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

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The suspension of voting rights in listed companies is not unconstitutional

Following an application for a preliminary ruling on the issue of constitutionality filed in December 2013, the French Constitutional Council has recently ruled (Decision n° 2013-369 QPC of February 28, 2014) that the automatic suspension of voting rights provided for under Article L. 233-14 §1 and §2 of the French Commercial Code ("FCC") in case of breach of the rules governing the crossing of disclosure thresholds in listed companies, is constitutional.

The decision, which upholds the regulations in force, provides the opportunity to recall the rules governing the crossing of disclosure thresholds.

1. Threshold crossing disclosure requirements

The quality of the information and the identification of the ownership structure of listed companies are essential to ensure that the market operates properly. The rules governing threshold crossing disclosure obligations contribute to the transparency of the shareholding structure of listed companies.

- **Pursuant to Article L. 233-7-I §1. 1 of the FCC**, any natural person or legal entity, acting alone or in concert, who/that comes to hold a number of shares representing more than a certain fraction of the share capital or voting rights^[1] of a company having its registered office in France and listed on a regulated market or non-regulated market (*Alternext* or the *Marché Libre*) must inform the company and the *Autorité des marchés financiers* (French Financial Market Authority, hereinafter the "AMF")

that will in turn inform the market. This obligation also applies when the natural person's or legal entity's number of shares or voting rights falls below these thresholds. This information must be given to the company no later than the **close of market on the fourth trading day following the date on which the threshold was crossed** (Article R. 233-1 of the FCC).

- **On regulated markets**, the natural person or legal entity subject to this obligation set forth in Article L. 233-7-I §1 of the FCC must, when he/she/it crosses certain statutory thresholds (10%, 15%, 20% and 25% of the share capital and voting rights), declare the objectives to be pursued during the next 6 months (Article L. 233-7-VII of the FCC). This **declaration of intent** must be sent to the company and to the AMF within 5 trading days. The AMF then provides this information to the public. When a person changes his/her/its intentions within six months from the filing of the declaration of intent, a new reasoned declaration of intent must be immediately sent to the company and to the AMF. Furthermore, if a person changes his/her/its intentions after the above-mentioned six-month period, he/she/it must immediately inform the public thereof in a news release (Articles 223-7 and 223-9 of the AMF General Regulation).
- **In addition to the statutory thresholds** set forth in Article L. 233-7-I1 of the FCC, the company's **by-laws may impose additional disclosure obligations** relating to holding of fractions of the share capital or voting rights below 5%, in increments that may be as small as but not inferior to 0.5% (Article L. 233-7-III of the FCC). The person or legal entity who/that crossed a threshold set forth in the by-laws must merely inform the company (not the AMF).

2. Consequences associated with the crossing of disclosure thresholds

Non-compliance with the obligation to notify the crossing of thresholds may entail serious consequences for the defaulting shareholder.

Suspension of voting rights:

Regarding **statutory thresholds**, Article L. 233-14 of the FCC provides as follows:

- (i) the shareholder^[2] who fails to declare within the prescribed time-line that his ownership of share capital or voting rights has exceeded any of statutory thresholds, **is automatically deprived, for a period of two years as from the date on which such failure is remedied, of the voting rights attached to the shares exceeding the threshold which has been exceeded;**
- (ii) in addition, the President of the company, a shareholder or the AMF may request the Commercial Court to suspend, in whole or in part, the voting rights of the defaulting shareholder for a period up to five years.

Contrary to the automatic suspension of voting rights addressed in (i) above, the suspension that may be ordered by the Commercial Court as per (ii) above can apply when the ownership of share capital or voting rights falls below a threshold. Yet, Commercial Courts generally refuse to order this suspension when it is not established that the person who failed to make the disclosure has acted with fraudulent intent (i.e. no intention

to conceal).

When **a thresholds below 5% of the share capital or voting rights, as set forth in the company by-laws, is exceeded**, the by-laws may provide that the suspension will only apply at the request of one or several shareholders holding a fraction of the issuer's share capital or voting rights at least equal to the smallest fraction of share capital, the holding of which must be declared (Article L. 237-7-VI of the FCC).

Other sanctions:

Criminal sanctions: pursuant to Article L. 247-2 §1 of the FCC, the chairmen, directors, executive board members, executive or general managers of legal entities, as well as natural persons who fail to comply with the disclosure obligations set forth in Article L. 233-7 of the FCC shall be liable to fine of 18,000 Euros.

Administrative sanctions: the lack of notification by the person who crosses a threshold or the filing of an incorrect notification constitutes a breach of the obligation to provide adequate information to the public to the extent that the concealed information, if it were made public, would be likely to have an impact on the prices of the relevant financial instruments (Articles 223-2 and 621-1 of the AMF General Regulation). In this case, the AMF may impose financial sanctions.

Civil sanctions: the deliberations of a general meeting of shareholders in which voted a shareholder who failed to disclose the crossing of a threshold may be nullified on the basis of Article L. 235-2-1 of the FCC.

3. The suspension of voting rights in listed companies is constitutional

Deprived of its voting rights during a general meeting of shareholders of the company DOMIA GROUP (Euronext) held in February 2008 as a result of its failure to comply with threshold disclosure requirements, the Swiss company MADAG initiated proceedings against DOMIA GROUP and sought the cancellation of the suspension.

The case was brought before the *Cour de Cassation* (French Supreme Court) in 2013. The *Cour de Cassation* referred to the Constitutional Council the two claims brought by MADAG against the sanction provided for under Article L. 233-14 of the FCC. These two claims were based on the breach of two principles enshrined in *1789 Declaration of the Rights of Man and of the Citizen* ("DRMC"), i.e. (i) **the individualization of penalties** (Article 8 of the DRMC), and (ii) **the inviolability of property rights** (Article 17 of the DRMC).

- (i) Regarding the first claim brought by MADAG, the Constitutional Council, after having recalled that the principle of strict necessity of penalties only applied to penalties and sanctions that are akin to a punishment, held that the **temporary suspension of the voting rights was not to be analyzed as a punitive measure but as a rule to ensure the proper operation of the company and its protection against occult acquisitions of ownership interests**. As such, the argumentation related to the breach of Article 8 of the DRMC was ineffective;

lastly,

- (ii) To dismiss the claim based on the alleged violation of property rights, the Constitutional Council ruled that (i) the provisions set forth in Article L. 233-14 of the FCC pursued an aim of general interest (i.e. preventing occult acquisitions of ownership interests in order to increase compliance with the rules that ensure loyal relationships between a company and its members and the market transparency), and (ii) the infringement of property rights was limited (i.e. it concerned only a fraction of the voting rights, was limited in time, and the economic rights were not impacted insofar as the shareholder remained the holder of the voting rights and as the temporary suspension did not affect any potential transferee of the shares).

[1] 5%, 10%, 15%, 20%, 25%, 30%, 33 $\frac{1}{3}$ %, 50%, 66 $\frac{2}{3}$ %, 90% or 95%

[2] The sanction applies to the shareholder, not to the shares As such,

- (i) If the shares are transferred, the transferee is not deprived of the voting rights attached to such shares;
- (ii) If the company is merged into another company, the automatic suspension of the voting rights passes on to the acquiring entity through the transfer of all assets and liabilities of the company being acquired.

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