Whereas under the aegis of the former article 1134 paragraph 3 of the French civil code, the good faith requirement only applied to the performance of agreements, order n°2016-131 dated February 10, 2016 has extended this principle to the precontractual phase, thus consecrating the duty to inform during negotiations.

The new article 1104 of the French civil code stipulates that agreements must be negotiated, formed and performed in good faith, this being a public order provision. Two new articles have been added to this general article, dedicated to precontractual negotiations, new articles 1112 and 1112-1 of the French civil code.

The new article 1112 of the civil code merely recalls the good faith requirement in the initiative, the negotiation process and the termination of negotiations.

The new article 1112-1 of the same code, on the other hand, could well have a real impact in the conducting of the precontractual phase of sales and M&A operations, in particular within the framework of the organisation of due diligence. It effectively creates a disclosure obligation for a party which is aware of information whose importance is decisive to the consent of the other party when the other party is legitimately unaware of this information or trusts its co-contractor.

This new provision could have the following consequences:

• putting an end to practices consisting in intentionally concealing significant information or answering Q&A procedures evasively in the context of setting up data rooms;
• restoring the purchaser’s duty to seek information, legitimate ignorance (or legitimate confidence) having become a condition of the precontractual information obligation. This means that a purchaser who has not asked for an audit or has deliberately not consulted the documents placed at his disposal in the data room finds himself in a position of illegitimate ignorance;
• inciting the parties to draw up contractually a list of information which they consider
Unforeseeable events in M&A transactions

Corporate Team

The reform of contract law (Order n°131-2016 dated February 2016) has introduced unforeseeable circumstances into French civil law by authorising the renegotiation of the terms of an agreement in progress as a result of a change in circumstances which was unforeseeable at the time of the conclusion of the agreement, and which renders its performance excessively costly for one of the parties.

In the past, case law has always refused to allow the revision of an agreement in progress, except in particular cases, due to a subsequent change in circumstances.

The new article 1195 of the French civil code is drafted as follows: “If a change in circumstances that was unforeseeable at the time of the conclusion of the agreement renders its performance excessively costly for a party which had not agreed to bear this risk, the latter may ask the other party to renegotiate the agreement. It continues to fulfil its obligations during the renegotiation process.

In the event of refusal or breakdown in the renegotiations, the parties may agree to terminate the agreement, at the date and in the conditions determined between them, or they may agree to ask a judge to adapt the agreement. If they cannot reach an agreement within a reasonable period of time, the judge may, at the request of one of the parties, revise the agreement or terminate it, at the date and in the conditions fixed by him”.

Three conditions must be met in order for one of the parties to claim unforeseeable circumstances:

(i) a change in circumstances that was unforeseeable at the time of the formation of the agreement. The change may just be part of an ongoing process and not only result from an upheaval. The circumstances may result from facts that are external to the party concerned (war, accident, price trends, etc.) and may be unforeseeable due to their nature or their amplitude.

(ii) a performance which has become excessively costly. In the light of European sources, this criterion is assessed on the basis of the cost/benefit ratio.

(iii) the absence of acceptance of the risk of unforeseeable circumstances by the party which is a victim thereof. The party which considers itself to be a victim of changes in circumstances must ask its co-contracting party to renegotiate the agreement, while continuing to comply with its obligations thereunder. Consequently, it is fundamental for the party concerned to keep proof of its non-acceptance of the risk and of its request to renegotiate the agreement.

If these conditions are met, the new article 1195 of the French civil code sets in place a mechanism which can be broken down into three stages:

1. the party which considers itself to be the victim of an unforeseeable change in circumstances making the performance of the agreement too costly for it asks the other party to renegotiate the agreement. If this renegotiation is accepted and is successful, the agreement is amended and continues as amended.

2. if the other party refuses to renegotiate or if the renegotiation fails, the parties may terminate the agreement or agree to ask the judge to proceed with the adaptation of the agreement. Although this last situation is likely to be very uncommon in practice, it could nonetheless enable the parties to effectively limit the debate to the points specified in the petition submitted jointly by the parties to the judge, acting as an «amiable compositeur».

3. if the parties were unable to agree on the renegotiation or the joint
petition to the judge to adapt the agreement, one of the parties may, after a reasonable period of time, ask the judge to revise the agreement or terminate it in conditions to be determined by the judge. The judge will then have full latitude to revise the agreement, the law not fixing any limit in this respect, or terminate the agreement if the party referring the matter to the judge so requests.

No other precision is given on the facts susceptible to constitute an “unforeseeable change in circumstances” nor on the threshold beyond which the performance of the agreement becomes “excessively costly”.

The parties nonetheless have the possibility of rejecting the application of article 1195 of the French civil code as a suppletive legal provision and bearing the consequences of a change in circumstances. They may also adapt the criteria for the change in unforeseeable circumstances and fix the threshold beyond which the performance of the agreement becomes too costly or even adapt the intervention of the judge, who may be a professional judge or third party appointed by the parties.

Within the framework of M&A operations, the frequent recourse to conditions precedent and/or resolutory conditions means that there may be a long period between the “signing” and the “closing”.

“Material Adverse Change” (MAC) clauses are therefore frequently included in sales and purchase agreements. This clause specifically takes into account the risk of a significant change in circumstances between the signing and the closing and its purpose is to terminate the agreement. In agreements which are performed over a long period of time, hardship clauses aim to provide for an adaptation of the agreement to the changes in circumstances.

The professional drafting these clauses must now take into account the new article 1195 of the French civil code. This means that parties wishing to include a MAC clause stipulating the termination of the agreement without negotiation of the terms will have to specify expressly that the parties waive the right to demand a renegotiation of the agreement.

For the seller, it will be necessary to be particularly precise regarding the assets or situations which the unforeseeable change in circumstances concern, and if possible quantify the threshold beyond which the performance of the agreement is considered excessively costly with regard in particular to the impact on the purchase price. In practice, sellers will seek to obtain from purchasers a waiver of the right to renegotiate or terminate the agreement in the event of unforeseeable circumstances.

For the purchaser, the drafting of the MAC or hardship clauses must be as wide as possible so as to offer an escape route or renegotiation of the agreement in particular as regards the purchase price.

In terms of the intervention of the judge, the parties may either purely and simply reject the judge in favour of a third party, or adapt the judge’s intervention by stipulating, for example, that the judge may only terminate the agreement and not amend it or allow for the modification only in certain proportions which have been agreed upon contractually.

Other impacts of the French Contract Law Reform

Corporate Team

Creation of a legal confidentiality obligation

The new article 1112-2 of the French civil code creates a confidentiality obligation: “He who uses confidential information obtained during negotiations without authorisation engages his liability in the conditions of ordinary law”. This general scope text which applies to periods of negotiation does not prevent the drafting of specific non-disclosure agreements, which are the first contractual document negotiated in the context of M&A operations, with a view to targeting the confidential information, the persons concerned and the exceptions.

Precisions regarding the conditions of the offer to contract (the case of letters of intent)

• The elements of the offer: The new article 1114 of the French civil code stipulates that to be valid, the offer must express “the will of its author to be bound in the case of acceptance” as well as “the essential elements of the contract envisaged”. Failing this “there is only an invitation to enter into negotiations”. Therefore in firm letters of intent (“binding offers”), it is necessary to indicate precisely the terms of the offer and the consequences of its acceptance even if conditions precedent are involved. Failing this, the offer will be considered to be indicative only (“non-binding offer”).

• Withdrawal of the offer: The 1er paragraph of the new article 1116 of the French civil code stipulates that the offer to contract “cannot be withdrawn before the expiration of the period of time fixed by its author or, failing this, until after a reasonable period of time”. During this period, the offer is irrevocable.

The reference to a reasonable period of time without further specification will encourage the systematic indication of a precise period of validity for the offer (mentioning if possible the date and the time).
• **Indemnification:** The 2nd and 3rd paragraphs of the new article 1116 of the French civil code provide for indemnification for the prejudice resulting from the withdrawal of the offer during the period fixed for the recipient to accept the offer: this withdrawal “engages the extra-contractual liability of its author in the conditions of ordinary law, without obliging it to compensate for the loss of the benefits expected from the contract”. In the absence of contractual precisions, the indemnification resulting from the withdrawal of the offer is limited principally to the costs incurred in conducting negotiations. It will be possible, nonetheless, to specify a more extensive indemnification contractually (for example by means of a penalty clause). On the other hand, if the withdrawal of the offer takes place after its acceptance, the liability of the offeror will be contractual, which will make it possible to obtain the performance of the contract thus formed.

**Clarification of the rules relating to non-performance**

Whereas the rules on contractual non-performance were scattered here and there within the French civil code, the reform groups together the different sanctions for non-performance within the same sub-section (articles 1217 to 1231-7 of the French civil code).

• **Defence of non performance (exception d’inexécution):** the sufficiently serious nature of the non-performance by one party gives the other party the right to refuse to fulfil its own obligation. A party may also suspend, in anticipation, the performance of its obligation if it is clear that the other party will not fulfil its obligation by the due date, subject to serving notice.

• **Forced execution in kind:** with the new article 1221 “the creditor of an obligation can, after formal notice, proceed with execution in kind unless said execution is impossible or if there is an evident disproportion between its cost for the debtor and its interest for the creditor”. The creditor may also have the obligation executed itself.

These new provisions considerably strengthen the efficacy of shareholders’ agreements which stipulate put and call options and tag along or drag along clauses to the extent that non-compliance with these clauses could lead to their forced execution and not simply to the payment of damages.

• **The reduction in price:** an intermediary sanction between the defence of non-performance and the termination which makes it possible to proceed with a revision of the agreement for up to its effective performance. If it has already paid, the creditor of the obligation may seek a reduction in price; if it has not yet paid, the creditor serves notice of its decision to reduce the price as rapidly as possible.

• **The termination of the agreement:** the termination results either from the application of a resolutory clause contained in the agreement or, in the event of sufficiently serious non-performance, in a unilateral decision by the creditor or a court decision.

• **Damages:** Damages are in addition to the above sanctions. They are only due if the debtor has been served formal notice to perform its obligations within a reasonable period of time.

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**Free shares: 1 step forward, 2 steps back!**

The Macron law adopted in July 2015 considerably improved the tax and social regime for free shares granted to company employees:

- Taxation of the acquisition gains as capital gains on securities rather than as wages and salary, thus allowing the person to whom the free shares were granted to benefit from a tax allowance based on the time during which the free shares were held;
- Discontinuation of the employee contribution of 10%;
- Reduction of the employer contribution from 30% to 20%.

During the night of October 19, 2016, the majority members of French parliament filed an amendment to the finance bill for 2017 with the intention of turning back the clock and terminating the improvements brought about by the Macron law.

The government nonetheless opposed a modification of this regime, in particular as regards the retroactivity attached to this modification.

In the end, a compromise was reached between the government and its majority. The finance bill for 2017, adopted on December 20, 2016, includes the following modifications:

- The acquisition gains up to the annual threshold of EUR 300,000 will subject to French personal income tax as a capital gains. Beyond the annual threshold of EUR 300,000, the acquisition gains will be subject to French personal income tax as an employment income.
- Rate of employer contributions fixed at 30%, the exemption from employer contributions maintained for SME (small and medium enterprises) which have not distributed any dividends since their creation;
- Application of the new regime to free shares whose grant is authorised after the publication of the finance bill for 2017.

Therefore, the free shares are governed by several rules depending on the date on which the general shareholders’ meeting decided to grant them. It will therefore be necessary to keep watch over the legal and tax regime for free shares in 2017 as it is likely that it will be modified again depending on the mood of the next governments.