

## M&A / PRIVATE EQUITY / CORPORATE

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### NEWSLETTER

#### **Reform of the French Civil Code and the New French Contract Law: What Are the Main Impacts on French M&A and Private Equity Practices?**

This long-awaited reform changed our French Napoleonic code. Its main purpose is to increase the attractiveness of French contract law compared especially to common law countries.

It brings simplification, clarification and predictability throughout the life of a contract (from its formation, to its performance until its termination). In most cases, it has resulted in a codification of a certain number of recognized case-law, sometimes with little changes. However, in other cases, it has introduced in French law new concepts, some of them which are well-known in common law systems.

#### *Date of application of the new law - Transitional Law*

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The new law (the "**New Law**") applies to contracts entered into on or after October 1<sup>st</sup>, 2016. The contracts entered into before this date shall remain governed by the former law.

This raises the following comments:

- First of all, the New Law and the former law will coexist until termination or expiry of the contracts existing before October 1<sup>st</sup> 2016. Therefore from a practical standpoint, you will have to be careful if you need to review the validity of a contract or of one of its provision: the New Law in force and accessible through specialized internet websites will not automatically apply to the contract under review. The applicable law will depend on the date of its signature.
- Under French law, a contract tacitly renewed is considered as a new contract. Therefore the New Law will automatically apply to existing contracts tacitly renewed after October 1<sup>st</sup> 2016.
- M&A and Private Equity transactions require many weeks of negotiations. There will be situations where the discussions between the parties have begun before October 2016 and the transaction documentation has been or will be signed after October 2016. In such cases, as long as the contract is entered into after October 1<sup>st</sup> 2016, the duty of pre-contractual information (see § 2 below) introduced by the New Law shall apply to the whole period of negotiations even with respect to the period prior to October 2016.
- Lastly the three new interrogatory actions (so called *actions interrogatoires* in French, see § 8 below) are immediately applicable, even to contracts entered into before October 2016.

- In addition it should be noticed that the French Supreme Court (*Cour de Cassation*) has already changed by recent decisions, or may change in the future, its interpretation of the provisions of the former law in light of the provisions of the New Law. This will therefore reduce in practice the hiatus between the former law and the New Law...

**Key Points you should be aware of and which will impact your cross-border M&A or Private Equity transactions involving a French counterpart.**

***1. Good faith***

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A general obligation of good faith is explicitly introduced by the New Law. It applies with respect to the negotiation, formation and performance of contracts.

Based on this principle, a victim of abusive termination of negotiations could obtain compensation for the various costs incurred in connection with such negotiations, in particular due diligence costs and/or counsel fees but excluding the loss of the profits expected from the contract which has not been entered into.

***2. Duty of pre-contractual information***

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The New Law introduced a general obligation of information prior to the execution of the contract which is reciprocal for the parties.

According to the New Law: any information known by a party, which is of decisive importance for the consent of the other party and is in direct and necessary link with the content of the contract or the quality of the parties must be disclosed to the other party.

This is a very important issue in M&A deals which shall be usually addressed through organization of a data room. The selling party shall be careful in selecting and making available the relevant and appropriate information with respect to the target. From a practical standpoint, evidence of the disclosed information shall have to be kept by the parties to avoid any risk in case of dispute.

This duty of pre-contractual information is one of the rare explicit rules of public policy of the New Law: the parties cannot exclude or limit in any way whatsoever this obligation.

Should a party be in breach with this obligation, the other party may claim for damages and, in case of fraud, even for the nullity of the contract.

***3. Confidentiality***

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Duty of confidentiality during negotiation is now explicitly provided by the French Civil code.

A party may be liable in case of use or disclosure of confidential information obtained during the negotiations, even if no Non-Disclosure Agreement has been entered into.

***4. Unilateral promise***

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The binding effect of the unilateral promise to contract is reinforced by the New Law. This overruled a widely criticized case law pursuant to which the promising party was entitled to revoke its undertaking prior to the exercise of the option by the other party.

It shall secure mechanisms often used in Private Equity transactions such as tag-along and drag-along rights or put and call options which are all based on a unilateral promise principle under French law.

## 5. Right of first refusal/offer

The New Law creates a specific regime applicable to the right of first refusal or right of first offer mechanisms.

However, this regime does not reach the expected security purpose:

- For the beneficiary of the right: the breach will only allow the beneficiary to seek damages. To obtain the nullity of the contract entered into in breach with the beneficiary's right, the beneficiary will have to prove that the third party contractor had knowledge not only of the existence of the right but also of the intention of the beneficiary to invoke it.
- For the third party contractor: it has the possibility prior the execution of the contract to ask the beneficiary to obtain confirmation or not of the existence of the right (provided that it can identify the beneficiary...) and if it intends to exercise it. If the beneficiary fails to answer to such request within a reasonable period, it shall no longer be entitled to ask for the nullity of the contract. However, provided that the right of first offer/refusal has not been explicitly disclosed and as long as the third party ignores the intention of the beneficiary to exercise its right, there will be no risk for the third party contractor (see above) and the use of such interrogatory action seems therefore very unlikely in practice.

## 6. Specific performance

According to the previous law, the right to obtain specific performance was very limited and the non-defaulting party could only seek damages in case of breach.

Specific performance will now be at the discretion of the non-breaching party subject to prior notice delivered to the breaching party. However, specific performance will be possible only if it does not entail a manifest disproportion between the costs of the performance for the breaching party and the interest for the non-breaching party.

Please also note that a non-breaching party can decide, without having to obtain prior authorization from the court, to ensure performance itself or by a third party, at the cost of the breaching party, or to accept incomplete performance and solicit a price decrease. In such latter case, the price reduction shall be proportionate to the concerned incomplete performance.

The non-breaching party can also decide to unilaterally terminate the agreement without having to go before the court, subject for the other party to dispute such decision in court.

## 7. Hardship

The introduction of the concept of hardship for civil and commercial contracts is one of the main innovation of the New Law since French civil courts always rejected this principle for such contracts (even if administrative courts applied it in respect of contracts entered into with governmental agencies).

From now on, without need to add a specific provision, a contract may be revised by a judge when a change of circumstances, unforeseeable at the time when the contract was entered into, makes the performance of the contract excessively onerous, unless the party has agreed to bear such risk.

What does it mean for French M&A practice?

We are already used to include in Share Purchase Agreements MAC (Material Adverse Change) clauses in order to cover material adverse changes which may occur between the signing and the completion of the transaction. The MAC clause enables the purchaser of a company to walk away and not perform the acquisition. However, this is not a standard practice for all transactions.

- The introduction of the hardship concept in France is a major change in the law. It may apply to any provision of the SPA; for example an earn-out clause or in respect of representations and warranties. As mentioned above it shall be possible to provide in the contract that the parties definitively agree to the contract regardless any material adverse change to occur in the future. This specific and explicit exclusion of the hardship concept will give rise to a new topic of negotiation in the French SPAs.

### 8. Three interrogatory actions

Three new interrogatory actions (so called *actions interrogatoires* in French) have been created and are applicable immediately even to contracts signed before October 2016. This covers requests in writing by one party to obtain confirmation from the other party of a particular fact. A party has the right to request confirmation of:

- the capacity and powers of a signatory to a contract,
  - the intentions of the beneficiary to exercise a right of first refusal/offer (see § 5 above), or
  - the intentions of a contracting party who may potentially seek nullity of the contract.
- These actions can be useful to end ambiguous situations and can reinforce legal security.



The M&A, Private Equity and Corporate team of Stehlin & Associés will be happy to assist you and your clients, analyzing concrete situations that may arise in your targeted operations in France and considering with you the most appropriate solutions.

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