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France's Ordinance of 10 May 2017 and Decree of 12 July 2017 for improving the development of bond issues*

Having taken its inspiration from the best practices and regulations applicable to the international bond market and with the ambition of increasing the competitiveness of the Paris market place the French government has recently published an ordinance and an implementing decree which modernise but maintain the integrity of the French bond market.

The capital markets' share of corporate financing, and of the economy in general, is growing year on year. As a financing tool, bonds are well adapted to today's markets; they respond well to both issuer's and investors' needs for traditional, but also more innovative, products.

For issuers, the bond market is no longer the exclusive preserve of large issuers. Medium-sized companies – traditional devotees of bank finance – have turned to the capital markets in order to benefit from the Euro Private Placement (Euro PP) phenomenon, in a move encouraged by all the players in the marketplace and the European Commission. Another current expression of this can be seen in large infrastructure projects (*i.e.*, motorways, wind farms and fibre-optic cabling) which can no longer solely be financed by the public authorities, construction companies and banks; they too, have had recourse to the bond market through the issue of "project bonds".

Investors have shown a clear desire for more diversified risk which has led to a greater appetite for high yield bonds, for Euro PP bonds and project bonds and also for green bonds and other socially responsible investments.

The French law governing bond issues has only been modernised piecemeal over time (most recently by the 2014 ordinance on financial instruments). The overarching principles date back to the 1966 French companies' law, which adopted provisions from the 1935 French decree-law on the protection of bondholders.

As the outdated French law applicable to bond issues has become increasingly out of touch with market expectations, the attractiveness of the Paris marketplace has suffered. This can be seen in the substantial number of English law-governed bonds issued by French issuers.

As a result, in December 2014 the Paris Europlace Bond Committee (presided over by the author of this paper) was tasked with submitting proposals for modernising, while maintaining the integrity of, French law applicable to bond issues. Alongside this marketplace-led initiative, the French government was granted an enabling legislation mandate (article 117 I 1° of the Sapin 2 Law of 9 December 2016) to legislate by means of an ordinance "aimed at facilitating the development of bond issues".

Both a draft ordinance and a draft implementing decree were accordingly prepared and submitted for public consultation on the website of the *Direction Générale du Trésor* on 30 January 2017. These drafts have, for the most part, adopted the proposals of the Paris Europlace Bond Committee. The ordinance and the decree were published respectively May and July 2017.

The ordinance and decree provide for the following:

- Firstly, contractualising the rules relating to bondholder meetings and representation for "wholesale" issues;
- Secondly, modernising a number of outdated provisions; and
- Finally, repealing a number of outdated provisions which are either no longer applicable or in use.

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* This paper is closely based on an article written by the author of this paper and entitled "Ordonnance du 10 mai 2017 visant à favoriser le développement des émissions obligataires régies par le droit français". This article was published by Bulletin Joly Sociétés, June 2017, no. 116 m 5, page 416.

I Contractualising wholesale bondholders representation

1. The previous system: the Bondholders' *masses*

In order to protect their common interests, bondholders were grouped into a so-called "*masse*" which had its own distinct and separate legal personality and took decisions either in general meeting or through one or more representatives. This system originated in the 1935 decree-law, as modernised by the 1966 companies' law and transposed into the commercial code, which still contains the detailed regulations governing the *masse*.

Since the *masse* constitutes a "block," to which bondholder protections automatically apply, it was and still is considered satisfactory for all public bond offerings. However, it no longer conforms to international market standards expectations: it is not suitable for investors such as banks, insurance companies, mutual funds and investment funds, since institutional investors need a degree of contractual freedom in their relationship with the issuing entity.

While the previous law provided some flexibility for bonds "issued outside France", this flexibility was also needed for bonds issued in France to French investors (particularly in the case of Euro PP bonds). Moreover, there was no specific legal definition for what constituted an "issue outside France" and the distinction "France/outside France" was out of date in a market in which the key distinction is between "retail" issues offered to the public and "wholesale" issues reserved for institutional investors. This is the distinction used by the ordinance and the decree.

2. The new system: the *masse* is no longer obligatory

Bonds with a denomination equal to or greater than EUR 100,000 now benefit from contractual freedom under the ordinance and decree. The same applies to issues for which the minimum subscription or purchase amount is equal to or greater than EUR 100,000. As a result, issuers and investors are now free to define their relationships without the traditional *masse* provisions applying automatically.

The ordinance permits the contractual agreement of, *inter alia*:

- provisions for general meetings of bondholders with quorum and majority voting stipulations binding on all bondholders of the same series of bonds, without requiring that such bondholders be constituted in a *masse* with separate legal personality or have to appoint a representative;
- provisions specifying that it will not be necessary to submit proposed mergers, demergers or partial asset contributions involving the issuer to the general meeting of bondholders (see paragraph 4 below);
- provisions specifying that the quorum and voting majority necessary for any proposal submitted to the vote of the bondholders will vary depending on the nature of the proposal; international market standards modulate the quorum and voting majority requirements in accordance with the materiality of the decisions to be taken (for example, a simple majority for an ordinary resolution and a larger majority for a material decision (*i.e.,* a change to the interest rate or maturity date)).

Even if differing quorum and majority voting decisions are of relatively lesser importance in the case of plain vanilla bonds, it is difficult to imagine project bonds which do not provide quorum and majority voting conditions that vary in proportion with the significance of the decision being made.

3. The "return" of the *masse*

Although the regulations relating to the *masse* are no longer mandatory for "wholesale" bond issues, there is nothing to prevent the continued use of the *masse* regulations in either their original or amended form. Indeed, the *masse* regulations will almost certainly continue to apply to secured bond issues, which are becoming increasingly popular with certain institutional investors, particularly when issuing Euro PP bonds (for which the security is usually comprised of pledged securities accounts), real estate financings and project bonds (holders of project bonds benefit from a wide range of securities). Without the use of the *masse* with separate personality, the security would have to be

granted either to each bondholder individually (which would add complications when transferring the bonds) or to a security agent (as provided for in the civil code), who would be the title holder to the security on behalf of the bondholders. A recent ordinance of 4 May 2017 has led to a clarification of the regime applying to the security agent under the civil code.)

4. Mergers, splits, etc. of the issuer

It is widely recognised that the current system, which provides the bondholders' *masse* with a right to oppose any merger, split or partial transfer of a business, unduly complicates matters for issuers, who need to submit any such operation to general meetings of the bondholders. When, as permitted under the ordinance, the *masse* does not apply to the bonds, this collective right of opposition disappears, unless specifically provided for in the terms of the bonds. Does this mean that the bondholders are prejudiced? No. The ordinance provides that, in the absence of the *masse* and its representative, bondholders are treated the same as any other non-bondholder creditors in the case of the issuer's merger, split, share capital reduction not resulting from a loss or, in the case of a European company, seeking to transfer its registered office to another member state of the European Union. In such circumstances, bondholders will, under the ordinance, benefit from the same protections afforded to these other creditors, *i.e.*, an individual creditor's right of opposition.

5. Correcting a manifest error

The ordinance allows an issuer to amend the terms and conditions of the bonds unilaterally in order to correct a manifest error. This is in accordance with established international practice.

The validity of such unilateral modification provisions by the issuer was unclear under French law prior to the ordinance, since French law required that any amendment of the terms and conditions of a financial instrument – no matter how insignificant – could only be effected with the approval of the holders.

6. Use of the English language

Although this has no link with wholesale bondholders' representation the provisions of the ordinance governing the latter allow the use of the English language for wholesale bond documents.

It is well known the *loi Toubon* on the use of the French language requires, *inter alia*, French local authorities and project companies to "contract in French" with the consequence that their international bond documents are usually bilingual, the French version being the authoritative one despite the fact that the documents may have been negotiated in English.

The ordinance now allows the use of "a language, other than French, customary in the sphere of international finance" (i.e. the common circumlocution designating the English language) for all contractual documents associated with a wholesale bond issue whatever the quality of the issuer of the bonds.

7. Convertible bonds, bonds redeemable in shares, government bonds

These bonds are excluded from the application of the ordinance. All bonds which give the right to acquire new shares in the capital of a French company are excluded since such securities, in the case of listed companies, usually involve a public offering. Government bonds benefit from a special regime and are therefore outside the scope of the ordinance.

II Modernising outdated provisions

The ordinance and the decree also update a certain number of other provisions, and brings them more in line with current market practice. Examples of these updates include:

1. Vote by means of a written consultation

The general meeting of the bondholders is a deliberative body. Taking decisions assumes calling a meeting of the bondholders. The ordinance allows the terms and conditions to specify how a draft resolution can be submitted to a vote of the bondholders, whether in a general meeting, or via a written consultation of the bondholders (including via electronic vote), without the requirement of a

general meeting (for example, in the case of Euro PP bonds held only by four or five bondholders it would be possible to "circulate" a draft resolution waiving the requirement of the issuer to comply with a financial ratio).

2. Issue authorisations

Under the current law, bond issues must be authorised by the board of directors (*Conseil d'administration* or *Directoire*). The board authorises an annual borrowing amount and delegates the actual issue decision to one or more specified persons. For banks or credit establishments, the board can delegate this power to any person of its choice. For corporates, however, the commercial code only allows delegation to a member of the board, the CEO (*directeur général*) or the deputy CEOs (*directeurs généraux délégués*). For large corporates, while it is frequently the finance director or the treasurer who actually agree the specific terms of an issue, neither the finance director nor the treasurer are typically members of the board, the *directeur général* or a *directeur général délégué*.

The ordinance applies the regime applicable to banks and credit establishments to all companies, and permits the board to delegate the issue decision to any person of its choice. Subject to any corporate governance issues specific to each company, issue decisions will become less rigid without prejudicing the concept of board control.

3. Companies which are less than 2 years old

If newly incorporated companies wish to issue bonds, under the current law as set out in the 2004 ordinance on financial instruments, they must have their assets and liabilities verified by one or more court-appointed independent auditors. However, prior to 2004, newly-incorporated companies could also issue bonds with the guarantee of another company which itself had at least two approved balance sheets (usually the guarantor company was the parent company of the issuing company, which tended to satisfy the investors). This possibility, which was removed in the 2004 ordinance for no obvious reason, is reintroduced by the new ordinance.

4. Secured bond issues

As noted above, there is a growing tendency for certain investors to turn towards secured bonds (for example, Euro PP bonds and project bonds). The provisions of articles L.228-77 et seq. of the commercial code with respect to secured bonds were very dated, and they are updated in the new ordinance:

- Firstly, although articles L228-77 *et seq.* maintained the expression "particular securities" (*sûretés particulières*) (an expression which has no meaning in French law), it was almost universally accepted that articles L228-77 et seq. referred to the taking of security over assets (*sûretés réelles*) such as pledges (*nantissements*). The ordinance replaces *sûretés particulières* with *sûretés réelles*.

- Secondly, under the pre-ordinance law, when an issuer created security in favour of the bondholders, the subscriptions had to be recognised in a notarised act (*constaté dans un acte authentique*). However, this notarised act is not used for any security other than real estate mortgages, when a notarised act will be used in any event (the mortgage itself). The ordinance removes the requirement for the recognition of such subscriptions in a notarised act.

- Finally, the commercial code only envisages security granted *before* the issue or *after*. In order to prevent an issuer from promising to grant security and then not doing so, the 1966 law required that all security be constituted prior to the issue. Security granted after an issue are however possible and may be justified in certain circumstances, but is always at risk of the insolvency-related "suspect periods". Today, market practice requires that security be granted at the time of the issue, when the debt comes into existence. Therefore, the ordinance now permits the granting of the security contemporaneously with, the issue. However, security may still be granted before or after the issue as prior to the ordinance.

5. Communications to bondholders

The means of providing bondholders with information under the pre-ordinance law was based on the principles applicable to shareholders. Bondholders were informed of an event affecting them by means of a notice in a legal journal (*journal d'annonces légales* - JAL) and, if the bonds were listed, in the BALO (*Bulletin des annonces légales obligataires*). This applied whether the information relates to the convening of a bondholder's general meeting, the taking of a decision by the bondholders (for example, the appointment of a representative of the *masse*) or to a decision of the directors of a company to ignore the bondholders' opposition to a merger. However, under international market practice, communications with bondholders typically use more contemporary methods, whether it be a publication on a stock exchange website or in financial newspapers with wide circulation, or through the clearing systems. These means of communication are usually already adopted when the bonds are issued "outside France". The ordinance and decree generalise this practice to bonds issued "inside France", and allow bond terms and conditions to adopt the means of communication that is most suited to them (eg through clearing systems and by posting on the issuer's website). Absent any specific provision in the terms and conditions, the fallback is the JAL and the BALO.

6. Placing of own bonds by credit establishments (CEs), investment firms (IFs) and finance companies (FCs)

Non-French CEs, IFs and FCs ("financial entities") can currently place their own bonds in the primary market and trade them in the secondary market. However, French financial entities can neither place nor trade their own bonds as a result of the principle that all bonds bought by an issuer immediately cease to exist. French financial entities must therefore carry out their placing and trading activities on their own bonds through subsidiaries, which must themselves be adequately capitalised and authorised as a CE, IF or FC.

While bond issuers have since 2010 been entitled to buy their own bonds without the bonds ceasing to exist, this is only if the bonds are purchased for the purpose of improving their liquidity (*aux fins de favoriser leur liquidité*), and such purchases can only be effected on the secondary market. This excludes the possibility of a financial entity placing its securities in the primary market, and ignores the fact that any trading by a financial entity of its own securities on the secondary market is not necessarily done solely for the purpose of improving its liquidity.

The need for French financial entities to create adequately capitalised and regulated subsidiaries in order to carry out such placement and trading of their own securities creates a distortion of competition between French and foreign financial entities.

The ordinance permits CEs and Fs and FCs to place their own bonds on the primary markets and to trade them in the secondary market, and aims thereby to bring an end to this distortion of competition.

In order to place their own securities, financial entities can subscribe all the securities of an issue and keep them for a maximum of 60 calendar days. The 60-day period corresponds to the maximum period for stabilisation activity in connection with the placement of a financial instrument (article 5.3 of the Commission delegated regulation (EU) 2016/1052).

For the purposes of secondary market trading of its own bonds, the new limits match those already applicable to the buyback of bonds for liquidity reasons: an issuer can hold up to 15% of the bonds of any one series for up to maximum period of one year.

III Repealing inapplicable and unused provisions

The ordinance has repealed several archaic and today unsued legal provisions. One example will suffice: decree-law of 30 October 1935 relating to bondholder protection

This decree-law was the French response to the 1929 financial crisis and the need to protect bondholders by uniting them into the *masse* which allowed them to act through a representative or in a general meeting.

Law n°66-537 of 24 July 1966 on commercial companies repealed the decree-law of 30 October 1935 so far as it related to bond issues by French companies. *A contrario*, it remained theoretically applicable to foreign issuers offering bonds publicly in France, as well as to French issuers (local authorities, public agencies, securitisation vehicles) which were not companies.

For foreign companies offering their bonds in France, the decree-law constituted French holders (and only them) into a *masse* subject to the provisions of the decree-law. This protection was necessary in 1935 since few foreign laws provided for the representation and protection of bondholders. However, this is no longer the case.

When a foreign company offers bonds in several countries, including France, the terms and conditions of the bonds include a system for the protection of the bondholders, French and foreign. The decree-law was therefore inapplicable and, furthermore, customarily disapplied for bondholders residing in France, since they cannot benefit from a form of protection unavailable to the other bondholders. The principle of equal treatment of bondholders of the same issue prevented the differential treatment of bondholders based on their country of residence.

Since the decree-law of 1935 had, in 1966, been expressly repealed with regard to “French companies”, *a contrario*, it was still applicable to French issuers other than companies, such as securitisation funds (*fonds commun de titrisation*), local authorities and public agencies.

However such issuers used the *masse* provisions legally applicable to French companies for the purposes of protecting their bondholders and never adopted the archaic provisions of the 1935 decree-law relating to bondholder protection.

In practice, the decree-law had been repealed by desuetude. It was, therefore, appropriate to repeal it legally.