

Corporate Finance/M&A - France

Stock Options and Free Share Plans in Company Acquisitions

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Background
Due Diligence, Term Sheet and Acquisition Agreement
Adjustment Mechanisms
Global Plans

Background

When acquiring a French listed or non-listed company, stock option and free share plans - instruments that have been set up in order to motivate employees and company management - should be taken into careful consideration. These plans may result in an important adjustment by tax or social authorities in case of violation of corporate, social and tax regulations.

This update highlights the key corporate issues that must be dealt with when acquiring a company with existing plans or that is likely to implement new plans following the acquisition. Acquirors that are not sensitive to the importance of these plans run the risk of missing out on favourable social and tax regimes in case of non-compliance with Commercial Code requirements.

Due Diligence, Term Sheet and Acquisition Agreement

An acquiror should audit existing plans and discuss with the target company's management whether these plans comply with corporate, social and tax regulations. Both internal and public documents must be reviewed in order to assess compliance with French law, identify the beneficiaries of such plans and determine the terms and conditions (eg, vesting and holding periods). Such documents include:

- the plans;
- shareholders' general meeting resolutions;
- minutes of the board of directors; and
- annual reports.⁽¹⁾

The acquiror should review the status of employees, managers and officers that it wishes to dismiss or revoke after the acquisition, and ensure that the plans provide that beneficiaries may exercise their rights only if they are employed by the company when exercising the options or acquiring the free shares. Further, the company will have to demonstrate that the beneficiaries of the plans received a copy, preferably in French. Even if there is a contractual presence condition in the plans, an employee that is dismissed without cause and loses the right to exercise his or her options or the benefit of free shares may consider suing the company in order to receive an indemnity.

Identifying potential liability associated with non-compliance of the plans with corporate, social and tax regulations may require not only the insertion of appropriate wording in the term sheet and acquisition agreement, but also the amendment of existing plans. Some consider it impossible to modify an existing plan for an existing beneficiary, and hold that only future grants may be affected by modifications to the terms and conditions of the plans. However, others take the view that a beneficiary's rights may be modified with the consent of the beneficiary, despite the risk of an indemnity claim. For instance, in one acquisition the due diligence report showed - and the company management recognized - that plans were not compliant with regulations. This was reflected in the buyer's offer, which estimated the risk in case of a control by social and tax administrations. The term sheet and the share purchase agreement also included a representation and warranty by the seller that the company had no other existing plans as set forth in a schedule to be attached to these documents, and a condition precedent to closing requiring the amendment of the plans and the beneficiaries' consent to such amendment.

Merger agreements generally provide the terms and conditions under which the absorbing company will substitute itself to the absorbed company for the commitments taken by the absorbed company in favour of holders of option and free share beneficiaries. The shares received by employees and managers will be those of the absorbing company and the number will be determined by applying the exchange ratio retained for the merger.

Adjustment Mechanisms

Reviewing the adjustment mechanisms of the plans is essential for a buyer looking to maintain tight control of a company and employees, managers or minority shareholders under a level of share capital participation. The level of participation of employees and managers in the capital of the company may be considered an obstacle to a 100% capital sale contemplated by some buyers, such as a private equity fund, or as a factor in reducing the value of the company, especially if adjustment mechanisms allow these beneficiaries to receive more shares.

Adjustment provisions provided by the plans are applicable when the company undertakes financial operations which are likely to have an impact on the value of the shares, such as capital increase and capital reduction. Under these adjustment mechanisms, which can be complex and aimed at protecting beneficiaries of the plans, a financial operation may trigger the need to adjust the price of the shares and the number of shares a beneficiary of a plan may receive following such a financial operation. The adjustment implies that the total subscription or acquisition price remains the same for the beneficiaries of the plans. It is generally considered that there is a need for adjustment only if the financial transaction concerns all shareholders.

Global Plans

The existing plans of a French company acquired by a foreign company may not be a relevant incentive mechanism after the acquisition. Where a foreign buyer considers offering to its future employees and managers of a French subsidiary plans relating to the shares of the foreign buyer, the existing plans of the subsidiary must be terminated for social and tax reasons and provide for a liquidity agreement in order to allow actual beneficiaries to exit from the existing plans. The new incentive mechanism will take the form of a global plan at the level of the headquarters of the foreign company and a sub-plan at the level of the French subsidiary. This sub-plan must comply with social and tax regulations that imply compliance with certain Commercial Code provisions. A French holding company may also implement plans in favour of employees and managers of its foreign subsidiaries. However, such operations may create difficulties for the employees and managers subject to the local tax regime.

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Endnotes

(1) Equivalent US Form 20-F.

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