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Corporate Governance 2022

France: Trends & Developments

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FRANCE

Trends and Developments

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Introduction

Trends in French corporate governance were, this past year more than ever, driven by a resurgence of ethics considerations and the growing influence of shareholder activism. In addition, the contemplated introduction of multiple voting rights for listed companies could reshape the current balance of power at the head of French listed groups.

The Resurgence of Business Ethics

On the business side, the crisis context of these past months (ie, the COVID-19 pandemic, worsening of global warming and the war in Ukraine) has certainly moved companies towards greater consideration of the environmental and social impact of their businesses; an impact that is also being increasingly scrutinised by all stakeholders. These considerations are shared by the European legislature, which intends to pass a new regulation – largely inspired by the "duty of care" (*devoir de vigilance*) imposed on large groups since 2017 – to make companies accountable for the impact of their activities on human rights and the environment.

On the management side, the resurgence of ethics at the core of company strategy enhances the board of directors' role and accountability and raised questions about the lack of diversity in top management positions as well as the amount and determination methods of executives' compensation packages.

Expansion of new ethics standards

The Pacte Act, enacted in 2019, was designed as a three-stage rocket to drive French companies to take into consideration their social and environmental impact. In addition to requiring boards of directors to "take into consideration" social and environmental issues when making their decisions, the Act introduced two optional tools into French corporate law: the concept of raison d'être (core purpose) as well as the status of "mission-driven" company. These tools are expected to be used by companies intending to redirect their focus on their wider role in society, beyond mere economic performance.

The raison d'être determines the orientation of a company's business and defines its identity and vocation, beyond its commercial purpose. Therefore, a company adopting a raison d'être makes the choice to define the ethical standards according to which its activities will be conducted.

However, companies adopting a raison d'être are free to define it more or less precisely. One can observe that there is a great deal of variation in the level of precision and relevance of the chosen raison d'être, which has an impact on the effectiveness of this tool in terms of creating new ethical standards: the more generic the raison d'être, the less likely it is to clarify the standards binding the company. Also, the consequences on management accountability vary based on whether the raison d'être is included in the articles of association or otherwise used as a simple communication tool. In the first case, the

shareholders shall give their approval through a qualified majority for the adoption of the raison d'être and a material violation of such standard could lead to liability claims against the management. In the second case, however, the binding effect of the tool could be questioned.

As of December 2021, 82% of CAC 40 companies and 57% of SBF 120 companies had adopted a raison d'être.

Besides the raison d'être, the Pacte Act also allows French companies complying with some conditions to be labelled as mission-driven companies. This status may be granted to companies choosing to adopt – in addition to a raison d'être – strong commitments towards environmental, ethical and/or social concerns. These commitments are submitted to the general meeting of shareholders and included in the Articles of Association. Compliance with these commitments is assessed regularly by a mission committee, convening at least one employee and usually representatives of other stakeholders. Failure to comply with the mission or the commitments not only entails the withdrawal of the status, but could also lead to liability claims against the directors and the company.

As of February 2022, 405 companies had obtained mission-driven company status, and Danone was the only listed company to have endorsed such status. More recently, mission-driven status has been the subject of renewed interest with the nursing home scandal involving Orpea (a French listed company): in a letter addressed to the Chairman of Orpea's board of directors, the investment fund Mirova, a shareholder holding 3.90% of Orpea's share capital, called for the adoption of such status by the company, requesting concrete commitments in order to guarantee the respect of all stakeholders, primarily residents and employees. This illustrates that this status could be seen by activist investors as a way to monitor the management of listed companies, on topics related to ethics and ESG concerns.

Contemplated renewal and expansion of the companies' duty of care

On 23 February 2022, the European Commission released a draft directive on Corporate Sustainability Due Diligence, which would require large companies to carry out due diligence in order to identify, prevent and stop any adverse impact of their activity on human rights and on the environment. The goal of the proposal is to implement sustainable and responsible corporate behaviour, throughout the relevant companies' global value chains.

The directive would introduce specific directors' duties to set up and oversee the implementation of due diligence and to integrate it into the corporate strategy. Also, the directive would introduce the principle, already enacted under French law, that when fulfilling their duties, directors must consider the human rights, climate change and environmental consequences of their decisions.

This new duty of care would apply to large companies (more than 500 employees and EUR150 million in turnover) as well as listed companies operating business in the European Union. It would also be extended to smaller companies in industries considered to have the greatest impact on human rights and the environment (ie, agriculture, mining and textile production).

National administrative authorities appointed by EU member states would handle the supervision of the new rules and may impose fines in cases of non-compliance. In addition, victims would have the opportunity to bring liability claims for damages that could have been avoided with proper due diligence measures.

The provisions adopted by the European Commission are largely inspired by the French duty of care introduced in 2017, except that the European duty of care would be applicable to a wider scope of companies, the French duty of care only applying to very large groups (more than 5,000 employees).

Heightened expectations faced by boards of directors

As observed in the draft Directive on Corporate Sustainability Due Diligence, the role of the board of directors is becoming increasingly pivotal in the implementation of new ethics standards in corporate strategy. This critical position is emphasised by governance recommendations and regulations.

In fact, the last amendment to the Middlenext Code, the corporate governance code applicable to small and medium-sized listed companies, issued in 2021 included a new recommendation for companies to set up a corporate social responsibility (CSR) committee, to be chaired by an independent board member. This CSR committee shall be in charge of proposing criteria to assess the company's extra-financial performance, informing the board with regard to ESG issues and assessing and advising on the right balance between shareholders' and employees' rewards.

Another – quite absurd – example of the growing range of responsibilities of boards of directors is the amendment, in March 2022, of the French Commercial code to introduce, besides social and environmental factors, cultural and sporting concerns as elements to be considered by the board in deciding the company's orientation. Implementation of this obligation raises questions as, depending on the nature of the operations of the companies, including cultural or sporting considerations could be an impossible task.

In addition to accumulating regulation and recommendations, the boards of directors are also confronted by new geopolitical issues in the context of the war in Ukraine. French groups established in Russia are facing a dilemma as to the extent to which they should suspend or terminate their activities in Russia, in part because public opinion condemns companies that have opted to remain in business there. As a result, the question of keeping interests in Russia, in one form or another, extends beyond international sanctions and embraces a broader logic, particularly in terms of ethics. Indeed, new interests must be taken into consideration by the management and, above all, by the board of directors when assessing the situation vis-à-vis the corporate interest of the company they manage. In this regard, the raison d'être, where applicable, may be a useful compass.

Developing ethical constraints on executive managers

Not only are ethical business strategies praised by investors and public opinion, but stringent ethics standards are also gaining grounds within the organisations themselves, in particular vis-à-vis top management.

An example of this development is the determination of executives' compensation, whose variable component is more and more dependent upon the achievement of CSR targets. In 2019, 30% of CAC 40 companies had settled CSR criteria in their executives' long-term incentive plans.

At the same time, excessive executive compensation packages are less-and-less tolerated by stakeholders. Recently, a new executive compensation package scandal broke when Carlos Tavares, the CEO of Stellantis (a Dutch company with deeply rooted interests in France), was awarded EUR19 million. This announcement caused widespread public outrage and pushed

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Emmanuel Macron, who described the compensation as shocking and excessive, to call – on ethics ground – for a European-level bargaining process to regulate the remuneration of major companies' top executives.

In France, the severance package of Orange's Chairman, Stéphane Richard, has also been the subject of strong criticism despite its modest amount. The problem here is not the amount, but the mere principle of a severance package, given that Stéphane Richard resigned from the position because of his conviction, in November 2021, for complicity in the misappropriation of public funds.

Another sensitive topic is diversity at the top management level. On 24 December 2021, the French Parliament enacted the Rixain Act to address the promotion of women to the top managerial positions at large companies. This Act provides for stringent representation quotas (30% by March 2026; 40% by March 2029) as well as requirements to disclose diversity gaps at the top management level as of March 2022.

Similarly, on 14 March 2022, EU member states gave their initial agreement to introduce representation quotas on boards of directors. The purpose is for companies to implement measures to reach a minimum target of 40% of the under-represented gender for non-executive directors, or, alternatively, 33% of all board members. Countries that already have national targets in place – such as France, since the entry into force of the Copé-Zimmermann Act in 2017 – may chose not to apply the requirements of the directive as long as their system is in line with the European targets.

Finally, in an effort to take into consideration stakeholders' views on diversity as well as upcoming regulations, a trend emerged in 2021 among CAC40 companies: the separation of Chair and CEO functions. Since the beginning of 2021, seven CAC40 companies announced that they were separating these functions: Bouygues, Danone, L'Oréal, ArcelorMittal, Air Liquide, Orange and Saint-Gobain. Among them, Orange appointed Ms Christel Heydemann as its new Chief Executive officer as of 4 April 2022.

Continued Expansion of Shareholders' Activism

According to the Lazard report on shareholder activism, 73 activist campaigns were launched against companies worldwide during the first quarter of 2022, a historic high.

In France, activist funds have been particularly exposed during some of the major stock market battles of the last two years. On the other hand, in a world where ethics and public opinion tend to become a cornerstone in defining business strategies, ESG issues-related activist campaigns are thriving.

Activism amid landmark stock market battles

Shareholder activism was particularly brought to light in the context of major stock market battles about some of France's largest companies.

First, Amber Capital was at the origin of the change in the corporate structure of Lagardere implemented in 2021. After a merciless struggle between the Lagardere family, Vivendi, LVMH and Amber Capital over the governance of the group and the acquisition of certain Lagardere assets, Lagardere finally accepted the abandoning of the protective status of *société en commandite par actions*, in favour of limited company status (*société anonyme*), in exchange for the integrity of its group.

Another example is the hostile takeover of Suez by Veolia. As part of this transaction, CIAM – at that time a Suez minority shareholder – repeatedly took a position in favour of the takeover bid

and threatened the Suez board of directors with civil and criminal claims against it if it continued to obstruct the bid. At the same time, Amber Capital also favoured Veolia's bid and requested Engie to accept it, although arguing in favour of a higher bid price. The takeover bid eventually succeeded at a price of EUR20.50 per share (compared to an initial price of EUR18).

Generalisation of ESG activism

ESG issues are increasingly central to the interests of shareholder activists. On 8 September 2021, the French Forum for Responsible Investment (FIR) called on France's 120 largest companies to extend say-on-climate resolutions, considering that such practice would create the conditions for a permanent dialogue between investors and companies on climate issues.

The introduction of advisory votes on the impact of the company's business on the climate and, in particular, on greenhouse gas emissions, were first requested by activist funds in the USA, and backed by the Securities and Exchange Commission, before spreading to France as of 2020, and particularly thriving in 2022 with the support of proxy advisors such as Glass Lewis, ISS and Proxinvest.

As a consequence, say-on-climate resolutions have been introduced in the agenda of general meetings of eight SBF120 companies as of April 2022 (Amundi, EDF, Engie, Getlink, Icade, Mercialys, Nexity, TotalEnergies), compared to only three in 2021 (Atos, TotalEnergies and Vinci).

Although most of the resolutions were proposed at the initiative of the companies themselves, activists have turned their focus to the content of the resolutions. In fact, since say-on-climate resolutions are not regulated at all, companies are free to choose what is submitted for the shareholders' approval, and when.

A topic example shows this new shift. Eleven shareholders of TotalEnergies, standing for 0.78% of its capital, intended to introduce a say-on-climate resolution requiring TotalEnergies to "assess the degree of alignment of their strategies with the goals of the Paris Agreement." TotalEnergies refused such introduction on the ground that it would encroach on the legal powers of the board to decide the strategy. It must be noted that TotalEnergies had already included a say-on-climate resolution on the general meetings agenda: in fact, the shareholders were called on to vote on the Sustainability & Climate Progress Report 2022. However, the nature of the two resolutions was quite different: the resolution proposed by TotalEnergies was purely advisory while the resolution proposed by the activists would require TotalEnergies to set and include in the annual report binding targets in terms of greenhouse gas emissions and to adapt its strategy to follow them. Faced with the refusal of TotalEnergies to include the requested resolution, the activists have asked the French Financial Markets Authority (AMF) to order TotalEnergies to do so. The AMF has declined the shareholders' request based on a lack of authority but expressed a strong desire for the adoption of a legislative framework relating to say on climate, based on the existing say-on-pay regime.

Pressures from activist investors are expected to remain and to develop in a context where, with the purpose of rendering European financial markets more attractive, regulations on multiple voting rights are under discussion in France and at the European Union level.

Contemplated Developments on Multiple Voting Rights

The "one share, one vote" principle applicable to listed companies could be challenged in the coming months. Nowadays, only double voting rights are authorised and strictly regulated. In

an attempt to attract more companies to the European capital markets, in particular tech companies, discussions are being held on the possibility of listing companies that have shares with multiple voting rights.

In practice, these shares would be issued to founders for them to keep control of their companies for a limited period of time after their initial public offering. Although multiple voting rights have been widely criticised, especially by activist funds, since they disconnect shareholdings and political power, they are spreading in the USA and in the UK. On Wall Street, one third of companies going public in 2021 had multiple voting shares.

In France, an influent legal think tank, the HCJP (*Haut Comité Juridique de la Place financière de Paris*), is currently drafting a report on the pros and cons of multiple voting rights for listed companies. The report is due this spring. Another professional legal think tank, the *Club des Juristes*, proposed, last December, to allow the issuance of multiple voting rights to sponsors of special purpose acquisition companies (SPACs). At the European level, the European Commission issued a public consultation on the so-called Listing Act last winter and questioned professionals and local authorities on their views on multiple voting rights.

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PR & Associés is a specialist corporate and dispute resolution firm, combining expert legal advice with the focus and flexibility of a boutique practice. The firm was launched in 2020 by renowned M&A and litigation adviser Christophe Perchet (ex Davis Polk) and Nicolas Rontchevsky, one of the most respected corporate and securities law scholars in France. Jean-Christophe Devouge joined the firm in late 2020 as the third partner. Building on its extensive experience, the team routinely assists companies, boards of directors, investors and senior executives in high-stakes corporate transactions (M&A, tender offers, squeeze-outs, spin-offs, joint ventures, etc) and corporate governance matters (CEO succession, executive compensation, related-party transactions, shareholder communications, investigations, etc). Monitoring carefully evolving trends and best practices, the firm's lawyers are at the forefront of regulatory developments both at EU and French levels and actively engage in public policy debates on matters related to listed companies.

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