International Corporate Rescue

Volume 14, Issue 6, 2017

Editorial

398 *Estro*: The End of the (Dutch) Pre-pack
Vincent Vroom and Rolf Sperling

Articles

402 Share Buy-Back Programs in Times of Economic Downturn: The French Perspective
Anker Sørensen and Julie Cornely

406 Applicable Bankruptcy Law to Foreigners in the Gulf Cooperation Council (GCC) Countries within the Framework of Regional Agreements and the Law of Cross-Border Insolvency
Dr Zubaydah Abd al-Hadi

409 The Arrival of Corporate Rescue in Malaysia: New Frameworks and Challenges
Dr Paul J. Omar

418 Preventive Restructuring Frameworks: A 'Comedy of Errors' or 'All's Well That Ends Well'?
Professor Reinhard Bork

428 Join the Party! An Overview of the Case Law on Representation Orders in Canadian Insolvency Proceedings
Ouassim Tadlaoui and Hugo Babos-Marchand

432 What Has the Judicial Insolvency Network Done for Cooperation between Courts in Multi-Jurisdiction Insolvencies?
Jessica Walker and Annabelle Trotter

435 United Kingdom's Approach to Cross-Border Insolvency: A Comparative and Critical Analysis
Asif Salahuddin and Nikita Shah

442 Coordination or Centralisation? Group Insolvencies and COMI-Shifting under the Recast EIR
Jente Dengler

449 'The Path to Redemption Is Not Always Smooth': Unfortunate Consequences for Unredeemed Investors in the Cayman Islands
Matthew Goucke and Chris Keefe

US Corner

453 The Second Circuit Interpretation of the Trust Indenture Act in *Marblegate* Restores Confidence in Out-of-Court Restructurings with Requisite Majority Approval
Paul V. Possinger and Maja Zerjal

Economists' Outlook

459 Brexit and the Future of the Eurozone
Nauro F. Campos and Corrado Macchiarelli

Case Review Section

461 Insolvency Set-Off and the Impact of Security Interests in Australia
Alistair Fleming

463 *The Joint Administrators of Lehman Brothers Limited (Appellant) v Lehman Brothers International (Europe) (In Administration) and others (Respondents)* [2017] UKSC 38
Madeleine Jones

467 *Grand TG Gold Holdings Limited*: Pragmatic Adjournment of a Winding Up Saves a Going Concern Business
Nigel Meeson QC and Fraser Hughes

ChaseCambria

SOUTH SQUARE

Centre for Commercial Law

UCL LAWS

ARTICLE

Share Buy-Back Programs in Times of Economic Downturn: The French Perspective[1]

Anker Sørensen, Partner, and **Julie Cornely**, Senior Counsel, De Gaulle Fleurance & Associés, Paris, France

A number of listed companies have decided to buy back their own shares while the main purpose is to raise capital through the issue of their common shares. The same can be said for non-listed companies. The authors analyse the rationale behind such counter-intuitive behaviour meaning that companies spend hard-earned money to reduce their share capital. We also comment on the attractive aspects of these programs in times of low growth and on the legal framework applicable to issuers whose shares are traded on Euronext Paris and to non-listed companies.

On the European side of the Atlantic, listed companies have increasingly been seduced by what share buy-backs programs may have to offer. Such programs have gained in popularity, including in France. Prior to this recent change, share buy-back programs had a rather bad press in France as they were generally associated with transactions carried out by companies unable to attract investors, due to their losses, or considered as inappropriate spending.

This mindset is clearly changing as companies with significant amounts of cash have favoured this tool over external growth opportunities with a limited return on investment expectations. So much so that in 2016 alone, it appears that more than EUR 9.5 billion was spent on share buy-back programs in France. The most noticeable ones have been Sanofi (for approx. EUR 2.9 billion), Vivendi (for approx. EUR 1.6 billion) and Schneider, L'Oréal, LVMH, Vinci, Airbus and Saint-Gobain (each for an amount of approx. EUR 500 million).[2]

On reflection, there are numerous reasons why it may be beneficial to a company to repurchase its own shares.[3]

1. Reasons behind the programs

The reasons behind the buy-back programs include:

- ownership consolidation/reducing the share of minority or 'small' shareholders – the fewer outstanding shares, the fewer shareholders the company has to answer to;
- return on investment expectations – buying back some of the outstanding shares can be a simple way to pay off investors and reduce the overall cost of capital;
- boosting financial ratios – making the business more attractive to investors by reducing the number of outstanding shares and thereby mechanically increasing the company's earnings per share ratio;
- meeting obligations arising from debt financial instruments convertible into equity;
- create incentives to employees or members of the management of a company; and
- undervaluation – if stock is materially undervalued, the issuer can repurchase some of its shares at the lower end of their value and then re-issue them once the market has improved, thereby increasing its equity without issuing any additional shares (this option being however strictly regulated in some jurisdictions including France). In this way, the issuing company is able to turn equity into cash without further diluting ownership by issuing additional shares.

The legal framework applicable to such programs varies from one jurisdiction to another and from one market to another.

Notes

1 This article is restricted to share buy-back programs governed by Articles L. 225-209 and seq. of the French Commercial Code which underwent recent legal revisions. Other legal tools leading to share buy-backs are also available under French law such as share buy-back offers (*offre publique de rachat* 'OPRA'), but they are governed by specific sets of rules. The OPRA option offers the advantage that the issuer may buy back more than 10% of its share capital. Its implementation, however, will require the convening of a shareholders' meeting and will consist of a real market operation requiring a visa from the French Market Authority.

2 'Ces entreprises françaises qui succombent aux rachats d'actions', *Les Echos*, 9 January 2017.

3 Investopedia, 'Why would a company buyback its own shares?', 30 March 2017.

Such practices, however, are strictly regulated in Europe, as transactions directly launched by an issuer in order to regulate the stock market price or solely motivated by market-related reasons are strictly prohibited.

The legal framework has been further tightened as new stricter requirements have been set by very recent European regulations impacting the legal framework applicable to share buy-back programs here in France.

2. The framework applicable to listed companies under Articles L. 225-209 and seq. of the French Commercial Code

Following stricter new requirements set out by the European regulation applicable in relation to market abuse, the legal regime applicable to share buy-back programs has been extensively revised. The conditions for implementing a buy-back program in compliance with the new European regulation have been tightened and some transactions which were formerly authorised can no longer benefit from the previous derogations.

a. New legal framework

The new legal framework applicable to issuers whose shares are admitted to trading on Euronext Paris or a multilateral trading facility (MTF) is governed by:

- Articles L. 225-209 and seq. of the French Commercial Code;
- Articles 241-1 and seq. of the AMF General Rules (i.e. the *Règlement général de l'Autorité des marchés financiers* ('AMF'), AMF being the French market authority);
- Regulation (EC) 596/2014 of the European Parliament and of the Council dated 16 April 2014 on market abuse (the 'EU Regulation') (and more particularly Articles 5, 13, 14 and 15);
- Commission Delegated Regulation (EU) 2016/908 dated 26 February 2016 supplementing the EU Regulation laying down regulatory technical standards on the criteria, the procedure and the requirements for establishing an accepted market practice and the requirements for maintaining it, terminating it or modifying the conditions for its acceptance;
- Commission Delegated Regulation (EU) 2016/1052 dated 8 March 2016 supplementing the EU Regulation with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures;
- Addendum to the Commission Delegated Regulation (EU) 2016/1052 dated 14 September 2016 (the EU Regulation together with the supplementing regulations, being hereafter referred to as 'MAR');
- AMF recommendation 2017-04 with regard to regulatory technical standards for the conditions applicable to buy-back programs and stabilisation measures. This recommendation replaces the AMF's position (DOC-2009-17) which has been updated following the implementation of MAR. It reiterates the conditions under which issuers may deal in their own shares; and
- AMF instruction 2017-03 with regard to regulatory technical standards for the conditions applicable to buy-back programs and stabilisation measures. This instruction specifies the information that must be disclosed to the AMF and, in some cases, the format for those disclosures.

The MAR elaborates conditions and restrictions under which companies implementing buy-back programs are deemed to comply with the EU regulations and corresponding domestic law. This presumption of legality represents a safe harbour for companies implementing such programs. They are, however, strictly construed and leave very limited space for companies to take advantage of the market.

b. Exemption for buy-back programs under MAR (Article 5)

In order for a buy-back program implemented by an issuer admitted to trading on Euronext Paris or a multilateral trading facility (MTF) to qualify under the exemption provisions of the EU Regulation, such program must comply with the main following set of restrictions and conditions:

Purpose-wise restrictions

The purposes allowed by the European legislation for implementing buy-back programs are limited to (a) reducing the capital of the issuer, (b) meeting obligations of the company arising from debt securities exchangeable into equity or (c) meeting obligations of the company arising from share option programs or other allocations of shares to employees or to members of the administrative, management or supervisory bodies of the issuer or of an associate company.

Price restrictions

Issuers shall not, when executing transactions under a buy-back program, purchase shares at a price higher than the higher of the price of the last independent trade and the highest current independent purchase bid on the trading venue where the purchase is carried

© 2017 Chase Cambria Publishing

out, including when the shares are traded on different trading venues.[4]

Volume restrictions

Issuers shall not, when executing transactions under a buy-back program, purchase on any trading day more than 25 % of the average daily volume of the shares on the trading venue on which the purchase is carried out.

The average daily volume shall be based on the average daily volume traded during either of the following periods: (a) the month preceding the month of the required disclosures to be made; such a fixed volume shall be referred to in the buy-back program and apply for the duration of that program; or (b) the 20 trading days preceding the date of purchase, where the program makes no reference to that volume.[5]

Trading restrictions

In order to benefit from the exemption laid down in the EU Regulation, the issuer shall not, for the duration of the buy-back program, engage in the following activities: (a) selling of own shares; (b) trading during the closed period (as further detailed below); (c) trading where the issuer has decided to delay the public disclosure of inside information.

c. Implementation requirements

Buy-back cap

A company cannot purchase more than 10% of its share capital through share buy-back programs.

Accounting-wise requirements

Repurchase of shares must not result in decreasing the issuer's equity to a level lower than its share capital plus unavailable reserves (i.e in France they essentially consist in the statutory reserve ('*réserve légale*') and the reserves declared as such under the company's bylaws ('*réserves indisponibles/non distribuables*')).

In addition, reserves held by the company, other than the statutory reserve, must at least equal the total value of company-owned shares.

Consequently, when considering implementing a share buy-back program a company must first make sure that it will have enough cash or available reserves to both meet all its financial commitments and implement the share buy-back program.

Closed periods

The issuer must refrain from interfering with its own shares during specific closed periods.

Under French law, this concept of closed periods is defined either as:

- the time between which the company acquires knowledge of inside information and the time when it is made public; or
- the 30-day period before the dates on which the company's annual and half-year accounts are made public (this period becomes a 15-day minimum period in the event of quarterly or interim accounts).

There are however exceptions to these restrictions and the above shall not apply in the following main events: (a) the issuer has implemented a time-scheduled buy-back program; or (b) the buy-back program is lead-managed by an investment services provider ('ISP') (*prestataire de services d'investissement*) who makes his trading decisions concerning the timing of the purchases of the issuer's shares independently of the issuer.[6]

Disclosure requirements

Prior to the implementation of a share buy-back program, the issuer shall release a detailed description of the main characteristics of the program. For transparency purposes, listed companies must also comply with several different publicity requirements during the execution of the program.

Issuers must now fully and effectively disclose their buy-backs within seven days.

Rights attached to repurchased shares

Repurchased shares are deprived of all political and financial rights: they carry non-voting rights and grant no rights to receive dividends or to preferential subscriptions when new shares are issued.

d. Market practices

Market practices considered compliant regarding share buy-backs have also evolved under the new set of European regulations:

- Liquidity contracts on shares: such liquidity contracts are still allowed under French law, provided they are entered into with ISPs who act in full and complete independence from the issuer. However,

Notes

4 Article 3.2 of Commission Delegated Regulation (EU) 2016/1052.
5 Article 3.3 of Commission Delegated Regulation (EU) 2016/1052.
6 Article 4.2 of Commission Delegated Regulation (EU) 2016/1052.

© 2017 Chase Cambria Publishing

they are being adjusted to meet the stricter new requirements set out in the EU Regulation. The new framework for executing these contracts will enter into force once the European Securities and Markets Authority ('ESMA') has issued a ruling on its compatibility with the new European Regulation.

- Takeover bids: the repurchase of a company's own shares to be held in custody and delivered at a later date as part of external growth operations is no longer accepted as market practice (as of 3 July 2016). These transactions are not forbidden, but they no longer qualify for the exemption set out in Article 13 of the MAR.

3. Non-listed companies

One would think that the legal framework applicable to non-listed companies would be more flexible. But that is not the case under French law.

Until 2012, French non-listed companies were solely allowed to repurchase their shares for purposes of (i) immediate cancellation or (ii) employees' corporate saving plans.

Since 2012, non-listed companies are also allowed to repurchase their shares through buy-back programs under Article L. 225-209-2 of the French Commercial Code.

In this respect, a non-listed company may acquire shares in order to offer or reallocate them:

- within a year as from their acquisition: to beneficiaries of employee-shareholder transactions;
- within a two-year period as from their acquisition: in payment or exchange of assets acquired by the company within the framework of external growth transactions, merger, spin-off or contribution; and
- within a five-year period as from their acquisition: to shareholders of the company wishing to acquire them.

In the same way as for listed companies, a non-listed company cannot purchase more than 10% of its share capital through share buy-back programs. However, the shares repurchased for purposes of external growth transactions, merger, spin-off or contribution may not exceed 5% of the share capital of the issuing company.

Shares repurchased by non-listed companies are also deprived of all political or financial rights: they are non-voting and grant no rights to receive dividends or to exercise preferential subscriptions when new shares are issued.

The implementation of buy-back programs by a non-listed company is a burdensome procedure as it requires the appointment of an independent expert by a unanimous vote of the shareholders, a prior decision of the Board acting upon authorisation of the shareholders' meeting as well as the submission of a buy-back offer to each of the company's shareholders.

The shareholders' authorisation must determine (i) the purposes of the program; (ii) the time period for which the authorisation is valid (maximum 12 months); (iii) the maximum number of shares which may be repurchased (subject to the 5% or 10% cap restrictions); and (iv) the price or the conditions for setting the price which may be paid for the shares.

The share price is paid by deduction from the company's reserves which are at the free disposal of the shareholders' meeting (i.e. reserves other than the statutory reserve and the other unavailable reserves). In addition and as indicated above, an independent expert has to be appointed in order to determine a price range for the shares to be repurchased by the company. Such price range shall have to be complied with by the shareholders' meeting in order to guarantee the principle of equal treatment between shareholders, failing which the repurchase price paid by the company shall be considered invalid.

Consequently, in times of slow economic growth or downturn, a share buy-back program may prove to be a tool to be reckoned with as it will allow a company to concentrate on what makes it attractive to an investor or the public and refine its development strategy for the future.

However, even though this tool may be alluring, it requires in most cases, as a prerequisite to its implementation, that the company has available cash and reserves, which supposes that the company has conservatively managed its finances in the past.

Moreover and obviously, no share buy-back program should prevent a company from funding its planned investments, nor drain it of required cash or kept as funding cushions against possible market sector downturns.

© 2017 Chase Cambria Publishing