of this chapter will examine the legal framework governing RPTs that has developed as an *ex ante* and *ex post* procedure, and has progressively expanded its scope *ratione personae*.[13] The second part will offer a critical analysis, showing how the framework reflects a general evolution in French corporate culture towards professionalisation, and also how it falls short in some respects.

I. REGULATING RPTS

At first sight, the regulation of self-dealing in France seems well thought out, reflecting the lawmakers' deep understanding of the risks as well as the potential benefits of certain transactions involving insiders, and the desire to calibrate applicable legal rules to maximize the benefits and minimize the risks.

This part sets out the rules governing RPTs in France. It first describes French statutory requirements and the categorical prohibition of certain types of particularly risky transactions (Section A). It then moves on to discuss the spsecial rules that apply to listed companies and

[12] John Armour, Henry Hansmann, and Reiner Kraakman, Agency Problems and Legal Strategies in Reiner Kraakman et al., *The Anatomy of Corporate Law. A Comparative and Functional Approach* (3rd edn, OUP 2017) 2, 35.

[13] This Chapter will focus on self-dealing transactions, excluding contracts that involve insiders' remuneration: specific requirements apply to these transactions (the legislator introduced laws to cover golden parachutes and additional retirement benefits, which must be reviewed a final time before payment; see article L. 225-42-1 of the Commercial Code, as introduced by Loi n°2005- 842 of 26 July 2005 and as amended by Loi n°2007-1223 of 21 August 2007). These transactions are also less suspicious since they are necessary.

groups of companies (Section B), ending with a discussion of the rules relating to the imposition of liability for, or the setting aside of, improper transactions (Section C).

A. Authorisation and approval requirements

1. History

The first French law regulating self-dealing transactions dates back to 1863.[14] This law prevented directors from concluding any contracts whatsoever with their companies, except upon specific, prior authorisation by a majority vote of shareholders.[15] This restriction proved too inflexible. If a banker was sitting on a company's board of directors, shareholders' approval would be required for the banker's institution to finance the company's operations. The law was amended in 1867 to limit its scope to substantive transactions. General anticipatory authorisations by shareholders, followed by formal reporting by the board, were then also permitted.[16] The amended law, in turn, proved insufficient to protect shareholders,[17] and the rules governing self-interested transactions were modified again in 1935 requiring statutory auditors to issue reports on high-risk transactions.[18] The law was further amended in 1943: it introduced criminal sanctions for abuse of corporate assets and abuse of corporate power;[19] and required prior approval of self-interested transactions by the board of directors.[20] In 1966 a major change in the law was introduced, which laid the foundations of modern French corporate law.[21] While keeping in place the principle of board authorisation inherited from 1943, the new law introduced a distinction between transactions entered into the ordinary course of business (which were free from any control)[22] and other RPTs (which were regulated). This distinction

[14] Loi du 23 mai 1863 sur les sociétés à responsabilité limitée.
[15] The chair of the Parliamentary committee reporting on the proposed statute stressed that the provision was "an eminently moral and welcome innovation" whose rationale was that it was not advisable "that directors be placed in the difficult position of having to choose between their personal interests and those of the company." *Sirey, Lois annotées* 78.
[16] Loi du 24 juillet 1867 sur les sociétés commerciales, art. 40, Recueil Duvergier, p. 241.
[17] A board might, for example, merely inform the shareholders' assembly that "all authorized transactions took place under typical conditions and do not raise concerns". Paul Didier and Philippe Didier, *Droit commercial – Volume 2 Les sociétés commerciales* (Economica 2011) 593. It was noted that these authorisation rules were "without any practical value", *Lois actuelles et projets récents en matière de sociétés par actions* (Rousseau 1933) 497.
[18] See Décret-loi du 8 août 1935.
[19] Under Commercial Code Book Two, Title IV – Criminal provisions: Articles L. 242-6 and L. 242-30.
[20] Loi du 4 mars 1943 relative aux sociétés par actions, JORF, 6 March 1943, p. 642.
[21] Loi n°66-537 of July 24, 1966 on commercial companies.
[22] But for disclosure requirements - that were however abolished by Loi n° 2011-525 2011 17 May 2011. A bill released on June 18, 2018 and under discussion (Projet de loi relatif à la croissance et à la

was later codified in the Commercial Code[23] and still operates. The scope of the RPT regulation remained limited to agreements entered into by board members until 2001, when it was extended to significant shareholders.[24]

Following an empirical study based on questionnaires sent to various jurisdictions, the OECD published in 2012 a report entitled *Related Party Transactions and Minority Shareholder Rights*.[25] The chapter on France concluded that the AMF should "intervene more aggressively" to improve the information provided to shareholders. It should, for example, provide guidance on the type of information shareholders should be given to be able to evaluate RPTs, and require "the public issuance of independent expert opinions on material related party transactions in which minority shareholders raise questions about the true market value of a deal."[26] The OECD further suggested that the French legislature lower the ownership share threshold required for requesting an independent valuation (*expertise de gestion*) or fairness opinion; that any fairness opinions provided for board deliberations be disclosed to shareholders; and that the AMF consider issuing injunctions restraining transactions that appear to be "against the interests of the company."[27]

A report issued by the AMF in February 2012, entitled *Rapport sur les assemblées générales d'actionnaires de sociétés cotées*, but known colloquially as the *Poupart-Lafarge Report*, shared many of the suggestions held in the OECD report.[28] On this basis, the AMF also issued a set of recommendations, and French legislators subsequently amended the Commercial Code in 2014 to reflect a number of these. For example, the AMF recommended that the board of directors annually review any RPT with respect to its long-term impact for the company[29] and support its approval of RPTs with appropriate justification.[30] The 2014 Ordinance that modified the Commercial Code adopted both of these requirements.[31]

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transformation des entreprises, also known as Projet de loi PACTE) provides that shareholders may ask the list of the non-regulated transactions that the company entered in the ordinary course of business.

[23] Art. L. 225-38 to 225-43.

[24] See below n xxx

[25] OCDE, *Related Party Transactions and Minority Shareholder Rights*, OECD Publishing, 2012, available at https://www.oecd.org/daf/ca/50089215.pdf.

[26] Id., 72.

[27] Ibidem.

[28] Available at http://www.amf-france.org/Publications/Rapports-des-groupes-de-travail/Archives?docId=workspace%3A%2F%2FSpacesStore%2F47f2cbe5-5261-4601-857b-444c3b9ebe06.

[29] Proposal n°27 of the 2012-05 recommendation of the AMF.

[30] Commercial Code Art. L225-38, paragraph 4.

[31] Respectively, Art. L. 225-40-1 and Art. L. 225-38, paragraph 4 of the Commercial Code.

2. Current Rules

As the law currently stands, certain high-risk transactions remain subject to authorisation and approval requirements. Known as "*conventions réglementées*", these requirements cover transactions in which any officer, director, or shareholder owning more than 10% of outstanding shares is either a party[32] or has an "indirect interest"[33] (a relatively vague standard that has given rise to interpretive difficulties, as will be discussed in Part II below).[34] Prior authorisation and approval are also required for transactions between companies that have common directors or managers.[35] Typical examples of these include the subletting of office space, sponsorship agreements, and sharing of R&D expenses.

Exempt from prior authorisation and approval rules, however, are, amongst others, transactions entered into "within the ordinary course of business" ("*conventions portant sur des opérations courantes et conclues à des conditions normales*").[36] This exemption has created some interpretation problems in practice, as the following case illustrates:

The dispute in question centred around the ownership and management of the television network Canal Plus by its majority and minority shareholders: Vivendi (80% owner) and Lagardère (20% owner), respectively. According to Lagardère, Vivendi had abused its dominant position to its detriment by entering into a long-term loan agreement whereby Canal Plus would lend to Vivendi at a trifling interest rate (Euribor + 0.1%). Alleging that the loan agreement violated French RPT rules because Canal Plus had not secured prior board approval for the loan agreement, Lagardère sued Vivendi in the Paris commercial court (*tribunal de commerce*). In its defence, Vivendi alleged, *inter alia*, that the loan agreement was not subject to the RPT approval requirements because it had been entered into "within the ordinary course of business". Ultimately, the parties resolved their dispute through mediation, with Vivendi agreeing to buy

[32] The rule requiring approval for transactions with substantial shareholders dates from 2001. Statute nº 2001-420 of 15 May 2001. Originally, the rule applied to shareholders owning at least 5% of capital, but the threshold was increased in 2003 to 10%. Statute nº 2003-706 of 1 August 2003, article 123-1.

[33] Commercial Code Art. L. 225-38, paragraph 2.

[34] See below Section II.C.

[35] Commercial Code Art. L. 225-38, paragraph 3.

[36] Commercial Code Art. L. 225-39. Routine agreements between insiders and the company are exempt as long as they relate to current operations and are concluded under normal conditions. The 2001 Statute for New Economic Regulations (NRE), Loi nº 2001-420, required a list of such agreements to be drawn up in order to disclose it to the chair of the board. Though no specific action was required, the chair was thereby in a position to exercise oversight over agreements identified by conflicted insiders as routine ones. After 2003, this internal disclosure requirement was eliminated for agreements that, on the basis of their objectives or of their financial implications, were not significant for either party. The Statute of 17 May 2011, Loi nº 2011-525, abrogated the requirement entirely.

out Lagardère for 1.02 billion euros in cash. According to some observers,[37] the lawsuit by Lagardère was a clever—and successful—negotiating ploy to gain leverage and prompt a buyout by the previously recalcitrant Vivendi.

Without any legislative guidance as to the scope of the "ordinary course of business" exemption, it is difficult to formulate arguments either way as to whether a given transaction falls within it.

For transactions that require authorization and approval,[38] the procedure takes place in three stages. First, the transaction must be approved by the board: a majority of the "disinterested" members of the board of directors must approve the transaction.[39] (The question of which directors are truly "disinterested" gives rise to problems, as will be discussed in Part II below.) The newly-reformed Commercial Code requires the board of directors to justify its decision by explaining with clearly stated reasons how the transaction benefits the company, highlighting in particular the transaction's financial consequences.[40] The reformed Commercial Code also requires that this information be included in the statutory auditors' report to the shareholders.

Secondly, once board authorization is secured, the chairman of the board of directors must solicit a report from a statutory auditor (*commissaire aux comptes*), which is to be presented to the shareholders at the following annual general meeting.[41] The auditor's report must include information about any other self-interested transactions whose performance took place in whole or in part during the prior financial year, even if those transactions had previously been reported at the general meeting.[42] The report must provide all information that enables shareholders to assess the benefit of maintaining these agreements, including informing them on the extent of

[37] http://conciliationtcparis.blogspot.com/2015/04/laffaire-lagarderevivendi.html.
[38] Pursuant to studies conducted by the consulting firm Finexis in 2013 and 2014 (available at http://finexsi.eu/wp-content/uploads/2016/05/ConvRegl_141023.pdf) on the basis of information disclosed by the Paris Stock Exchange SBF 120 companies that comprises the 120 largest listed companies (by market capitalisation and trading volume) incorporated in France, about 750 RPTs are approved every year (including compensation agreements), among which 30% are new, and the number of RPT vary from 0 to 25 per company. RPTs are mainly entered into with managers or with a company that has a common board member or manager; RPTs entered into with a board member (e.g., consulting contracts) are less frequent.
[39] Commercial Code Art. L. 225-38.
[40] Commercial Code Art. L. 225-38, paragraph 4.
[41] Commercial Code Art. L. 225-40, paragraph 2.
[42] Commercial Code Art. L. 225-40-1.

the supplies or services purchased or sold, and the amount paid or received during the financial year in pursuance of these arrangements.[43]

Thirdly, the transaction must be ratified by a majority of disinterested shareholders.[44] If a majority fails to approve the transaction, it is nevertheless binding on the company, unless procured by fraud.[45] Shareholders may, however, sue members of the board and conflicted insiders for damages sustained because of the disapproved transaction.[46] And even if ratified, if the agreement results in harmful consequences, board members can be held liable for causing damage.[47] French shareholders do not always rubber-stamp transactions that have received board approval, as the following case illustrates.

In February 2009 the board of Gecina, a publicly-owned real estate investment trust, authorised the acquisition of a 49 percent stake in Bami Newco. The acquisition was completed in June 2009. RPT law applied since Gecina and Bami had directors in common and the chairman of Gecina's board, Joacquin Rivero, was a significant shareholder of Bami.[48] In June 2010, shareholders of Gecina were asked to approve the transaction at the annual general meeting. They did not.[49] Meanwhile, the Association for the Defense of Minority Shareholders (ADAM), together with a former Gecina director, had also contacted the AMF to lodge a complaint for misuse of corporate assets. In addition, the purchase was challenged in the civil court for liability purposes based on harm caused to Gecina.

3. Prohibited transactions

Some RPTs are strictly prohibited by French law. These include loans and guarantees by the company on behalf of an insider.[50] This rule constrains agents *ex ante*.[51] In effect, it removes the temptation for directors to "forget" to repay their loans and have the company forgive them. While loans do not appear any more suspicious than other conflicted contracts such as

[43] Similar rules exist for companies with a board of directors and a supervisory board. Commercial Code Art. R. 225-57, Paragraph 1, and Arts. R. 225-58, 59, and 60.
[44] Commercial Code Art. L. 225-40, paragraphs 2-4.
[45] Commercial Code Art. L. 225-41, paragraph 1.
[46] Commercial Code Art. L. 225-41, paragraph 2.
[47] Commercial code Art. L. 225-41, paragraph 2. Under the principle of separation and specialisation of corporate bodies, duties of the board cannot be discharged by shareholder vote.
[48] https://www.gecina.fr/sites/default/files/20100319-RapportFinancier2009_v22-03.pdf.
[49] https://www.gecina.fr/sites/default/files/Gecina_DRF2010_FR.pdf.
[50] Commercial Code Art. L. 225-43.
[51] This type of strict prohibition is uncommon, though two other major jurisdictions, the US and China, have fairly recently introduced a similar prohibition. See Enriques 2015.

consulting contracts, they are particularly unlikely to create efficiency benefits that could offset the risks they create.[52] However, the law permits loans to directors that are legal persons.[53]

By way of exception, if the company is a bank or a financial establishment and its routine activity is to provide loans or surety, insiders are allowed to contract with the company for that purpose, under normal commercial conditions.

B. Special rules for listed companies and corporate groups

In addition to these rules, French law contains special rules governing listed companies and groups of companies. Certain supplemental legal requirements are imposed on listed companies, while groups of companies are exempt from some otherwise applicable rules.

1. Listed companies

In French corporate law, the same provisions generally apply to both listed and non-listed companies. However, accounting rules and the AMF have gradually carved out specific requirements for listed companies.

First, companies whose shares or bonds are publicly traded are required, pursuant to the IAS 24 requirements, which are part of the International Financial Reporting Standards [54]to make semi-annual disclosures of all major transactions with related parties, as defined by accounting standards. The accounting definition is both more extensive (it targets transactions between controlled companies, even if they do not have common directors) and less inclusive (it includes a materiality threshold) than the legal domain of RPTs. In any case, these additional disclosures provide information and play a role in monitoring compliance with the approval procedure of RPTs. In addition, they put directors who authorise conflicted agreements under public scrutiny. Directors are therefore expected to act more assertively.

Secondly, since its inception in the mid-1960s, the AMF has actively shaped rules to enhance the integrity of the financial market. It has, especially since 2012, issued a number of recommendations to supplement the Commercial Code's authorisation and approval

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[52] Luca Enriques, Gerard Hertig, Hideki Kanda, and Mariana Pargendler, 'Related Party Transactions', in Reiner Kraakman et al., *The Anatomy of Corporate Law. A Comparative and Functional Approach* (3rd edn, OUP 2017) 145, 158.

[53] Commercial Code Art. L. 225-42.

[54] International Financial Reporting Standards were previously known as International Accounting Standards. Standards adopted prior to renaming, like the one dealing with related party transactions, have kept their previous name of International Accounting Standards (IAS) followed by the relevant number.

requirements discussed in the previous section.[55] For instance, the AMF has recommended that companies establish internal charters setting forth criteria for deciding whether a transaction is subject to RPT laws. Listed companies are encouraged to submit these internal charters to the board of directors and to disclose them to the public.[56] For RPTs significantly affecting the financial status of the company or its group, the AMF has recommended that the board of directors appoint an independent advisor.[57] The special report of the board must disclose to the public this independent fairness opinion (except for parts which might compromise business secrecy). Finally, companies typically bundle together multiple resolutions relating to RPTs, the AMF has recommended that separate resolutions for each significant RPT should be submitted to a shareholders' vote.[58] Soft law recommendations are influential in practice, because they can shape judicial assessment.[59] Judges can refer to them as corporate customary usages, and can also take these good practices into account to figure out the content of the standard they use in order to assess negligence in the corporate settings.

2. Intra-group dealings

A few special rules on intra-group RPTs apply, but there is no general regime. RPTs taking place within a corporate group have been largely authorized by the French Supreme Court through the *Rozenblum* doctrine.[60] This ruling permits, in particular, unbalanced transactions under certain conditions in recognition of the interest of the group, creating an affirmative defence to liability for abuse of corporate assets when four conditions hold : (1) there must be a group of companies characterized by capital links between the companies; (2) there must be strong, effective business integration between the companies; (3) financial support from one company to another company must have an economic *quid pro quo* and must not break the balance of mutual commitments between the concerned companies; (4) support from the company must not exceed its financial capabilities: it must not put the company at risk of

[55] On the active role of the securities regulator in the development of corporate rules, see Pierre-Henri Conac, 'La loi du 24 juillet 1966 sur les sociétés commerciales et le juge : la Cour de cassation prisonnière d'un fantôme ?' in Isabelle Urbain-Parléani and Pierre-Henri Conac (eds), *Regards sur l'évolution du droit des sociétés depuis la loi du 24 juillet 1966* (Dalloz 2018) 97, 102-4.
[56] Proposal n°20 of the 2012-05 recommendation of the AMF.
[57] Proposal n°25 of the 2012-05 recommendation of the AMF.
[58] Proposal n°32 of the 2012-05 recommendation of the AMF.
[59] V. Yves de Cordt, *Evolution et perspective du droit des sociétés* (Bruylant 2006) 68; Alain Couret, 'Les commandements de la gouvernance, in *Regards sur l'évolution du droit des sociétés* n 55, 149, 165-66.
[60] Court of cassation, Criminal Chamber, 4 February 1985, Rozenblum and Allouche, D. 1985, p. 478, n. D. Ohl, I-639, JCP 1986, II-20585, n. W. Jeandidier, Rev. Sociétés 1985, p. 648, n. B. Bouloc.

bankruptcy.[61] Furthermore, as anticipated by the 2012 AMF report,[62] the 2014 Ordinance exempted all agreements concluded with a wholly owned subsidiary from the range of regulated agreements.[63]

C. Redress for violation of procedural requirements

Violation of the rules discussed in Sections A and B can trigger criminal or civil liability, as well as the avoidance of transactions in cases where the company has suffered harm.

1. Criminal liability for abuse of corporate assets

French criminal law contains provisions against the abuse of corporate assets (*abus de biens sociaux*) that can be used in the context of RPTs.[64] These provisions apply to board chairs, directors and CEOs of listed and non-listed companies. They prohibit "using the company's property or credit, in bad faith, in a way which [the person] knows is contrary to the interests of the company, for personal purposes or to favour another company or undertaking in which [the person] has a direct or indirect interest."[65] The penalty is a prison term of up to five years and a fine of up to 375,000 euros. Criminal prosecutions can be initiated either by public prosecutors or by a minority shareholder acting in the name of the company (*action sociale ut singuli*). The criminal complaint must establish that it is "possible" that there has been damage to the company and that there is a link between the damage and the alleged wrongdoing.[66] This kind of claim is very attractive to minority shareholders, since once this relatively undemanding standard is met, the examining judge can access corporate documents at little or no cost to the shareholder. Moreover, prosecutors seem particularly willing to pursue these sorts of charges,

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[61] On this doctrine, see Trib. Corr. Paris, 16 May 1974, *Soc. Saint-Frères* (D. 1975, p.37, Rev. Sociétés 1975, p.657, n. B. Oppetit; JCP E. 1075, 11-11816, p.381); court of Cassation, Criminal Chamber, 4 February 1985 Rozenblum and Allouche (D. 1985, p.478, n. D. Ohl, Rev. Sociétés 1985, p. 648, n. B. Bouloc); Marie-Emma Boursier, 'Le Fait Justificatif de Groupe dans l'Abus de Biens Sociaux: Entre Efficacité et Clandestinité' (2005) 2 Rev. Sociétés 273.

[62] See above n 28, 34.

[63] Commercial Code Art. L. 225-39 and L. 225-87.

[64] Commercial Code Art. L. 242-6.

[65] *Ibidem*.

[66] Cass. Crim., 5 November 1991, *Société Industrielle et Financière Bertin* (Rev. Sociétés 1992, p.91, n. B. Bouloc). See also Eva Joly and Caroline Joly-Baumgartner, *L'abus de biens sociaux à l'épreuve de la pratique* (Economica, 2002), 288. Case law has long made it clear that the examining magistrate has a duty to investigate if he or she considers that this standard has been met. Cass. Crim., 8 December 1906 *Laurent Attbalin* (S. 1907.1.377 n. Demogue, D. 1907.1.207).

whose limitations periods are relatively long.[67] Judges also have interpreted the law broadly, imposing liability, for example, in the absence of a showing of intent.[68] And case law has clearly established that even RPTs authorised by the board and approved by the shareholders can be criminally prosecuted. Consequently, criminal prosecutions for corporate asset abuse are the most frequent white-collar criminal charge in France.[69]

The following story illustrates the role of French criminal law in controlling abusive self-dealing.

Jean-Luc Lagardère was the board chairman of Matra, a defence consortium, and of Hachette, a publishing company.[70] Matra and Hachette entered into a management and consulting contract with Arjil, a consulting firm whose board Jean-Luc Lagardère also chaired. Under the contract, Arjil was to consult in matters of human resources, finances, strategy, international development, organisation, corporate operations and image. The contract stipulated an annual fee equal to 0.20% of the turnover of the client, subject to revision in the case of a significant change in overall turnover. The boards of Matra and Hachette authorised the agreement, and the general meeting approved. But minority shareholders of Matra and Hachette, unhappy with the transaction, brought an *ut singuli* claim, asserting that the services were overpriced and that the contract amounted to an abuse of corporate assets. After 15 years of litigation, the Court of Appeal of Versailles[71] held that there had indeed been an abuse of corporate assets. The court noted that Arjil had no employees and was relying on external consultants or the employees of Matra and Hachette to perform the consulting contracts, and that the contracts appeared to be a means to provide Jean-Luc Largardère with additional remuneration. According to the court, "purely formal compliance with the approval procedure for regulated agreements (…) does not, on its own, mean that there has not been a breach of the

[67] The limitations period was extended from six to twelve years in 2017, Code Procédure Civile Art 9-1, introduced by Loi n° 2017-242 of Feb 27, 2017. Moreover, it begins to run only upon discovery of the misuse of assets, with the result that some convictions have been secured almost twenty years after the occurrence. Crim. 4 nov. 2004, n°03-87327.

[68] Court of appeal of Paris, Sept. 18 1996, Dr Sociétés April 1997, comm. 64, noted by D. Vidal.

[69] There are approximately 500 convictions per year under Commercial Code Art. L. 241-3, which applies to SARLs and creates criminal actions for abuse of corporate assets, abuse of power, fictitious dividend repartition and erroneous financial statements. There are approximately 300 convictions per year for similar offenses under Commercial Code Art. L. 242-6, which applies to SAs and SASes. For context, there are approximately 1.5 million SARLs and 50,000 SAs in France.

[70] These two companies later merged into Groupe Lagardère.

[71] Versailles Court of Appeal 30 Jun 2005, noted by Alain Lienhard, Recueil Dalloz 2005, 1942. Decision confirmed on that question by Cass Crim 25 Oct 2006 noted by Bernard Bouloc in Revue des Sociétés 2007, 146.

corporate interest, in particular where it is established that the manager has all the powers and is assured of the unconditional support of the majority of the main shareholders."[72]

As this case demonstrates, French criminal prohibitions against the misuse of corporate assets can amount to a useful backup for punishing self-dealing, particularly when authorisation and approval procedures fail.[73] Very few such charges, however, relate to listed companies, perhaps also because they have internal control mechanisms to prevent obvious misconduct.[74]

2. Civil liability

Corporate officers can also be held personally liable to a company or its shareholders for giving prior authorisation to a self-dealing arrangement that turns out to be contrary to the company's interest. In practice, though, such actions are quite rare, despite provisions enabling shareholders to appoint a special auditor to assist in obtaining access to evidence.[75] While individual shareholders have traditionally been able to sue directors on behalf of the corporation (*actions sociale ut singuli*),[76] derivative suits are uncommon.[77] The ban on contingency fees is part of the explanation, [78] but it does not help that plaintiff shareholders are at a procedural disadvantage in several respects. For instance, they may not know the details of the agreement and the company can always mobilise substantial material and financial resources in officers' defence.

[72] Translation by the author.

[73] The frequency of private and public prosecutions of RPTs in France seems to contrast with the dearth of such prosecutions in Italy, as reported by Bianchi et alii in Luca Enriques and Tobias Tröger (eds.), The Law and Finance of Related party Transactions (Cambridge University Press, 2019 forthcoming).

[74] The number of reported abuses may increase with the introduction of the Sapin II law (2016) on transparency, anti-bribery and modernization of the economy. This provides greater protection for whistleblowing and the reporting of corporate wrongdoing. Loi n° 2016-1691 du 9 décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique, JORF n°0287 du 10 décembre 2016.

[75] French law provides that shareholders representing at least 5% of the capital may, after having submitted a written question and received an unsatisfactory explanation, petition the court for the appointment of a business expert (*expert de gestion*) in order to gather information about business decisions (Commercial Code Art. L. 225-231). Since these business decisions can sometimes be motivated by directors' self-interest, appointment of a business expert can help uncover self-dealing. Using this procedure is convenient for the minority shareholder since the judge can compel the company to pay for the expert's compensation, which is not the case for the generally applicable procedure providing for the appointment of a pre-trial court expert (*expertise in futurum*) (Art. 145, French Code of Civil Procedure).

[76] Commercial Code Art. L. 225-252.

[77] See Yves Guyon, *Droit des affaires – Droit commercial general et Sociétés – Tome 1*, (Economica, 12th edn, 2003) No. 462 (stating that the 'action sociale ut singuli' is rarely exercised).

[78] This last factor is often identified as a main hurdle to shareholder litigation: see Pierre-Henri Conac, Luca Enriques and Martin Gelter, 'Constraining Dominant Shareholder's Self-Dealing: The Legal Framework in France, Germany and Italy' (2007) 4 ECFR 491, 509.

3. Avoidance of harmful transactions

In addition to civil and criminal liabilities discussed above, setting aside RPTs is the most direct form of redress. It can, however, only be granted if it is the case both that the RPT was entered into without authorization by the company's board of directors and that it creates prejudicial consequences for the company.[79]

Avoidance is not encouraged as a matter of public policy because of the uncertainty it creates. Hence, a short statute of limitation bars avoidance three years after the conclusion of the agreement.

II. ASSESSING RPT LAW

Recent reforms have rendered obsolete the criticisms long expressed by businesses,[80] regulators,[81] and legal scholars that French RPT law presented "maximum complexity and minimum efficacy".[82] In its present form, the French regulatory framework for RPT is rather comprehensive and systematic. In practice, however, it does not always deliver everything that it sets out to achieve. In this part, I stress that the evolution of RPT law, and the high level of compliance that is observed, reflects a larger and profound change in French corporate culture. The move is towards a higher level of professionalization and more attention to conflicts of interests and investor protection. The most significant reforms focus on the improvement of both the quality and the quantity of information available to shareholders. It must be noted, though, that changes are happening faster in listed public limited companies than in non-listed companies, where abuses of corporate assets and of majority power are still regularly encountered (Section A). A trace of the older corporate culture seems to remain when one comes to consider the role of independence. While independent directors and auditors play a key role in other jurisdictions, their role in France is limited: political initiative will be required to change this (Section B). Finally, both "indirect interest" and "ordinary course of business" are notions that lack clarity. In the absence of case law clarifying the criteria, there are uncertainties

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79 Commercial Code Art. L. 225-42. If the board authorized the RPT, nullification is not an available redress, even if harm was created.

80 The Paris Chamber of Commerce published in 2011 a report (*Renforcer l'efficacité de la procédure des conventions réglementées*) stressing the need for procedural reform in order to improve the effectiveness of RPT rules. Available at http://www.cci-paris-idf.fr/sites/default/files/etudes/pdf/documents/conventions-reglementees-del1109.pdf (last accessed on 10 February 2018).

81 French Market Authority (*Autorité des Marchés Financiers*), Recommendation n° 2012-05, proposition n°22, as updated on February 11, 2015 and October 24, 2017.

82 Raymonde Vatinet, 'Les conventions réglementées' (2001) *Revue des sociétés*, 561.

as to the precise scope of RPT law. This ambiguity undermines the effectiveness of the procedure by either flooding shareholders with unnecessary authorizations and disclosures or failing to control potentially harmful transactions (Section C).

A. Taking tunnelling seriously

1. Increased transparency

French law requires a systematic review of regulated RPTs at multiple levels. While the key control is at the level of the board, shareholders also ratify RPT in specified forms, and statutory auditors must report on them. Recent reforms have increased transparency in various ways. The law further promotes awareness by requiring a new authorization every time these agreements are modified or renewed, and now also requires annual reporting to shareholders of all RPTs whose performance is ongoing. Transparency is further strengthened for listed companies through accounting rules.[83]

Requiring shareholders can have a prophylactic effect, as numerous RPTs are eventually not entered into as a result of concerns about a negative or weak majority vote and potential reputation damage. A 2012 OECD report highlighted that shareholder opposition was frequent, reporting that negative votes were often above 20 percent.[84]

2. Professionalization of corporate culture

Sociological features specific to French capitalism have traditionally limited the effectiveness of RPT law. These are, however, fading. In France, the business network has until recently been highly close-knit: most top business people attended the same elite schools (known as *Grandes Ecoles*), their shared background and values leading them to regard one another favourably. [85] A study showed that only two of these schools, the Ecole Nationale d'Administration and the Ecole Polytechnique, accounted for half of the managers and directors of France's leading firms.[86] Another study evidenced a correlation between the CEO's social network and that of the directors, as well a show social networks in the boardroom negatively impact corporate governance (higher CEO's compensation, lower likelihood of replacing

[83] See above Section I B 1.
[84] See above n 26, 71.
[85] Mairi Maclean, Charles Harvey and Jon Press, Business Elites and Corporate Governance in France and the UK (Palgrave Macmillan 2006) 88 and 90: "in France there is a prescribed route which may enhance the individual's chances of success, through the *classes préparatoires* followed by entrance to a *grande école* of renown, then admission to a *grand corps* and perhaps a ministerial cabinet".
[86] Michel Bauer and Bénédicte Bertin-Mourot, Administrateurs et Dirigeants du CAC 40, Report of CNRS Observatoire des dirigeants 1997

underperforming CEOs, etc).[87] Given the tight-knit nature of the community of managers and directors in France, it is possible that directors may have been less likely to interfere with their peers' activities involving RPTs, even if in a formal sense they were not "interested" in those activities.

In addition, accountability has historically not been a strong element in French management culture. Traditionally, members of the French corporate "club" have a status mostly defined by their graduate degree prestige and therefore acquired at a young age for their entire life.[88] This enables this particular group to impose their point of view:[89] a feature central to the French tradition of republican elitism. A modern form of aristocracy stems from "talent."[90] While in US corporate culture, decision-making power comes with expectations of accountability and moral leadership, French directors and executives of large companies may rely on their status to impose a vision. Jean-Marie Messier's impulsive leadership of Vivendi, the one-time utility he transformed into a global media group that he left mired in losses, provides an illustration.[91]

The current system and habits are under pressure in various ways. First of all, foreign investors and activists have already triggered changes in French corporate governance practices. The number of shareholders' challenges to management proposals has risen steadily in recent years.[92] Such challenges have perturbed the consensual corporate culture that was once widespread in France.

Secondly, corporate conflicts of interest have received heightened attention in France over the last few years. The expression "conflicts of interest" did not historically feature in the legislation—"regulated conventions" does not refer to conflicts of interest—and for many years, the concept itself seemed to be of little interest to the French business community and regulators. That situation has started to change dramatically. French newspapers now regularly highlight improper self-interested behaviours. French firms have both a challenge and an opportunity to be innovative in the culture of conflicts of interests.

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[87] Francis Karmaz, David Thesmar, 'Social Network in the Boardroom', Journal of the European Economic Association 2013 11(4) 780-807.

[88] Philippe d'Iribarne, 'L'origine singulière des dirigeants français', in Franck Bournois, Jérôme Duval-Hamel, Sylvie Roussillon, Jean-Louis Scaringella, Comités Executifs. Voyage au cœur de la dirigeance, Eyrolles, 2007, 222-225, 224.

[89] Philippe d'Iribarne, 'L'origine singulière des dirigeants français', in Franck Bournois, Jérôme Duval-Hamel, Sylvie Roussillon, Jean-Louis Scaringella, Comités Executifs. Voyage au cœur de la dirigeance, Eyrolles, 2007, 222-225, 223.

[90] Pierre Bourdieu, La noblesse d'Etat : Grandes Ecoles et esprit de corps, édition de Minuit 1989.

[91] See Financial Times 21 January 2011 "Ex-Vivendi executives found guilty".

[92] Les Echos, 25 November 2016, "*2016, année record pour la contestation des actionnaires*".

Thirdly, since 2015 multiple directorships have been restricted: the same person cannot sit on more than three boards of large listed companies.[93] Such limits should curtail the network effect,[94] although there is evidence of some resistance within the "club." For instance, in 2017 Vincent Bolloré was president of the board of Vivendi and a board member of seven listed companies not belonging to the Vivendi group.[95]

B. Role of independent third parties

Some weaknesses in French RPT law stem from the minor role assigned to independent third parties, which may be a hangover from the old "club" culture.

1. Disinterested vs. independent directors

From a behavioural perspective, various features of the current procedure undermine its effectiveness. To start with, insiders have to assess whether deals in which they have an interest require authorisation. Psychological research sheds light on inadvertently biased decision-making. This dynamic is known as self-serving bias: judgments and decisions are unconsciously biased in favour of the decision maker. They arise when individuals have a stake in the outcome of a dispute but are asked to ignore their own preference and indicate a range of fair outcomes.[96] This phenomenon suggests that when insiders have to judge whether a transaction needs approval by the board or falls within the "usual business activities" exception, insiders are likely to be biased: even an honest but interested party may unconsciously make a distorted assessment.

An experimental study of judgments under the influence of affiliation[97] demonstrates that bias occurs even when there are clear incentives in favour of objectivity. In other words, people who are influenced by partisan affiliation believe their own biased assessments to be objective.[98] An insider instructed to ignore his own affiliation bias will adjust his evaluation – but not sufficiently to compensate for his self-interest.

This result suggests that a board's assessment of the contribution to a company's success of an RPT submitted for their approval by a fellow board member is likely to be systematically

93 Loi of August 6, 2015 known as *Loi Macron*.
94 For instance, until 2010, Michel Pebereau was sitting on the boards of Total, Awa, BNP Paribas, Saint-Gobain, Lafarge and EADS.
95 Financière de l'Odet, Bolloré, SOGB, Socfinaf, Socfin, Socfinasia, Safa.
96 Tess Wilkinson-Ryan, 'Fiduciary Duties and Psychology' in Andrew Gold and Robert Sitkoff (eds), Oxford Handbook on Fiduciary Duties (Oxford University Press, forthcoming 2018).
97 Don Moore, J. Lloyd Tanly and Max Bazerman "Conflict of interest and the intrusion of bias" (2010) 5 Judgment and Decision Making, 1, 37-53.
98 Wilkinson-Ryan n(34).

biased. It will be difficult for the board to recognise that the RPT will not benefit the company, all the more so if the interested person takes part in the deliberation preceding the vote, as currently permitted by RPT law.[99] The absence of a direct or indirect interest does not guarantee the integrity of decisions where conflicts of interest are involved.

In the context of transactions known to be particularly likely to be harmful to the company, such as loans to insiders that do not get repaid, the two behaviours just described – self-serving bias and affiliation bias – warrant a ban. French RPT law rightly bans loans and financial guarantees to insiders, but a wider category could be designed: other transactions that are empirically known often to be sources of harm for companies could also be banned. The list could be tailored for each company or industry and be included in the charter.

In light of the potential judgment flaws of disinterested directors, one can argue that independent persons are more likely to act in the best interest of the company: independent directors would be best placed to decide whether a transaction should be subject to the procedures. Interestingly, the role of independent directors is not well defined in French corporate tradition and law,[100] although some companies have set up special committees of independent directors to handle sensitive transactions.[101] The Afep-Medef Code emphasizes that an independent board member must not hold any specific conflict of interest with the corporation, enumerating cases in which independence is not fulfilled (e.g. significant shareholder or employee).[102] In addition, the board would benefit from having more systematic input from independent expert opinions regarding substantial transactions. Some French companies have started to implement the AMF recommendation to that effect.[103]

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[99] The most commonly referred to code of conduct was amended in 2018 and now recommends that interested parties shall not be permitted not only to vote but also to take part in the discussion preceding the vote. See Afep-Medef Corporate Governance Code of Listed Corporations art. 19, available at http://www.afep.com/wp-content/uploads/2018/06/Code-Afep_Medef-révision-du-20-juin_VF.pdf. A bill released on June 18, 2018 and under discussion (Projet de loi relatif à la croissance et à la transformation des entreprises, also known as Projet de loi PACTE) provides for the same ban (art.66).

[100] See Y Chaput, 'L'émergence du dirigeant executive. Les mutations politiques du droit des sociétés' in Erik Le Dolley (ed), *Les concepts émergents en droit des affaires*, LGDJ, 2010, 221, 230-1.

[101] See Iliad's acquisition of a minority stake in EIR: a specific committee composed exclusively of Iliad's independent board members reviewed the transaction before the board formally approved it. https://www.iliad.fr/finances/2018/CP_130318_Eng.pdf.

[102] Afep-Medef Corporate Governance Code of Listed Corporations Art. 8.1 and 8.5, updated in June, 2018, http://www.afep.com/wp-content/uploads/2018/06/Code-Afep_Medef-révision-du-20-juin_VF.pdf.

[103] See, for example, Iliad's acquisition of a participation in EIR (RPT) in https://www.iliad.fr/finances/2018/CP_130318_Eng.pdf; See also the RPT whereby Ubisoft bought back shares from Vivendi: "Finexsi, acting as independent financial expert, rendered a fairness opinion on the share buy-back confirming that the financial terms of the transaction were fair for the minority shareholders of Ubisoft and that the transaction was in the corporate interest of Ubisoft" (https://ubistatic19-a.akamaihd.net/comsite_common/en-

2. Auditors

In principle, after a board has approved a self-interested transaction, companies' auditors are required to prepare a report for shareholders describing the transaction.[104] In practice, the reports on which they rely may not provide all of the information they need to make a meaningful review of the transaction, as they are often threadbare and formulaic. The information transmitted may be minimal, limited to the names of the parties and the transaction.

An examination of the special reports submitted to CAC 40 meetings reveals that the statutory auditor often devotes a maximum of 10 lines to each RPT.[105] No guidance is usually given to help the shareholders assess whether the transaction is legitimate.[106] In addition to this, auditors rely on the board to obtain information regarding the presence of self-interested transactions. This leads to the possibility that some transactions fail to receive attention from any auditor. So far, no judicial decision has imposed a penalty on the chairman of a board for failure to notify the auditors of a transaction with knowledge that the transaction does not satisfy Article L. 225-38. This might theoretically indicate perfect compliance by the board with the requirement to solicit auditor reports; however, it is also possible that the legal requirements are not complied with. In fact, there is some evidence found in recent cases in this regard of evasion or non-compliance.[107] Here, the law does not require or authorise the financial and accounting services of a company to notify their auditor of agreements made by or on behalf of the company.[108] It is also commonly understood that auditors are not liable merely as a result of a

US/images/pressrelease_downloadablemm_20180320_054451_ubisoft_pr_shareholding_20032018_eng_final_tcm99-320716_tcm99-196733-32.pdf).

[104]Commercial Code Arts. L. 225-40, L. 225-40-1.

[105] See Dominique Schmidt n6. To be sure, the Court of Appeal of Paris, by its judgment of 24 February 1954 (Gaz, Pal., 1954, 166, conclusions Av. Gen. Gégout), held that a report that includes a simple, unjustified opinion, which brings 'no light to shareholders' is tantamount to having no report.

[106] There is uncertainty in the application of the reporting criteria, including accounting criteria for listed companies. It was found that firms audited by "Big 4" auditors reported fewer related-party transactions that firms audited by professionals with a less prominent reputation: Moez Bennouri, Mehdi Nekhili, and Philippe Touron 'Does Auditor Reputation "Discourage" Related-Party Transactions? The French Case' Auditing: A Journal of Practice & Theory American Accounting Association Vol. 34 2015, 1–32.

[107] For recent cases, see Cass. Com, 5 Jan 2016, 14-18.688 and 14-18.689.

[108] A government regulation authorised, however, statutory auditors of listed companies to gather information about related party transactions, including via interviews of people within the audited organisation having knowledge of the transaction. Arrêté du 21 juin 2011 portant homologation de la norme d'exercice professionnel relative aux relations et transactions avec les parties liées, JORF No. 178, 21 August 2011, p. 13257 "Afin de collecter les informations appropriées quant à l'identification des risques d'anomalies significatives dans les comptes résultant de relations et de transactions avec les parties liées, le commissaire aux comptes met en œuvre les procédures d'audit décrites ci-après aux paragraphes 8 à 13 ..." "Le commissaire aux comptes interroge la direction et toute personne compétente au sein de l'entité, ayant connaissance de relations et de transactions avec les parties liées...".

failure to investigate whether unreported transactions that are within the scope of the scrutiny procedure exist,[109] and are also under a duty to directly alert the prosecutor if they uncover fraudulent practices warranting criminal charges.[110]

C. Scope of RPT law

The two principal uncertainties in French RPT law have already been mentioned. These are the expressions "indirect interest" and the "ordinary course of business". Workable definitions of these terms would greatly improve the clarity of the law. As such, the following sections consider their possible range of meanings.

1. Indirect interest

Until 2012, there had been little guidance as to the meaning of the expression "indirect interest".[111] The Code does not contain a definition, which leaves it to the courts to determine what kind of interest is sufficient to trigger board and shareholder approval rules.

There has however been little case law, and in the few decided cases, courts have interpreted the legal provision rather strictly .[112] This lack of clarity has undermined the effectiveness of RPT law as the following recent cases illustrate.

At the end of May 2017, the French media reported that a government minister (now retired from the post) enabled his romantic partner to benefit from an under-priced real estate investment to the detriment of the mutual insurance company of which he was CEO before becoming a minister. The matter attracted a lot of attention.[113] Although the directors were informed of and approved the transaction, the auditors did not provide the report required for transactions involving insiders.[114] The ex-CEO argued that there was no "indirect interest"

[109] See Bruno Dondero, 'Le commissaire aux comptes et les conventions réglementées', Gazette du Palais 11 August 2012, n°224 8, 11.
[110] Commercial Code Art. L. 823-12.
[111] Commercial Code Art. L. 225-38, paragraph 2.
[112] Pierre-Henri Conac, 'La loi du 24 juille 1966…' n 112, 112.
[113] See a scathing op-ed by Edmond Schlumberger in the Bulletin Joly Sociétés, a French-language corporate law journal widely read by practitioners and academics: E. Schlumberger, "De l'intérêt indirect dans les conventions réglementées" (2017) 9 Bulletin Joly Sociétés 505.
[114] Le Monde, June 2 2017, 8.

because he was neither married to, nor had a civil partnership with, the controller of the lessor – she was merely his girlfriend.[115]

Other jurisdictions might regard this as an obvious abuse: the absence of a legal marriage or civil partnership may look to many outsiders like a flimsy evasion, a reversion to the kind of "club" excuse that France is trying to move away from.

On the other hand, in some situations the enforcement system can work effectively, as the following case shows.

A board member of a consulting firm, Thales Consultants, also worked as an employee of another consulting firm. Thales Consultants entered into a high-value contract with the board member's employer, under which the board member was to assist with headhunting, in exchange for a fixed monthly fee to be paid to his employer. This transaction did not fall squarely within the categories of transactions subject to RPT law because the contract was with the board member's employer, and not with a board member. As such, Thales's board did not subject the agreement to board and shareholder approval, based on the argument that the board member did not have a direct or indirect interest in the contract. The Court of Appeal of Lyon ultimately disagreed and set aside the transaction. The conflicted board member and the company that received payment were ordered to reimburse Thales the total sum paid under the contract.[116]

Both cases described above arise out of the traditional tension between the literal and purposive construction of rules. In the first case, the transaction was plainly within the scope of conducts that the rule was intended to catch, and it required an almost aberrant interpretation to find a way around the application of the rule. In the second, it required the intervention of the court of appeal to reach a result that accords with common sense.

According to the AMF, a person should be considered to be "indirectly interested" in an agreement "if, by virtue of his or her links to the parties and of his or her powers to influence their conduct, he or she derives a benefit from it".[117] This definition is rather broad in scope in comparison with IAS 24 and seems to capture cases like the one discussed above involving a corporate officer channelling funds from the company that he oversees to his romantic partner.

[115] A criminal action brought by the anticorruption NGO Anticor based on misuse of corporate assets and abuse of trust was set aside because the limitation period had expired.
[116] Court of Appeal Lyon 3 Ch B, 22 November 2007, Thales Consultants SA c/ Sarl ARIV, BRDA 2008 n°19, 3.
[117] Recommendation n° 2012-05 of the French Market Authority (2012), proposition n° 22.

2. Ordinary course of business

Like the RPT laws in many countries, French RPT law provides an exception for transactions entered into during the "ordinary course of business" (*opérations courantes conclues à des conditions normales*). However, assessing the scope of this exception is difficult in practice. "Ordinary course of business" is a standard that refers to transactions assessed with reference to both the usual business activities of the company (*opérations courantes*) and the arm's length nature of the transaction in consideration of market conditions (*conditions normales*).

The consequence of the current open-textured drafting is an over-disclosure by listed French companies, which prefer to err on the side of caution. Even ordinary occasional contracts which are clearly in the ordinary course of business,[118] are sometimes disclosed. This leads to inflation in the number of RPTs reported. But an excess of information weakens the purpose of disclosure – the overwhelming amount of information concerning RPTs makes it difficult for shareholders to discern what might be really important: it simultaneously overburdens and trivialises the effect of disclosure.

Efforts have been initiated in order to streamline the process of ascertaining exempted RPTs while keeping the useful flexibility that the legal standard offers. For example, the professional auditors association published guidelines,[119] updated in 2014, to provide examples of current transactions concluded under normal conditions and to illustrate intragroup transactions. French companies now widely follow these guidelines. Regularly updated guidelines could become the basis for a "comply or explain" requirement,[120] which would encourage a more principled categorisation of RPTs.

In addition, under the AMF recommendation, listed companies should (1) establish their own charters that enumerate the criteria for transactions that fall under RPT law, and (2) submit the charter to the board, and (3) disclose it to the public.[121] Only a limit number of French companies currently comply with the AMF recommendation.

The English legal experience may also provide some inspiration. English law entrusts the certification of transactions falling under the "ordinary course of business" to a third party that is both familiar with the company's "ordinary course of business" and incentivized to perform

[118] E.g., a contract entered into by a publishing company with a journalist for freelance contributions.
[119] Compagnie nationale des commissaires aux comptes (CNCC), *Les conventions réglementées et courantes*. Available at https://cdn.cncc.fr/download/CNCC_ConvRegl_fev2014.pdf
[120] The Paris Chamber of Commerce made this suggestion in its 2011 report on RPTs (Section 2.2), available at http://www.cci-paris-idf.fr/sites/default/files/etudes/pdf/documents/conventions-reglementees-del1109.pdf
[121] Proposal n°20 of the 2012-05 recommendation of the AMF.

good, independent evaluation.[122] This role could potentially be given to French companies' third-party statutory accountants registered with the AMF – they are familiar with the company's business but at the same time face sanctions (such as the loss of AMF certification) if they are found to have misbehaved.

CONCLUSION

In France, the regulation of RPTs involves three steps following the notification to the board of an RPT. First, the board gives its prior authorisation to the transaction. Those who are self-interested do not take part in the vote. Secondly, auditors prepare a report on RPTs. Thirdly, a general meeting of shareholders approves or rejects it. If the shareholders do not endorse the transaction, any adverse consequences will be borne by the interested insiders. The RPT can only be avoided if it was not approved by the board and is harmful to the company. This longstanding procedure has been designed to prevent company officers and substantial shareholders from using their power to influence a contract with the company on terms less advantageous than those that the company would have obtained from a third party in a fair and balanced negotiation.[123]

This rather burdensome procedure often proved artificial and ineffective. Anti-tunnelling laws may have been unproductive because demand for them and shareholder protection more generally had traditionally been low in a culture where top management was a closed club.[124] However, the addition of AMF recommendations in 2012 and legislative modifications in 2014 have increased the quality and quantity of information passed on to auditors and shareholders. The implementation of the 2017 Directive on Shareholders' Rights[125] may be the occasion to introduce further useful adjustments, such as a legislative clarification of the scope of French RPT law.[126]

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[122] See Paul Davies' Chapter in this volume xxxx [p. 35 in working paper].

[123] Dominique Schmidt, *Les conflits d'intérêts dans la société anonyme* (2nd edition, Joly Editions, 2004).

[124] When there is a demand for it, France is capable of passing effective laws and of setting up credible enforcement, see Mark Roe, *Political Determinants of Corporate Governance. Political context, corporate impact* (OUP, 2003) 68.

[125] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC with regards to the encouragement of long-term shareholder engagement. The Directive requires Member States to introduce tougher rules on related party transactions by June 2019, including rules on approval, public announcement, and optional fairness reporting.

[126] In effect, the procedure set out in the Directive is very similar to the one already in effect in France, as it involves approval by a supervisory body, the board, or the shareholders.

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