DROIT ET CROISSANCE
FAIRE DU DROIT UN VECTEUR DE CROISSANCE

FOR A REAL CORPORATE GOVERNANCE IN FRANCE

REFLECTIONS ON SHAREHOLDER ACTIVISM

25 September 2019

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ABSTRACT

In the wake of the introduction of the PACTE[2] Act, the Rules for Growth Institute invites French and European legislators to move beyond ideological squabbles over the "corporate purpose" and to build on the most recent academic work in order to improve corporate governance and complete the construction of the Capital Markets Union.

The advent of a real Capital Markets Union is, as everyone will agree, essential in order to ensure the long-term financing of European companies, which are facing severe competition from American and Chinese companies. Completing this Union requires, in particular, that Member States provide greater protection for investors through corporate governance rules. However, the public authorities have recently both at the European and at the French level, taken measures that are at odds with this objective by undermining the rights of the most proactive shareholders, pretexting that such activists only have a short-term vision for the companies in which they invest.

French and European law lack in this area a strong foothold in academic research. Rather than making activist funds the scapegoats of the challenges that financial markets face, this study mobilises a conceptual framework guiding the formulation of proposals that deserve to contribute to the public debate on the subject of corporate governance in France, but also in Europe. It is by no means intended to claim that this framework applies in all circumstances, nor does it describe in

[1] The authors would like to thank Thomas Bourveau, Edouard Cluet and Vasile Rotaru for their careful review and suggestions for improvement.

[2] Law n° 2019-486 of 22 May 2019 on the growth and transformation of companies

all places all the possible situations encountered by corporate officers and their shareholders in the day-to-day life of a company. The objective is, on the contrary, to pacify the terms of the debate on the role of activists in France through a few general proposals which, although not accepted on their own merits, deserve at the very least to be debated.

In corporate law, the most recent shareholder-manager relationship models, based on the principles of the so-called agency theory, include two types of costs incurred in the context of this relationship:

- agency costs, incurred by the principal, who accepts them, for the management of its asset by an agent, or, in the case of a commercial company, the cost of the control, by shareholders, of their corporate officers (supervision, risk of conflict of interest, etc.); and

- principal costs, which are opportunity costs incurred when shareholders' control is not the optimal solution (coordination problems, lack of competence, investment horizon problem, etc.).

Each of these two types can itself take two forms: costs of conflict, generated by unfair behaviour towards the company, and costs of competence, resulting from errors in judgment.

As a result of this analysis, the Rules for Growth Institute proposals are structured around two themes:

Proposal n°1: reducing agency costs, and in particular:

1) for **conflict costs**, (i) making company's managers more accountable when they risk putting their personal or divergent interests ahead of those of the company and the shareholders' community through the introduction of duties of loyalty, (ii) ensuring the representativeness of the boards of directors, (iii) granting additional rights to minority shareholders in companies with a controlling shareholder (e.g. the right to appoint only independent directors and to appoint auditors) and (iv) effectively ensuring that investors can exercise their rights before the courts, in particular by introducing a French class action;

2) with regard to **competence costs**, encouraging the French Financial Market Authority ("AMF") to review its transparency standards in order to facilitate the work of information intermediaries, such as financial analysts, whose role is essential in assessing the strategic choices of the management. This presupposes that the AMF take up the subject of protecting financial analysts exposed to a risk, established or suspected, of retaliation by the issuers they analyse.

Proposal n°2: reducing principal costs, and in particular:

1) with regard to **conflict costs in general**, reviewing the provisions on majority abuses by introducing an effective duty of loyalty to be borne by controlling shareholders; also, reviewing rules relating to the regime of so-called "regulated agreements;"

2) for **conflict costs with minority shareholders** and **competence costs of principals**, implementing (i) an appropriate corporate governance regime in order to ensure regular dialogue with investors, for instance through the systematic appointment of a referent director to enable closer interaction with them and (ii) a high standard of financial reporting.

The objective of these measures is to move beyond a confrontational approach that is detrimental to the benefits of activism and, instead, focus on a collaborative approach. Improved corporate governance will facilitate collaboration between issuers and active and committed

shareholders at a time when companies, large and small, have never been more reliant on a strong stakeholder ecosystem in an increasingly competitive world.

INTRODUCTION

Two hundred American CEOs recently signed a statement through the American Business Roundtable calling for a shift from the so-called "principle of maximizing shareholder value" to a redefinition of the purpose of companies in favour of a larger number of stakeholders[3], without ever specifying exactly who these stakeholders should be. In a public memorandum, the American firm Wachtell, Lipton, Rosen & Katz, a fervent promoter of this approach, described this commitment as the best way to respond to the revolt of the losers of capitalism which, if ignored, would lead first to populism and then to "state corporatism."[4]

This position has not been unanimously accepted in the United States, particularly in the academic world. For Professor Zingales of the University of Chicago, the American managers' call to redefine the company's role was not without its backwards motives. As a clear dilution of their responsibility, a duty on the part of managers to be accountable to a broad community of stakeholders would ultimately hold them accountable to no one.

According to Professor Zingales' argument, there is nothing to prevent American companies, as things stand, from "delivering value to consumers", "investing in their employees", "negotiating fairly and ethically with their suppliers" or "supporting the communities in which we live:"[5] who could reasonably challenge these objectives? Since the long-term interests of shareholders are not separate from the interests of the common undertaking, it is first and foremost necessary to avoid that corporate officers relinquish their responsibilities without the necessary and legitimate countervailing power of shareholders, at the expense of significant agency costs for the company.

Other authors argue that the weight of investors in determining the conduct of their company's business is a source of undesirable principal costs (costs of competence, of justification, etc.), which are therefore harmful to the companies' performance.

In France, the debates that preceded the entry into force of the PACTE Act, in which the idea of a broader social interest - a concept similar to what has recently been proposed by the Business Roundtable - was embodied, were unfortunately not very nourished[6]. In particular, the Rules for Growth Institute regrets the total absence of academic references in the preparatory work for the law,

[3] D. Benoit, *Move Over, Shareholders: Top CEOs Say Companies Have Obligations to Society*, The Wall Street Journal, 19 August 2019

[4] M. Lipton, S. A. Rosenblum, K. L. Cain, Sabastian V. Niles, A. S. Blackett and K. C. Iannone*, It's Time To Adopt The New Paradigm*, 11th February 2019, available at: http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK. 26357.19.pdf

[5] L. Zingales, *Don't trust CEOs who say they don't care about shareholder value anymore*, The Washington Post, 20 August 2019

[6] Except for a report from the think tank *Generation Libre*, "*Ne laissons pas les juges moraliser l'entreprise*", available at: https://www.generationlibre.eu/wp-content/uploads/2018/06/ 2018-06-Objet-social-_generationlibre-2.pdf

with the sole exception of an outdated reference to the doctrine of corporations upheld by the "*École de Rennes*" in the eighties.[7]

Undoubtedly, the rise in institutional shareholding, reflected in increased competition between asset managers, has led to an increase in the propensity of some institutional investors to reduce their investment horizon. However, the link between this reduction and, for example, the decline in corporate investment has never been clearly established by scientific research.[8] On the other hand, it has been established that the transformation of the capitalist system into a, economic system "without capital," as a result of the evolution towards an increasingly intangible economy,[9] was, more than short-termism, a global factor in reducing corporate investment.

Thus, it seems that the challenges to which our economic models are exposed require responses other than a law which, by stating that the social interest must be defined by taking into account other stakeholders than shareholders, merely is a reminder of the obvious. The poor quality of the preparatory work and impact studies on this subject - the Sénard-Notat report, commissioned by the Ministry of the Economy and Finance, distinguishing itself by its extraordinary paucity[10] - not even to mention the deafening silence of French academic research, particularly legal research,[11] on this subject, encourages risky initiatives by the legislator.

The purpose of this study is to assess the conditions under which the interests of the company's various stakeholders deserve to be taken into account and, in particular, to determine the conditions under which shareholder activism can be beneficial. To fully understand the state of corporate governance and the respective positions held by executive officers and shareholders in France, it is essential to recall how the French market economy as we know it today has gradually emerged (I). The way in which this development has shaped the economic landscape of our country contrasts sharply with the contemporary rise of a new shareholder engagement, of which hedge fund activism is only a symptom, and which the French public authorities have not yet taken to its proper measure (II). It is this contrast that today leads the Rules for Growth Institute to develop a series of proposals in favour of a more balanced approach between the respective rights and duties of managers and shareholders (III).

I. ANALYSIS OF THE FRENCH SITUATION

The Second World War and the "*Trentes Glorieuses*" (the thirty years following WWII) were, for France, the era of a "*post-dirigiste*" market economy. The State has devoted itself to the creation of national champions, the "*fleurons*" of the French industry, notably through a series of

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[7] French National Assembly, Report n°1237, 15 December 2018, available at: http://www.assemblee-nationale.fr/15/rapports/r1237 tII.asp ; J. Paillusseau, *Les fondements du droit moderne des sociétés*, JCP 1984. I. 3148

[8] M. Roe, *Don't Blame Stock Markets for Peril of Short-Termism*, Harvard Law School Forum on Corporate Governance and Financial Regulation, 15 June 2018

[9] J. Haskel and S. Westlake, *Capitalism without Capital. The Rise of the Intangible Economy*, Princeton University Press, Hardcover, 2017

[10] J.-D. Sénard and N. Notat, *L'entreprise, objet d'intérêt collectif*, 2018.

[11] By way of comparison, it should be noted that there is substantial work in the field of management sciences relating to the corporate purpose and prior to the debates on the PACTE law, carried out by researchers from the École des Mines in particular. For a position in favour of an extended role of a companies, see in particular . Segrestin and K. Levilain, *La mission de l'entreprise responsable. Principes et normes de gestion*, Paris, Presses des Mines, 2018 ; For the opposite view, see. M. Albouy, *Autorité de gestion et avaries communes : une note de lecture*, Finance Contrôle Stratégie, 2011, vol. 14, no. 4, pp. 7-19

nationalisations. The fallen leaders after years of collaboration of the Vichy regime have then given way to a new generation of high-ranking civil servants.[12]

Although it was no longer justified during the wave of privatisations at the end of the 1980s[13], the presence of these leaders from the public sector remains, even today, very significant within the CAC 40 (the 40 highest valuations among French listed companies) as well as within banking institutions.[14] A study has shown that former high-ranking civil servants control 60% of listed companies in France.

This is a peculiarity of French capitalism compared to what is observed in the other Member States of the Union. Yet, the influence of high-ranking civil servants in the governance of CAC 40 companies seems to represent, because of its cultural homogeneity, an obstacle to diversity, innovation and initiative. It can even have a cost for companies, and in particular, as it has been demonstrated before, when its managers decide to put their political connections ahead of their social mandate.[15]

In these circumstances, personal relationships are too central for financial markets, dominated by impersonality, to effectively play their role in allocating funds to the best projects. Thus, and as almost everywhere else in Europe, where corporate financing is mainly based on banking institutions, the formation of a ruling class, at the helm of both companies and credit institutions, encourages the creation of alliances that hinder the development of the Capital Markets Union[16] and, especially, of bond markets.[17] The European Union must challenge itself to reverse this trend.

As with the position of State agents at the top of French companies, the ownership structure of large French companies, most often having a controlling shareholder, is partly due to historical reasons. The privatisation movements of the 1980s led to what some authors have described as "locked governance structures"[18] resulting from the development of cross-shareholdings between newly privatised companies. Finally, the financial engineering of Parisian bankers, who have developed skilful pyramidal structures and limited partnerships, has fostered the emergence of omnipotent controlling shareholders who, when they do not merge with them, impose their will on the managers they appoint, to the detriment of minority shareholders[19] and the market's transparency[20] in general.

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[12] R. Elgie, E. Grossman, A. Mazur and V. Schmidt, *Varieties of Capitalism: a distinctly French model?*, The Oxford Handbook of French Politics, Oxford University Press, 2016

[13] M. Maclean, C. Harvey, et J. Press, *Business Elites and Corporate Governance in France and the UK*, Basingstoke, 2006

[14] J. Delépine and M. Chevallier, *Enquête sur l'aristocratie du CAC 40*, Alternatives Economiques n°379, 2018

[15] M. Bertrand, F. Kramarz, A. Schoar and D. Thesmar, *The Cost of Political Connections*, Review of Finance, 2018, pp. 849–876

[16] P. M. Thomsen, *On Capital Market Finance in Europe*, Fonds Monétaire International, 14 June 2019

[17] Bond markets thus make it possible to limit the transformation risk inherent to banking credit, while promoting greater transparency through the "price discovery" market mechanism by reducing the cost of financing and diversifying the credit offer.

[18] P. Harbula, *The Ownership structure, Governance, and Performance of French Companies*, Journal of Applied Corporate Finance, 2017, 19, 88-101

[19] J. C. Coffee, *The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control*, Columbia Law and Economics Working Paper n°182, December 2000

[20] As explained below, this also calls for a strengthening of the internal and external audits of these companies. See in particular S. E. Ghoul, O. Guedhami and J. Pittman, External versus Internal Monitoring: The Importance of Multiple Large Shareholders and Families to Auditor Choice in Western European Firms, SSRN, 28 May 2018

Some of these family structures have emerged with the assumed support of the State, as the case of a French leader of the luxury industry has shown.[21]

The weak prerogatives of minority shareholders in these companies contrast with the predominant role that French corporate law traditionally attaches to the CEO as a corporate officer, with a range of tools being at his disposal to neutralise any counter-power within the company. This is reflected, for example, by the energy with which the so-called "monist" system of the Chairman and Chief Executive Officer continues to exist within public limited companies. Despite the governance concerns raised by this system, the 2001 NRE Act[22] only partially challenged it rather than prohibiting it[23]. This type of evolution, more symbolic than real, is symptomatic of a French legal regime that suggles to get rid of the systematic preponderance of the manager within the company[24].

Faced with this central role of the CEO as a corporate officer in French companies, and as explained below, our capital markets and the French cultural and regulatory environment encourage significant shareholders to extract substantial personal benefits from the control they exercise, to the detriment of minority shareholders and/or other stakeholders.

In a globalised environment, the development of the French economic model must take place in such a way as to encourage the development of financial markets and, above all else, the construction of the Capital Markets Union, which is the only way for Europe to succeed in front of the American and Chinese domination. However, recent developments in both French and European legislations do not support this view. This situation is all the more regrettable at a time when the government is introducing a pension reform which, by setting up a points system, will see its success conditioned by the quality of our financial markets, where pension funds will go to finance the pensions of their members.

II. THE RISE OF ACTIVISM

The actors of the "French capitalism" now feel threatened by the progressive emancipation of shareholders, which is enabled by the concentration of capital in an always smaller number of institutional investors' hands, including activist funds. The influence of these activists has kept increasing in recent years, in the wake of the rise of asset management, which is becoming more and more passive. However, it is the Anglo-Saxon world, and in particular the United States, that is both the birthplace of activism[25] and the place where most investment funds specialising in this type of practice can be found.

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[21] In this way, Bernard Arnault started his fortune by getting the consent of the French government to acquire Christian Dior, which was in distress, see V. H. Agnew, '*I always liked being number one' The world's third-richest man on luxury, LVMH's succession — and taking a point off Federer*, Financial Times, 21 June 2019.

[22] Art. 106 of Law No. 2001-420 of 15 May 2001 on new economic regulations.

[23] Art. L. 225-51-1 C. com.

[24] If there may be exceptional circumstances requiring the temporary reunion of the positions of Chairman and Chief Executive Officer, this should be limited in time and strictly supervised by the counter-power of a designated director for that purpose. Many governance codes from different OECD countries have deployed a series of tools to ensure the effective exercise of these countervailing powers, for example by removing the ability of the Chairman and CEO to determine the agenda of board meetings.

[25] As early as 1926, Benjamin Graham, founder of the practice of "value investing" and mentor to Warren Buffet, was known for his questioning to the managers at the general meeting of the Northern Pipeline, surprised by the presence of a shareholder at the meeting (!) and who, offended by this impudent intervention, rescheduled the meeting in a remote and less accessible town. These first "activist"

This activity developed throughout the 20th century to finally adopt, among other forms, that of the activist hedge fund, as it is regularly depicted by the press. Unlike traditional asset managers, these funds do not hesitate to communicate directly with managers. The evolution of corporate ownership as a whole has also contributed to their resonance, with passive institutional investors aligning their strategy with that of activist funds on an *ad hoc* basis.[26]

While the rise in shareholder engagement is rightly desired by public authorities, in an effort to attract ever more capital and to offset the perverse effects of passive management, it is wrong for public authorities to try to distinguish between "good" long-term shareholders and "bad" short-term shareholders, with investment funds being considered to be in the vanguard of such a short-termism trend. Recently, the "Shareholders' Rights" Directive, known as "SRD 2", whose explicit aim is "to promote the long-term commitment of shareholders",[27] has thus wrongly believed that it could encourage shareholder engagement and, in its wake, the Capital Markets Union by weakening investment funds' rights[28], for instance by increasing their strict reporting requirements when thresholds are crossed. However, research has shown that many institutional investors are not proactive, but simply reactive, and that despite the essential role played by them[29], it is difficult to conceive shareholder engagement without the participation of investment funds.

However, the increased constraints imposed by the rules applicable to threshold crossings reduce the incentives for these funds to adopt an activist approach. The publication of their positions leads to the immediate mimicry of passive investors, who intend to appropriate a share of the profits generated in the long term by activists and, in so doing, cause an increase in share prices, significantly limiting the profit made by activist funds from their own strategy.[30]

In general, the long-term effects of activist campaigns by investment funds on target companies are the subject of intense debate. The first area of contention relates to their investment horizon. Indeed, there is a wide variety of funds that can be considered as "activists," just as *a priori* passive investors can sometimes adopt strategies similar to those implemented by the most active funds. From one to the other, investment strategies and horizons can change completely.[31] It is therefore necessary to adopt an approach that is as scientific as possible to determine precisely the extent of the benefits as well as the pitfalls of shareholder activism.[32]

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interventions in the modern sense, recounted in Jeff Gramm's book, have made him one of the founding fathers of the movement. J. Gramm, *Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism*, HarperBusiness, 23 February 2016.

[26] R. J. Gilson and J. N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, Columbia Law Review, 2013

[27] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC to promote long-term shareholder engagement

[28] A. Pacces, *Hedge Fund Activism and the Revision of the Shareholder Rights Directive*, European Corporate Governance Institute (ECGI). Law Working Paper n°353/2017, 5 July 2017

[29] I. Appel, T. A. Gormley and D. B. Keim, Passive Investors, Not Passive Owners, Financial Economics (JFE), forthcoming, 6 February 2016.

[30] *Ibid*.

[31] M. Nussenbaum, *L'impact de l'action des fonds activistes sur la valeur actionnariale*, La Semaine Juridique n°36, 6 September 2018

[32] T. Frossard and C. Jakymiw, *L'activisme actionnarial — Surpasser les craintes françaises pour en faire une force !*, April 2018

A. — Benefits and pitfalls of shareholder activism

Clearly, shareholder activism cannot flourish unrestrained: in the absence of appropriate rules, minority shareholders may be tempted to adopt unfair market practices that are guided solely by their personal interests and harm the interests of the company and other shareholders.

First, there is a risk of low shareholder sophistication or even low relevance of the information at their disposal, which could lead to competence costs. In this field, however, the company is in principle able to set up effective palliatives, such as appropriate communication, an educational approach towards less sophisticated shareholders and the search for investors understanding its industry and activities.

Secondly, it is worth considering whether the ponctually short-termist motivations of some investors, often denounced, might be unlikely to destroy long-term value. Although short-term thinking may be in the interest of some, it should be remembered that shareholders of the same company often form a very diversified group. It is therefore important to prevent them from serving their own interests at the expense of the corporate interest. This requires a balance between the powers of managers, employees and other stakeholders in the company.

That being said, it is important to recognise the beneficial effect, demonstrated by a great deal of research,[33] that activism can have in markets where bad practices, on the part of both the managers and the controlling shareholders, have accumulated. Activists have thus shown their singular effectiveness in challenging the construction of empires that flatter the ego of leaders more than the group's performance.[34]

Moreover, the strategy of activist funds rarely consists in fundamentally disrupting the core business of the invested company, but rather in influencing its management when it appears that inefficiencies in terms of governance or strategy can be corrected by their action. It should be borne in mind that activist funds are almost systematically aiming to influence minority shareholders. Therefore, their real impact necessarily consists, in the end, in convincing other shareholders of which management problems deserve to be corrected. This is evidenced by the observation that the strategy of activist funds has almost invariably consisted, in the past, in making criticisms (often public) of the company's management, or even in coordinating shareholders' vote.[35]

However, it is clear that this approach can only be successful if it is demonstrated that acting in accordance with the recommendations made maximises the value of the company in the interest of everyone. The very nature of the activist funds' strategy therefore leads to a rejection of the preconceived idea that these funds systematically seek to profit from companies on a short-term basis and in a way that is contrary to the interests of other shareholders.[36]

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[33] See on the spillover effect of shareholder activism on the target's competitors: N. Gantchev, O. Gredil and P. Jotikasthira, *Governance under the Gun: Spillover Effects of Hedge Fund Activism*, Review of Finance, forthcoming 2018 ; C. Zhu, *The Preventive Effect of Hedge Fund Activism*, 2013 ; H. Aslan and P. Kumar, *The product market effects of hedge fund activism,* Journal of Financial Economics, Elsevier, vol. 119(1), 2016, pp. 226-248.

[34] N. Gantchev, M. Sevilir and A. Shivdasani, *Activism and Empire Building*, Journal of Financial Economics (JFE), forthcoming ; European Corporate Governance Institute (ECGI) - Finance Working Paper n°575/2018, 28 August 2019

[35] M. Lipton, *Dealing with Activist Hedge Funds and Other Activist Investors*, Harvard Law Review, 2019

[36] A. M. Pacces, *Shareholder activism in the CMU*, 2017

The action of activist funds, which generally has many beneficial effects on the governance of the companies in which they are involved, has also been widely documented[37]. Suffice it to mention the number of companies that have had to endure years of mismanagement before the arrival of such funds, who have encouraged the expulsion of executives who were not able to demonstrate their worth, or even may have been dishonest for some of them, before these companies' governance has been improved[38]. Similarly, activist funds have been able to contribute to improving the governance of many companies by appointing new independent directors, or even by promoting the interests of all shareholders through an upwards renegotiation of the price of public offers targeting their company.[39]

Finally, the gradual emancipation of shareholders identified in recent years and the emergence of constructive approaches by activist funds are signs that this new phenomenon will prevail in the long-term. The constantly increasing number of campaigns and assets under management, as well as the doubling of the capital deployed in Europe for this investment class between 2013 and 2017[40], are eloquent examples.

B. — Shareholder activism in France

Many French listed companies, including major companies such as Safran, have recently witnessed the arrival of activist funds in their capital.[41] While the long-standing experience of the largest companies in our country often leads to such companies being presented, rightly or wrongly, as jewels of our industry, the fact that activist funds, which have recently acquired stakes in their capital, are essentially foreign, has led to the idea that such acquisitions constitute speculative attacks that represent a danger for France. This myth, formerly embodied by the "Danone amendment," is still so prevalent today that even the current Minister of Economy, Sir Bruno Le Maire, has had the opportunity to echo it with regrettable and worrying approximations relating to the impact of activist funds on the French economy.[42]

Yet, in both France and Europe, a particularly large arsenal of anti-abuse devices designed to counter the potentially harmful effects of shareholder activism already exists.[43] Regulations punishing market abuses, as well as rules applicable to concerted action, thus appropriately preserve the integrity of financial markets in front of activists who, in their absence, might be tempted to act in a way that is contrary to the interests of the companies invested and the market as a whole.

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[37] Including in Europe: M. Albouy, C. Decante, A. Mauro and P. Studer, *L'impact des Hedge Funds activistes sur les performances à court, moyen et long terme des entreprises européennes*, Finance Contrôle Stratégie, 2017, vol. 20, n°1

[38] L. A. Bebchuk and A. Hamdani, *Independent directors and controlling shareholders*, 2017

[39] M. Kahan and E. B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, UPenn Law Review, 2007

[40] K. Romanteau, *The Golden Age of Activism Investing*, 2019

[41] A. Dupeyron and P. Kubisa, *Quel est l'impact des attaques des fonds activistes sur la communication financière des sociétés cotées françaises ?*, Pwc

[42] T. Leigh, *La France prépare sa riposte aux fonds activistes, dit Le Maire*, Reuters, 5 April 2019

[43] O. de Vilmorin and A. Berdou, *Activisme actionnarial : vade-mecum de la société-cible*, Bulletin Joly Bourse, BJB March 2016, n° 113e3, p. 114.

Moreover, the fear that some activist funds may disrupt the proper functioning of the economy has led, particularly since the 2008 crisis, to the multiplication of specific regulations directly addressing the activities of these funds, without ever having demonstrated their benefits.

In addition to the recent provisions of the PACTE Act mentioned above, the Florange Act has thus produced effects that are contrary to the objective sought by making minority shareholders, including long-termist ones, fear that the majority will be in a position to hold sway over general meetings thanks to the doubling of their voting rights,[44] a fear that has given rise to numerous withdrawals from SBF 250 companies. A dedicated study thus had the opportunity to highlight the withdrawal, following the adoption of the Act, of foreign long-term institutional funds from the capital of French companies, with the consequence of an increase in their cost of capital[45].

In this context, it is clear that future legislative and jurisprudential developments would benefit from greater rationality, taking into account the concrete effects of positive law on our economy, rather than following the passions and dogmas that may have been at their origin in recent years. In this regard, it is worth welcoming the personal position recently expressed by the President of the Autorité des Marchés Financiers, Robert Ophèle, who recalled on this occasion the benefits that can be derived from shareholder activism as well as the need to subject activist funds to regulations applicable to concerted action and market abuses.[46]

III. — Proposals

The issue of shareholder activism is sufficiently complex to require a clear understanding, before any intervention is made, of the nature of the various costs that the legislator must aim at reducing. To this end, we take up the matrix recently developed by Professors Goshen (Columbia University) and Squire (Fordham University)[47] and synthesize it:

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[44] P. H. Edelman, W. Jiang and R. S. Thomas, *Will Tenure Voting Give Corporate Managers Lifetime Tenure?*, ECGI Law Working Paper n°384/2018.

[45] V. T. Bourveau, F. Bochet and A. Garel, *The Effect of Tenure-Based Voting Rights on Stock Market Attractiveness: Evidence From the Florange Act*, working paper; see also: L. Boisseau, *Loi Florange : les droits de vote double découragent les grands fonds étrangers*, Les Echos, 11 February 2019.

[46] R. Ophèle, *Contribution de Robert Ophèle aux réflexions sur l'activisme en bourse*, AMF, 11 July 2019, available (only in French) at: https://www.amf-france.org/Actualites/Prises-de-paroles/Archives/Annee-2016?docId=workspace%3A%2F%2FSpacesStore%2Fa037e9e6-efbf-4ac7-9d82-c7d6dff51f0f

[47] Z. Goshen and R. Squire, *Principal Costs: a New Theory for Corporate Law and Governance*, Columbia Law Review, 2017

C. *Synthesis: The Control-Cost Matrix*

TABLE 1

	Competence Costs	Conflict Costs
Principal	- Lack of expertise - Inadequate information - Lack of intelligence - Poor emotional control - Duplicative efforts - Coordination problems - Cognitive myopia	- Collective-action problems - Reneging on promises - Rational apathy - Rational reticence - Holdouts - Empty voting - Different horizons
Agent	- Lack of expertise - Inadequate information - Lack of intelligence - Poor emotional control - Overconfidence bias - Optimism bias	- Shirking (reduced effort) - Diverting (self-dealing) - Option backdating - Entrenchment - Merging for size - Merging for diversification - Excessive or inefficient pay

The proposals below, inspired in particular by the work of Simone Sepe[48], implement a law & economics analysis taking into account the need for a certain balance of incentives of the various players involved.

I. Reducing of agency costs

A. Reducing conflict costs

Given the conditions under which French-style capitalism was born, it is not surprising that the issue of whether managers are sufficiently accountable to investors has often been ignored in political debates. However, the interest for the company of such reports is obvious, insofar as they make it possible, in accordance with the famous Modigliani-Miller theorem,[49] to reduce the cost of capital by reducing agency costs.

France is now undergoing the same trajectory as Germany, where the liability of the managers, and especially of the members of the board of directors, who are supposed to offer a counterweight to the omnipotence of the managers, is much more theoretical than real.

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[49] F. Modigliani and M. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, American Economic Review, 1958, p. 261–297 ; V. également : A. M. Pacces, *Shareholder Activism in the CMU*, 2017

1. Holding managers accountable

The French management liability regime is obsolete. The insufficient number of liability litigation cases has, on the one hand, prevented its evolution in case law; on the other hand, the absence of major convictions, and therefore of political scandals prompting it to act, has led the legislator to disregard the shortcomings of French law in this respect. However, it is not only necessary to make managers more accountable, but also to guarantee the independence and representativeness of the boards of directors, without which management supervision cannot be exercised effectively. Finally, shareholders must be able to act directly when the board of directors does not adequately protect their interests.

While giving judges the power to question the strategy implemented by the managers in the management of the company is obviously out of the question, it is at the very least necessary to ensure that the latter are not tempted to put their personal interests before those of the shareholders and the company they manage. To achieve this objective, case law should acknowledge the existence of a general duty of loyalty of directors towards shareholders, which would make it possible to go beyond the obvious abuses to which sanctions of mismanagement are confined today;[50] not to mention the even narrower scope of the "detachable fault," which is the only ground allowing to trigger the personal liability of a director.[51] This evolution would also give real meaning to the role played by the Board of Directors.

2. *Ensuring the independence and representativeness of the Board of Directors*

In order for the Board of Directors to be truly representative of all shareholders, one needs to make sure that the appointment of its members does not depend solely on controlling shareholders. Otherwise, there is a risk that the board will systematically act in the exclusive interest of his electors, without regard for minorities whose votes have no direct consequences for it.

The only way to ensure this is to make sure that the appointment of a minimum number of independent directors is at least partially dependent on the will of minority shareholders. This system, which has already proved its worth in several countries, can be implemented through various mechanisms: election of one or more directors by minority shareholders alone, veto power, choice of the appointment method by the company itself under certain conditions, etc[52].

3. *Ensuring that auditors are accountable to shareholders*

Investors should be allowed, beyong general meetings, to require auditors to report on their mandate, in particular when their renewal is considered. While auditors are subject to a regime guaranteeing their statutory independence, and despite major progresses introduced in 2016 by the

[50] See, for instance, the late declaration of *cessation of payments* (a date determined by the commercial courts, at which the current liabilities of the company were greater than its available assets so that it is considered insolvent): two cases from the Commercial Chamber of the Cour de Cassation, 27 September 2016, n°14-13926 and 14-50034.

[51] See the case law of the Commercial Chamber of the Cour de Cassation dated 20 May 2003, n°99-17092.

[52] L. A. Bebchuk and A. Hamdani, *Independent directors and controlling shareholders*, 2017.

European audit reform Act,[53] the risk of management's influence in the appointment process of auditors remains high. This issue is currently subject to intense discussions in both the United Kingdom[54] and the United States,[55] initiated after a number of scandals. Again, there are a multitude of possible methods to ensure this investor influence, including, as Professor Coffee[56] suggests it, by allowing minority shareholders to contribute to the appointment of auditors in certain situations. Whatever the chosen solution is, it is important that a debate take place in France on these essential issues.

4. *Ensuring that auditors are accountable to shareholders*

In addition to the board of directors, which is supposed to defend the interests of all shareholders, shareholders themselves must be able to act directly when their representatives do not perform their role properly. While allowing the company's management to be disturbed on a daily basis by misleading legal actions is obviously out of the question, there is also a need for a minimum number of safeguards enabling shareholders to exercise their supervisory powers directly in Court.

However, the French management responsibility regime strongly disincentivizes shareholders to engage in litigation, in two respects. On the one hand, it requires shareholders wishing to act on behalf of the company to pay the cost of the procedure in advance (and which they risk keeping at their own expense in the end) while denying them the benefit of the success of their action, which is reserved to the company.[57] On the other hand, it defines the individual prejudice of the shareholder, which is the only means by which he can exercise an action in his own name, in a way that is far too narrow for his action to be admissible in most cases.[58] In this respect, French law should be inspired by the wise balance between freedom of management and loyalty embodied in the "business judgment rule" implemented by the State of Delaware in the United States.[59]

In addition to substantial rights, shareholders must be able to organise themselves more easily on a procedural ground - if necessary through the creation of a genuine class action, the only way to solve free rider and shareholder coordination problems - so that they can really hold managers accountable. The Rules for Growth Institute will discuss this subject in the future.

Finally, in order for the board of directors and shareholders to be able to play their role properly, it is necessary for the company's management to be as transparent as possible. Intentional

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[53] Notably in terms of rotation of auditors in public interest entities: ord. n°2016-315 of 17 March 2016 relative au commissariat aux comptes.

[54] Following the collapse of Pâtisserie Valérie, the British Financial Reporting Council initiated a review of the auditors' accounting practices, particularly those of the Big Four. A reform is underway. See for instance: J. Jolly, *Decline in quality: auditors face scrutiny over string of scandals*, The Guardian, 1st February 2019.

[55] See for instance, through many examples, the recent scandal involving GE and PWC, J. Coffee, *Why Do Auditors Fail? What Might Work? What Won't?*, Columbia Law and Economics, working paper n°597, 11tJanuary 2019; European Corporate Governance Institute (ECGI), law working paper n°436/2019.

[56] J. Coffee, *Why Do Auditors Fail? What Might Work? What Won't?*, Columbia Law and Economics, working paper n°597, 11 January 2019; European Corporate Governance Institute (ECGI), law working paper n°436/2019

[57] Art. L. 225-252 of the French commercial code.

[58] See for instance the case law of the Commercial Chamber of the Cour de Cassation dated 19 April 2005, n°02-10.256.

[59] The Delaware government, The Delaware Way: Deference to the Business Judgment of Directors Who Act Loyally and Carefully, https://corplaw.delaware.gov/delaware-way-business-judgment/

breaches of transparency rules must be subject to severe criminal penalties. The Rules for Growth Institute will make several proposals in a future study.

B. Reducing competence costs

The AMF must reconsider its role and become aware of the issues associated with information costs. In particular, in order for activist funds to be able to contribute to the development of a value-creating strategy, the information provided by companies must be sufficiently precise and reliable to limit the scope for intentional opacity (such as complex bookkeeping set-ups).

Because the AMF's mission is to serve market efficiency, it must ensure with the utmost rigour that "information intermediaries," who accelerate the return of prices to the company's underlying value and at the forefront of which are financial analysts, can carry out their mission in the best possible conditions. Greater rigour on the part of the AMF in implementing corporate transparency rules, particularly on issues that contribute to conflicts of interest between managers and investors, such as the presentation of results, makes it easier for financial analysts to carry out their work, and therefore to carry out more effective external audits of companies. Similarly, analysts must be protected by the AMF so that they are able to carry out their work independently, since they do not enjoy a comparable legal protection to that of statutory auditors.

Giving analysts the opportunity to expand their reports by having additional information also contributes to a more effective control of managers by boards of directors, as directors can rely on these reports in the exercise of their control.[60]

II. Reducing principal costs

A) Reducing conflict costs for controlling shareholders

It is clear that minority shareholders are likely to commit abuses, as recently pointed out in the SCOR case, in which a director and minority shareholder of the company allegedly misappropriated confidential information to his personal benefit.[61] However, the action of majority shareholders, who are more likely to abuse their position in their own interest than their minority counterparts, should be regulated above all else. From this point of view, French law rules are insufficiently protective.

1. *Recognising a duty of loyalty of majority shareholders towards the company and all shareholders*

It is sufficient to note how case law on majority abuse actions, the main defence of minority shareholders against the action of the majority, defines the abuse strictly, to realise that majority shareholders are able to act with complete impunity in many circumstances. The abuse is indeed characterised only in the presence of the decision of a general meeting adopted against the interests

[60] Z. Goshen and G. Parchomovsky, *The Essential Role of Securities Regulation*, Duke Law Journal, February 2006

[61] L. Thévenin, G. Maujean and F. Vidal, *SCOR-Covéa : l'interview choc de Denis Kessler*, Les Echos, 11 February 2019.

of the company and for the sole purpose of favouring the majority to the detriment of the minority.[62] Yet, majority shareholders are likely to harm the interests of minority shareholders in many circumstances other than at a general meeting.[63]

In particular, and as mentioned above, their powers enable them to directly influence the decisions taken by the Board of Directors, or even directly or indirectly those of the Company's CEO. For example, managers are likely to be encouraged by the majority to make decisions or carry out transactions with third parties in which the majority has a personal interest, even in direct contradiction to the interests of the company and minority shareholders.

It is therefore appropriate to recognise, under French law, the existence of a general duty of loyalty owed by majority shareholders to minority shareholders and, more generally, to the company. The recognition of such a duty would allow minority shareholders to take direct action against majority shareholders to seek compensation. Other jurisdictions thus require majority shareholders to disclose any fact that is likely to have significant consequences for minority shareholders.[64]

2. Improving the related-party transaction regime

Because a broad conception of majority abuses would make it possible to limit transactions initiated by majority shareholders in their sole interest and to the detriment of other interests, it is also necessary to question the effectiveness of the French regime on related party transactions. This type of transactions can naturally be detrimental to companies and their shareholders, insofar as the company's contracting partner, for example a sister company as part of an intra-group agreement, is able to unduly capture part of the value of the transaction. This is why it is important to implement safeguards to protect the interests of both the company and its shareholders. It must be acknowledged that the French system does not stand out for its effectiveness in this respect[65].

The new provisions of the SRD 2 Directive introduce a framework for transactions carried out by the company with "related parties," a term used at the European level to designate regulated agreements within the meaning of French company law. However, although the PACTE Act has transposed some of the provisions of the Directive, it has remained silent on the system of disclosure and control by shareholders of transactions binding the company to related parties, and in particular does not allow non-controlling shareholders to assess their fairness[66]. It is therefore essential that public authorities quickly address this issue as part of the full transposition of the European directive.

In 2012, the AMF had already been given the opportunity to make a number of particularly welcome comments about regulated agreements, which unfortunately were not followed. Thus, decisions to approve regulated agreements by the board of directors should be justified. Similarly,

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[62] See for instance the case law of the Commercial Chamber of the Cour de Cassation, dated 18 Apil 1861.

[63] See for instance the "fiduciary duty" borne by majority shareholders in Germany, explained in A. Cahn, *The Shareholders' Fiduciary Duty in German Company Law*, Kluwer Law International, 2017; Nordic & European Company Law Working Paper n°18-13

[64] See Lynch v. Vickers Energy Corp., 383 A.2d 278 (Del. 1977).

[65] G. Helleringer, *Related Party Transactions in France - A Critical Assessment*, law working paper n°474/2019, SSRN, August 2019.

[66] According to the Recital 44 of the Directive: "Public disclosure of such transaction, for example on a company's website or by other easily available means, is needed in order to allow shareholders, creditors, employees and other interested parties to be informed of potential impacts that such transactions may have on the value of the company. The precise identification of the related party is necessary to better assess the risks implied by the transaction and to enable challenges to the transaction, including by means of legal action."

agreements entered into between an officer of a parent company and a subsidiary should, in certain cases, be subject to approval by the parent company's board of directors, taking into account the implications of the agreement for the entire group. In addition to these essential points, many other aspects of the regime, for which reference will be made to the report of the AMF, would deserve to be modified.[67]

B) Reducing conflict costs for minority shareholders and competence costs for principals in general

Obviously, injunctions from minority activist shareholders may not be in the interest of the company and, from this point of view, their influence may be costly. Since minority shareholders only have limited powers, it seems inappropriate to implement legal measures directly restricting their action. That being said, it is necessary to supervise their action by promoting (i) a corporate governance regime allowing a regular dialogue with investors and (ii) systematic financial disclosure that allows the company to deny, if necessary, the public message of activists who criticise the management of the company.

Regarding the first point, it seems useful for boards of directors to systematically appoint a lead director in order to facilitate dialogue with investors.

With regard to the second point, it is necessary, in order to promote collaboration between companies and activists, to put in place sufficient safeguards to protect the company against the undue exploitation, by minority shareholders, of the information obtained.

We return to these last two points after having detailed what they mean for companies and activist shareholders.

The challenge of reducing agency and principal costs: promoting collaboration between activist shareholders and managers

Despite the many virtues of cooperation between shareholders and managers, managers of listed companies have neither an incentive nor a natural constraint to collaborate with their shareholders. However, French positive law, as it stands, does not make it possible to remedy this situation[68].

The traditional paradigm is that of managers who have the necessary information to make the "right" decisions in the interest of the company. This view is, however, simplistic: optimal governance decision-making requires the participation of those who may have complementary information to that of the management. As such, the collaboration of managers with shareholders, who are increasingly sophisticated and specialised investors, is likely to create value, thus offering companies a competitive advantage. It is certainly possible that the rapid development of an innovative company may require to temporarily strengthen the management's powers by separating them from his capital ownership,

[67] French Financial Market Authority, Report of the Working Group on General Meetings of Shareholders of Listed Companies (End of consultation: 31 March 2012), available at: https://amf-france.org/en_US/Publications/Rapports-etudes-et-analyses/Rapports-des-groupes-de-travail?docId=workspace%3A%2F%2FSpacesStore%2F47f2cbe5-5261-4601-857b-444c3b9ebe06&langSwitch=true

[68] J. E. Fisch and S. M. Sepe, *Shareholder Collaboration*, Texas Law Review, U of Penn, Inst for Law & Economics, research paper n°18-22, 1st March 2019.

in favour of the company's development. However, this type of mechanism necessarily needs to remain temporary.

Even in the most innovative areas, long-term success is systematically due to the ability not only to raise a lot of capital, but also to take advantage of one's ecosystem, starting with shareholders,[69] many of whom are highly specialised in their industrial sector.[70] This trend explains, for example, why a large number of French biotech companies are setting up in New York, where investors have a real knowledge of the sector in which these companies operate.[71]

While activist funds were originally able to confine themselves to "simple" orientations, focusing on corporate governance and the use of profits, it seems that we should expect them to specialise in specific sectors and to be increasingly able to be more specific in their recommendations.

The risk that minority shareholders may seek to derive, in bad faith, undue benefit from the information made available to them in the context of a possible collaborative project must also be treated with the utmost rigour; otherwise, even honest minority shareholders would risk suffering from an anti-selection phenomenon - by which the managers would rather give up collaborating than risking that the information be misused - discrediting these minority shareholders' actions. Two possible approaches are (i) the recognition of a specific duty of loyalty on the part of collaborating minority shareholders, for example by prohibiting their global investment strategy from priming the company's interests when they receive confidential information,[72] and (ii) as mentioned above, the appointment, by minority shareholders, of independent directors who are willing to collaborate with them.

Conclusion

It is crucial to insert effective and concrete mechanisms protecting the rights of shareholders in order to restore a counter-power that would promote a model of collaboration between shareholders and managers. In the absence of appropriate legal instruments, France will remain a second-tier country in the emerging 21st century capitalism. Cooperation between shareholders and managers, in a context of fragmented information, is a competitive advantage that increasingly depends on the handling of information. The information circulating between players in a given market and their customers, as well as the ability to correctly process all relevant information in order to constantly adapt offers in the context of the market, have become crucial; this capacity stems from the aggregation of information from various sources for which different types of expertise are required, which we can doubt can all be reunited in the hands of the same individuals.

The concrete protection of shareholders' rights depends on the possibility, for investment funds, to form alliances with other institutional investors, as well as on the recognition of personal

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[69] T. F. Hellmann and M. Puri, *Venture Capital and the Professionalization of Start-Up Firms: Empirical Evidence*, Sauder School of Business, working paper, September 2000

[70] P. Gompers, A. Kovner et J. Lerner, *Specialization and Success: Evidence from Venture Capital*, Journal of Economics & Management Strategy, 2009, 18(3), 817–844

[71] *Les États-Unis, un eldorado pour les biotechs françaises*, Capital, 5 November 2016

[72] J. E. Fisch and S. M. Sepe, *Shareholder Collaboration*, Texas Law Review, U of Penn, Inst for Law & Economics, research paper n°18-22, 1 March 2019.

injury that renders credible the threat of legal action against the managers. It is also crucial that on both the manager's and shareholders' sides, collaboration represents a positive gain, especially with respect to listed companies. Finally, this collaboration cannot take place without holding managers accountable. An effective way to implement this system could be to create in France an equivalent of British fiduciary duties.

Shareholder activism represents an opportunity for French companies. They will only be able to seize it if the evolution of the French legal framework takes into accounts the respective incentives and interests of the various stakeholders of the corporate ecosystem. One needs to face the facts: those who have the capital necessary to finance French and European companies through the financial markets are also those who have the means to choose the markets they wish to enter. However, only rules guaranteeing, on the one hand, the rights of these investors while maximising, on the other hand, the value of companies for shareholders will make French and European markets sufficiently competitive in the long run for European and foreign investment funds to decide for good to invest in European companies. Only then can a true Capital Markets Union be created.