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Soulhier Bunch, Cabinet d'avocats d'affaires basé à Paris et Lyon

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PACTE Law: Clarification and modernization of the rules governing preferred shares

Law n°2019-486 of May 22, 2019 on business growth and transformation, known as the “PACTE” Law, aims at “*improving and diversifying business financing methods*”[1]. It is in this context that various measures have been taken to clarify and modernize the rules governing preferred shares.

Preferred shares are shares “*with or without voting rights, with special rights of any kind, on a temporary or permanent basis*”[2]. Because these shares make it possible to separate political and financial rights, they are a tremendous tool for business growth.

To encourage the use of this instrument in France, Article 100 of the PACTE law modernizes and clarifies the rules applicable to the issuance of such securities which were considered vague and sometimes ambiguous by legal practitioners.

1. Standardization of the rules governing the issue of preferred shares within unlisted joint stock companies

Article L. 228-11 §1 of the French Commercial Code is amended as follows: “*At the time of incorporation or during its existence, preferred shares may be created [...], with special rights[...]. These rights are set forth in the by-laws and, for companies the shares of which are admitted to trading on a regulated market or multilateral trading facility, in accordance with Articles L. 225-122 to L. 225-125.*”

The difference between the rules applicable to *sociétés anonymes* (joint stock companies) and *sociétés en commandite par actions* (limited partnerships with shares) on the one hand, and *sociétés par actions simplifiées* (simplified joint stock companies) on the other hand, is thus eliminated.

This amendment also removes the uncertainties related to the application or non-application of the proportionality rule set out in Article L. 225-122 of the French Commercial Code^[3] to *sociétés par actions simplifiées*, which is now expressly excluded in this case.

1. Confirmation of the application of the so-called “special benefits” procedure in the event of creation of preferred shares in favor of new shareholders

Article L. 228-15 §1 of the French Commercial Code is amended as follows: *“The creation of these shares entails the application of Articles[...] related to special benefits when the shares are issued to one or more named persons”,* instead of : *“The creation of such shares entails the application of Articles [...]related to special benefits when the shares are issued to one or more named shareholders”.*

This amendment confirms an application already established in practice. ^[4].

1. Extension of the cancellation of preferential subscription right to all preferred shares with limited financial rights, with or without voting rights

The last paragraph of Article L. 228-11 of the French Commercial Code is amended as follows: *“By way of derogation from Articles L. 225-132 and L. 228-91, preferred shares with a limited right to dividends, reserve accounts or assets sharing in the event of liquidation shall be deprived of preferential subscription right for any share capital increase in cash, subject to any contrary provisions set forth in the by-laws”,* instead of: *“By way of derogation from Articles L. 225-132 and L. 228-91, preferred shares without voting rights on issue and with a limited right to dividends, reserve accounts or assets sharing in the event of liquidation shall be deprived of preferential subscription right for any share capital increase in cash, subject to any contrary provisions set forth in the by-laws”.*

The preferential subscription right is a right by virtue of which the shareholders of a joint stock company benefit, in proportion to the amount of their shares, from a preferential right to subscribe for shares issued for cash in case of a share capital increase (Article L. 225-132 of the French Commercial Code).

The purpose of this amendment is to facilitate the subsequent issuance of shares reserved for one or more individual investors, by waiving the obligation to convene in advance a special meeting of holders of preferred shares with limited financial rights, in order to obtain the agreement of the latter on the cancellation of their preferential subscription right.

However, since it is a subsidiary provision, the by-laws may derogate from this rule and provide for the application of this anti-dilutive mechanism to issued preferred shares with limited financial rights.

1. Clarification of the rules governing the issue of securities giving access to the capital in the presence of preferred shares

The drafting of Article L. 228-98 of the French Commercial Code that deals with the issuance of securities giving access to the capital in the presence of preferred shares has long been a source of concern for legal

practitioners: *“As from the issuance of securities giving access to the capital, the company that is to allocate such securities [...] may neither modify the rules for the distribution of its profits, nor amortize its capital, nor create preferred shares leading to such modification or amortization [...]”, then, in paragraph 3 of said Article: “[...] Subject to the same reservations, it may however create preferred shares”.*

The aforementioned paragraph 3 is quite simply deleted.

This amendment confirms the interpretation of the majority of legal writers who considered this paragraph redundant with the preceding provisions.

1. Introduction of preferred shares redeemable at the initiative of their holders

Article L. 228-12, III §4 of the French Commercial Code is amended as follows: *“In companies, the shares of which are admitted to trading on a regulated market, the buy-back is on the exclusive initiative of the company or on the joint initiative of the company and the holder of the preferred share. In companies, the shares of which are not admitted to trading on a regulated market, the by-laws shall determine, prior to subscription, whether the buy-back may take place on the exclusive initiative of the company, on the joint initiative of the company and the holder or on the exclusive initiative of the holder, under the conditions and within the time limits specified therein”, instead of: “The buy-back is on the exclusive initiative of the company”.*

This amendment confirms a procedure already established in practice[5].

[1]Impact study of the draft Bill, June 18, 2018.

[2]Article L. 228-11 of the French Commercial Code.

[3]Article L. 225-122 of the French Commercial Code *“I.- [...] the voting right attached to capital or dividend shares is proportional to the percentage of capital they represent and each share gives the right to at least one vote. Any clause to the contrary shall be deemed unwritten [i.e. unenforceable].”*

[4]Cf. in particular Ministerial Answer n°43987, Official Journal of the National Assembly, August 24, 2004, p. 6685, and Ministerial Answer n°13315, Official Journal of the Senate, May 19, 2005, p. 1441: *“[...] Article L. 228-15 §1 refers to existing shareholders and shareholders who become shareholders at the time of subscription, provided that these shareholders are named.”*

[5]Cf. in particular Ministerial Answer n°431, Official Journal of the French Senate, December 27, 2007, p. 2371: *“[...] the by-laws of these companies can lay down in advance the terms and conditions for the buy-back of preferred shares, it is possible to provide that the buy-back is implemented on the initiative of the holder.”*

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