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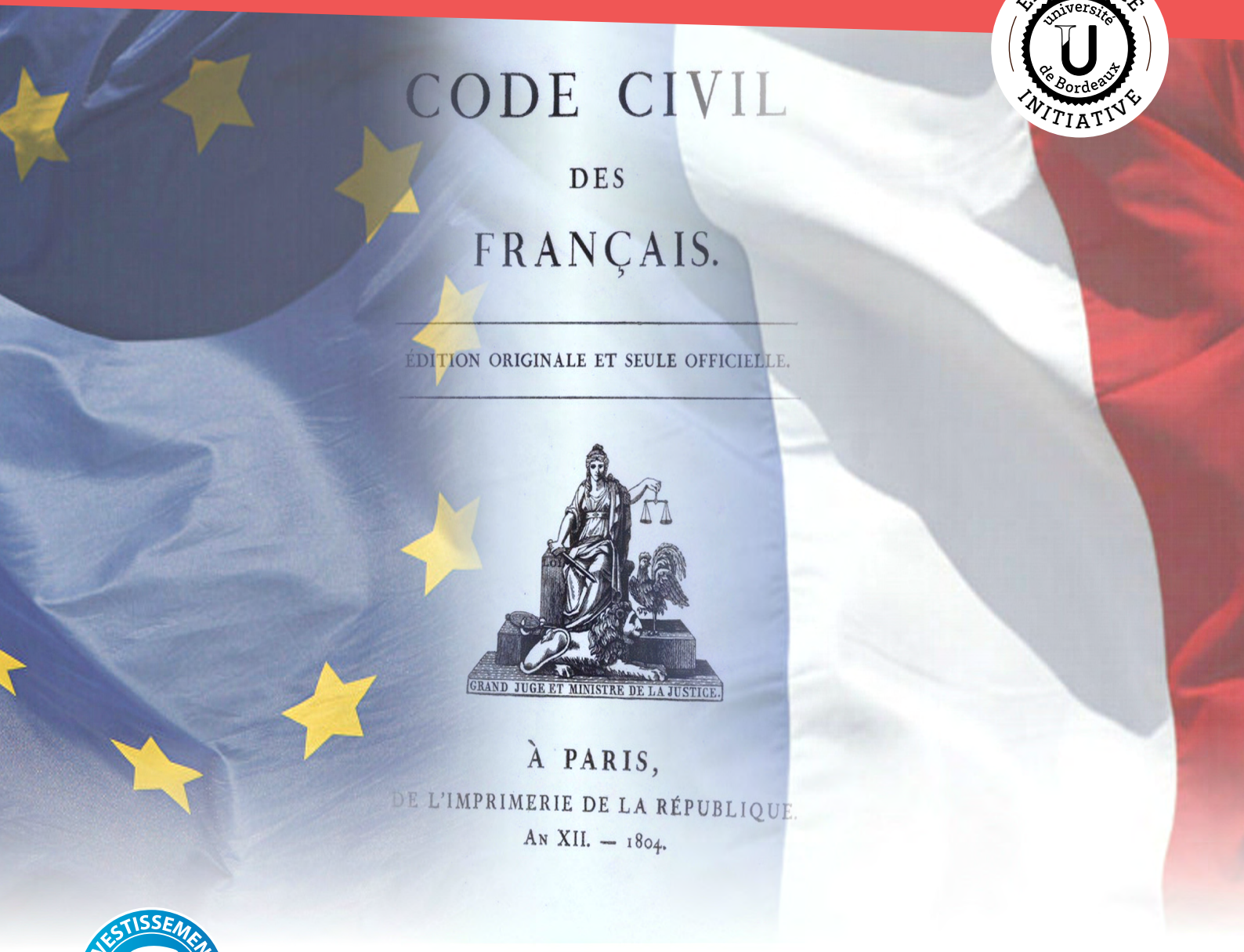

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The Impacts of the Reform

Company Law and the Reform of Ordinary Contract Law

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Contemporary French company law undoubtedly owes its creation, at least formally, to Law No. 66-537 of 24 July 1966, which, codified in the Commercial Code, has since provided the main framework for this area of business law. Even as we were about to celebrate its fiftieth anniversary, the adoption of Ordinance No. 2016-131 of 10 February 2016 reforming the law of contracts and obligations brought with it a palpable chill, by raising questions as new as they were embarrassing.

The 2016 Ordinance puts company law in a new, normative position. Reformed several dozen times since 1966, the changes made remained within the notional and technical field of company law. Even while some reforms were not without their impact on the very conception of a company (one thinks in particular of the legal recognition of single-person companies), these were essentially technical adjustments absorbed by this area of law. For the first time, a reform of the ordinary law of contracts is likely to make what may prove to be profound changes to the principles on which company law had previously become accustomed to function.

It is not the aim of this study to carry out a detailed and exhaustive examination of all aspects of company law likely to be affected by the reform of contract law (1). In emphasising certain points, the aim will be to help in identifying what can be identified as the hard core, the heart, of the specificity of this branch of law, revealed by the greater or lesser receptiveness of the reforms resulting from the new ordinary law of contract. Beyond that, the examination set out here will seek to determine the margin for improving or enhancing company law and which the new ordinary law could help to fill.

The examination of the impact of the recent reform on company law can be carried out in two complementary fields. As they immediately appeared to be liable to give rise to particular difficulties for business practices, the contracts concluded by a company must first be examined (I). Even if they pose fewer fundamental problems, contracts concluded with regard to a company must also incorporate input from the reform (II).

(I) Contracts concluded by a company

It is by considering the company as a legal person liable to be party to a contract that the impact of the reform of the ordinary law of contracts appeared to be likely to have the greatest impact on the law then applicable to the contracting company. Fundamental questions have arisen in areas where company law is relatively quiet, and these questions have sometimes been presented as being so important that they could affect even the most mundane practices in a company's operations, thus undermining the stability of the legal context in which companies operate. The questions raised by the reform of the ordinary law of contracts probably deserve to be given the attention they deserve, as they affect both the company's capacity to enter into a contract (I) and its representation in a contract (II).

A. The capacity of the company to contract: legal recognition of the principle of speciality.

a) The formal expression of the principle of speciality

Hitherto essentially reduced to a jurisprudential assertion of a principle of specialty of legal persons which requires them to carry out only acts which are part of their purpose, the question relating to the determination of the capacity of legal persons – and, in particular, companies – is now subject to a new normative framework, as a result of the Ordinance of 10 February 2016.

Paragraph two of Article 1145 of the Civil Code now lays down the following rule: *"The capacity of legal persons is limited to acts useful for realizing their purpose as defined by their statutes and acts which are incidental to them, in accordance with the rules applicable to each of those persons*". Each of the proposals which together constitute the new measure is likely to raise many questions. The determination of "*useful*" acts necessarily presupposes an interpretative approach and it will be necessary to plead, up to the highest degree of jurisdiction, in order to try, step by step, to give consistency to this reference. The character of acts "*incidental to*" acts useful for the realization of the purpose which a particular act must fulfil in order to fall within the scope of a company's capacity will, moreover, very often involve judicial intervention in order to determine whether it is properly fulfilled (2). Lastly, the reservation according to which the delimitation of capacity, as reflected in the new text, should be "*in accordance with the rules applicable to each of those persons*" inevitably raises questions as to what exactly is meant by this wording. In reality, there is little doubt that the latter point necessarily refers to the types of company whose purpose is established by law. Thus, even if a private professional company of notaries has mentioned the sale of second-hand cars in its purpose, it would not have the capacity to perform the acts related to this purpose since, legally, these companies may be constituted *"solely for the joint exercise of the profession of their members"* (Article 1, Law n° 66-879 of 29 November 1966). The same applies to the case of a *société d'exercice libéral à responsabilité limitée* (limited liability company formed by persons carrying on a professional activity) (Article 1, Law n° 90-1258 of 31 December 1990).

Without denying the importance of the queries concerning the condition of utility of the act in question or its ancillary nature in the context of the present examination, it is the very principle of the delimitation of the company's capacity, as expressed by the new rule, which will be investigated here.

As has been clearly stated in the doctrine, the capacity of legal persons – and therefore companies – to enjoy rights is limited by the principle of speciality (3). The limitation of a company's capacity to carry out acts related to its statutory purpose is a logical rule inherent in the theory of legal persons and has always been present in company law (4). The insertion into the Civil Code of a rule incorporating the principle of speciality of legal persons should therefore not come as any surprise and should even lead to rejoicing in the enshrinement of such a rule. The new rule, however, has raised questions (unfounded, in our view) as to its impact on the state of the law and, specifically, its scope.

b) Determining the scope of the rule

Any questions on this point are likely doomed to fail. The rule is of general application for all companies with legal personality. In a very direct way, the general rule echoes the special rules, which are expressly set out in provisions relating to private companies (Article 1849, Civil Code),

general partnerships (Art. L. 221-5, Commercial Code) and limited partnerships (Article L. 222-2, Commercial Code). For these companies, it is stated that *"in dealing with third parties, the manager commits the company by acts falling within the scope of the company*". For these types of companies, the recent reform of the Civil Code does not modify the principal rule, subject to the adjustments linked to the above-mentioned references relating to the utility test and the ancillary nature of certain acts.

Beyond that, in reality, the reform does not change the rules applicable to other forms of companies and, in particular, for limited liability companies and joint-stock companies. These companies are equally subject to the principle of speciality of legal persons and the new law merely recalls that. It is not because Articles L. 223-18 and L. 225-56 of the Commercial Code provide that "*the company is committed even by the actions of the manager (general manager) which do not fall within the scope of the company*" that this constitutes an exception to the principle of limitation of the capacity of legal persons in consideration of their purpose. That has strictly to do with it. The proof is provided by those same articles which do not fail to specify that the company is not committed if it proves "*that the third party knew that the act exceeded the corporate purpose or that he could not have been unaware of the same considering the circumstances*". Were there a special rule concerning the capacity of such companies, which would not be limited by the corporate purpose, the latter phrase would have no *raison d'être*. It is therefore clear that the principle of speciality, now enshrined at Article 1145 of the Civil Code, gives no ground. There is no special rule here with regard to the capacity of companies, and one can only regret that a different impression - and a false one, in our view - could have been given (5). The special rules apply only to the the company's commitment by its representative, which is a question relating to the representation of the company in an act, considered elsewhere.

Ultimately, the inclusion in the Civil Code of a provision formally expressing a traditional principle of company law reinforces the legal regime of the companies. After the reform as before, companies have only the capacity to undertake acts that are part of their corporate purpose, whether they be partnerships or capital companies. Commitment by an act which does not fall within the corporate purpose presupposes a prior modification of this statutory clause. Failing this, the risk is taken to see the act thus undertaken declared invalid. This is necessarily the case for partnerships and potentially the case for capital companies if the proof is provided that the third party had knowledge of the fact that the corporate purpose had been exceeded.

B. The representation of the company in the contract: strengthening the prevention of conflicts of interest

Since a company, as a legal person, can only act through a natural person who represents it in the legal act concerned, the question of the representation of companies is more familiar in this area of the law and has given rise to legislative provisions that provide a well-known frame of reference (6). The adoption of new rules by the Ordinance of 10 February 2016, however, raises delicate questions of the linkage between company law and the new, ordinary law of contracts.

Gauging the impact of the reform on the law applicable to companies requires that a distinction be mde between a representation of the company in an act that carries no risk of a conflict of interest or, conversely, a contractual situation which may give rise to a conflict of interest.

a) Representation of the company, without conflict of interest

When the act in which the representative acts in the name and on behalf of the company is concluded with a third party, the questions likely to arise mainly concern the determination of the terms and conditions of the representative's involvement. The new law appears to have no rules which could disrupt the current functioning of commercial companies. In addition to the fact that we find ourselves here in the presence of special rules based on legal representation, the commitment of the company by its representative benefits, for limited liability companies and joint-stock companies, from the favourable position noted above, according to which the company is bound by the acts of its representative even if they exceed the corporate purpose (with the exception of the reservation based on proof of knowledge on the part of the third party that said purpose has been exceeded).

Company law also benefits from a new rule, the absence of which in special law could be perceived as a normative defect. Article 1160 of the Civil Code provides, quite expediently, that the powers of the representative shall cease if he has no capacity or is subject to a prohibition. As the law stood previously, in the absence of such a rule, it could happen that a person acting as a legal representative (manager, general manager, etc.) might remain in post ven where, in personal terms, he had no capacity or was subject to a prohibition. Company law is now better equipped to respond to such circumstances, affecting the person of the company representative, which could undermine the functioning of the company.

b) The representation of the company in the presence of a risk of conflict of interest

Where the act in question is liable to give rise to a conflict of interest, specific rules of company law come into play and the combination of the rules of ordinary law arising from the 2016 Ordinance with the special rules contained, essentially, in the Commercial Code, appears more delicate. The adage *specialia generalibus derogant* must, of course, also serve as a guide but without exaggerating its impact. The risk of conflicts of interests may arise, in most cases, from contracts in which the representative of the company acts in two ways: in the name of the company and in his own name, as a contracting party. It may also happen that the same person is, for a given contract, the representative of the two contracting companies, creating a particular risk of conflict of interest. While, for the first scenario, the reform may have only a very limited effect, for the second, the new rules constitute a new legal framework. Article 1161 of the Civil Code provides, in a rather sober wording at its first paragraph, the rule according to which *"A representative cannot act on behalf of both parties to a contract nor can he contract on his own behalf with the person whom he represents*". The second paragraph states: "*Where he does so, any act which is concluded is a nullity unless legislation authorisesit or the person represented has authorised or ratified it*".

As regards contracts concluded between a company and its representative, the Commercial Code contains specific provisions which must keep out those arising from ordinary law. Demonstrating that it was a forerunner in the field, company law has long had a system of rules on what are called regulated agreements (7). While the terms and conditions may vary from one form of company to another (prior authorization or subsequent ratification), the aim of the provisions of the Commercial Code is to subject such agreements to specific shareholder control. By the same reasoning that the special rule precludes the application of the general rule, "*ordinary agreements concluded under normal conditions*", to use the wording of the Commercial Code (8) which may be

passed between the company and its representative, remain "*free*" and cannot trigger the new general provisions contained in the Civil Code. Taking advantage of the precedence of the rules relating to commercial companies and their special nature, company law is therefore not affected by the new Article 1161 of the Civil Code for the aforementioned scenarios. For private companies engaged in economic activities, it must be considered that they also are also subject to special rules under the new ordinary law and that compliance with the provisions of Article L. 612-5 of the Commercial Code will suffice to validate the acts concerned, without there being any question as to the possible impact of Article 1161of the Civil Code.

However, many situations involving private or commercial companies can trigger the application of the new rule contained in the ordinary law of contracts, which attests to the 2016 Ordinance's impact on company law. Firstly, in the absence of special rules, acts relating to general partnerships, limited partnerships and private companies not engaged in economic activities fall within the scope of Article 1161 of the Civil Code. The new ordinary law is therefore a reform of company law. The act which was concluded through the representative of such a company acting on his own behalf or as a representative of two companies is now null and void and company law practitioners would do well to take this into account. The avoidance of such a penalty supposes that the act in question was authorised in advance by the company concerned or is subject to subsequent ratification. In both cases, it will be for the shareholders to decide in order to validate the act in question (9). It is hard to imagine that the representative of the company, whose commitment authority is involved, should grant itself/himself the authorisation or ratification necessary to validate the act. Ultimately, the reform of the ordinary law can be regarded, opportunely, as complementing the existing special law. It does not call the latter into question; it maintains it by confirming the relevance of establishing rules intended to prevent unfortunate conflicts of interests when the company is committed by its representative.

II. Contracts concluded in respect of a company

In a more incidental way that is not without interest, the reform of ordinary contract law, as wrought by the Ordinance of 10 February 2016, has brought new information into the normative framework applicable to the various contracts which may be concluded in connection with a contract in respect of a company. This category is obviously heterogeneous but it is possible to identify groups reflecting the intensity of the link with the company. Firstly, contracts may be concluded between the partners themselves, intended to govern their relations within the company. It could be the partnership contract itself or an internal regulation; however, during the existence of the company, the partners most often commit themselves by means of contracts which in practice are known as *pactes d'associés* or associates' agreements and will be examined here alone. Beyond this perimeter, the most frequent contracts in respect of a company concern the transfer of shares, company stocks or shares, in respect of which the impact of the reform also deserves to be measured. In all these hypotheses, we note that the the new ordinary law makes a highly nuanced contribution to company law.

A. Contracts relating to the functioning of the company: reinforced performance of undertakings

a) New rules to ensure the performance of the contract

The right to obtain specific performance in kind of an obligation contained in Article 1221 of the Civil Code must of course be the first point to be addressed. The undertakings given, in particular, in the associates' agreement suffered from an inability, in the event of non-compliance, to result

in anything other than the award of damages. The performance of the agreement can now be envisaged with greater certainty if the partner, a contracting party to said agreement, may be ordered to perform in kind the obligation incurred. Admittedly, Article 1221 excludes such performance in kind if it proves to be "*impossible or if there is a manifest disproportion between its cost to the debtor and its interest for the creditor*"; however, in many cases, the performance of the undertaking and not a kind of cash equivalent can be obtained, whether it is to cast a vote for the appointment of a director or to proceed with the transfer of shares, depending on the circumstances.

One of the weaknesses in the performance of associates' agreements was undoubtedly the fate of the performance of the undertakings given by a partner when they decided to sell the shares held in the company concerned. The purchaser of the shares did not automatically continue with the obligations contained in the agreement to which the seller was a party. The framework for the assignment of contract, established by the new Article 1216 of the Civil Code, would appear likely to secure the performance of the undertakings contained in an associates' agreement over time, notwithstanding the sale of shares that may arise. The transferor of the shares may, according to the terms and conditions provided in the legislation, concomitantly transfer concomitantly his status as a party to the associates' agreement, thereby providing the other contracting partners with the assurance of maintaining the balance that governed the undertaking given by each of them, despite the change ofpartner/associate.

b. New rules to manage the risk of non-performance of the contract

Still on the subject of the innovations resulting from the reform of the ordinary law of contracts likely to permeate company law, the unusual exception of suspension of performance, as provided for by Article 1220 of the Civil Code, is particularly striking. In providing that "*a party may suspend the performance of his obligation as soon as it becomes evident that his contracting partner will not perform his obligation when it becomes due and that the consequences of this non-performance are sufficiently serious for him*", the new legislation offers an interesting legal tool allowing the situation created by the non-performance of an obligation by a contracting partner to be managed by anticipation. Of course, the assessment of the manifest nature of the future non-performance and the seriousness of the consequences of the non-performance will be open to discussion and, no doubt, to nuanced approaches in case law (10), but the presence in the legal arsenal of such a weapon can also play a preventive role and encourage the parties to an associates' agreement to comply with their respective commitments.

When the non-fulfilment of obligations imposed in a contract arises from the termination of the contract, the parties are more directly affected by this extinction of their contractual provisions. Thanks to the reform effected by the 2016 Ordinance, they are no longer without any means whatever to manage the consequences of this event. Article 1230 of the Civil Code states that termination affects "*contract terms relating to dispute-resolution, nor those intended to take effect even in the case of termination, such as confidentiality or non-competition clauses*". Business practice, and particularly in the company sphere, can thus find a normative medium that preserves interests that are not necessarily extinguished with the termination of the contract. Mediation or arbitration clauses may continue to produce effects in onder resolve disputes that would survive the associates' agreement. Similarly, protection against the disclosure of information that may have been exchanged during the negotiation of the contract must of course continue and the maintenance of the effects of the confidentiality clause introduced, provided by

the new text, is a tangible improvement of the legal framework for contracts concluded in connection with an associates' agreement. A similar appreciation of the usefulness of the reform can be expressed in relation to maintaining the effects of a non-competition clause, which would preserve a status quo in the situation of the contracting parties.

B. Contracts relating to the sale of shares: improved security of undertakings

a) A more enlightened consent to the transfer

The formulation of a general principle of good faith (Article 1104 of the Civil Code), together with a general obligation to provide pre-contractual information (Article 1112-1, Civil Code), cannot constitute a brand-new legal framework for the transfer of company stocks or shares. Case law had already fully played its role in sanctioning behaviour that was not the faithful reflection thereof. Similarly, the obligation of confidentiality (Article 1112-2, Civil Code) or the freedom to break off negotiation, on the sole condition not doing so unduly (Article 1112, Civil Code), were already part of the general context of negotiations with a view to the transfer of shares and securities. Company law no doubt now finds a formal expression in the Civil Code of what were essentially requirements in case law, but without this disrupting the applicable law.

However, in the case of the Civil Code, this upgrading of the demand for fairness at the pre-contractual stage may well lead to higher expectation on the part of investors in corporate securities, particularly in the event of the transfer of control. The information "*which is of decisive importance for the consent of the other*", in the words of Article 1112-1 of the Civil Code, could now be used more readily than before to cover information which is not expressly reflected in the accounts of the company whose securities are coveted but which is essential to the investment decision (developmen of the local commercial context; town planning projects; likely withdrawal of an important partner; etc). The reform of the ordinary law of contracts could be of key benefit if it were to lead to greater transparency and fairness in negotiations concerning the transfer of control of companies.

b) More secure transfer arrangements

In most cases, transfers of shares are preceded by preparatory acts, some of which take on a contractual nature and are essential elements of the transaction. For convenience, there are known as pre-contracts and mainly cover promises and pre-emption agreements. As a result of the reform of ordinary contract law, these acts - which are very common in practice - now have with rules that play a direct role the legal management of transactions in the transfer of corporate securities.

This study not being able to encompass all aspects of the normative recognition of contractual techniques practised without the support of a very secure legal framework, a few points can be put forward to illustrate what the reform of the ordinary law of contracts can contribute to company law in this field. As far as pre-emption agreements are concerned, the legislative improvement is not due to the sanction of its possible violation. In the light of the provisions contained in Article 1123 of the Civil Code, the beneficiary of the pre-emption agreement cannot seek the invalidity of a transfer of securities which would have been concluded in breach of his preferential right (or his substitution in the act) unless he proves that the third party was aware of the pre-emption agreement and the intention of its beneficiary to rely on it; this is a simple reiteration of existing case-law (11). On the other hand, the investor interested in purchasing corporate securities can, to

some extent, purge the situation by using the enquiry procedure provided at the third and fourth paragraphs of Article 1123 Civil Code. The proposed purchaser may, on the basis of Article 1112-1, ask the seller whether there is a pre-emption agreement; such information is obviously of decisive importance to his consent, of which he is legitimately unaware. On the basis of the information thus obtained, he may under the terms and conditions laid down at Article 1123, ask the beneficiary of the pre-emption agreement to confirm the existence of said agreement and indicate whether he intends to rely on it. As a result of this process, the purchaser will be able more clearly to assess whether to proceed with the proposed investment or whether it is more appropriate to abandon it. Since uncertainty is the most feared risk for investors, the new law opens up the possibility of reducing it and may well contribute to improved security for the transfer of corporate control. With regard to unilateral promises to sell shares, the reform puts an end to the main handicap that marked their use. It was the result of heavily-criticised case law, under which in the event of the revocation of the promise before the beneficiary had exercised his option, the latter was entitled only to damages in compensation of the loss suffered (12). This weakness in unilateral promises is no more, as a result of the reform wrought by the 2016 Ordinance. The second paragraph of Article 1124, in stating that "*revocation of the promise during the period allowed to the beneficiary to exercise the option does not prevent the formation of the contract which was promised*", brings long-awaited security to company law in such a way as, by enhancing this contractual technique, to restore the confidence of investors who seek investments in corporate securities and wish to benefit from promises to sell.

Notes

(1) See in particular A. Lecourt, *L'impact de la réforme du droit des contrats sur le droit des sociétés : aspects théoriques et pratiques*, RTD com. 2016, p. 767 ; M. Mekki, *Les incidences de la réforme du droit des obligations sur le droit des sociétés : rupture ou continuité ?*, Rev. Sociétés 2016, p. 483 et seq, 563 et seq, 711 et seq; *adde*, the studies published in in Bulletin Joly Sociétés, September 2016, p. 508 et seq; Revue de Jurisprudence commerciale, 2017, n° 1, p. 107 et seq.

(2) On these questions, see in particular B. Dondero, *Capacité et représentation des sociétés*, BJS 2016, p. 510.

(3) See G. Wicker, *Personne morale*, Rep. Civ .Dalloz, No. 64

(4) For an up-to-date presentation on this, see in particular P. Le Cannu & B. Dondéro, *Droit des sociétés*, 6th ed., Lextenso, No. 247 et seq.

(5) See in particular *La modification des dispositions du code civil sur la capacité et la représentation a-t-elle un effet en droit des sociétés?*, Comité juridique ANSA, octobre 2016, Avis n° 16-039

(6) For a recent analysis of this issue, see in particular G. Wicker, *La théorie de la représentation dans les actes juridiques en droit français*, in *La représentation en droit privé, 6e Journées franco-allemandes*, ouvrage collectif, Société de législation comparée, 2016, p. 47 et seq; B. Fages, *La représentation en droit des groupements*, *ibid*, p. 125

(7) See Articles L. 223-19, L. 225-38, L. 225-86, L. 226-10 and L. 227-10 of the Commercial Code.

(8) See Articles L. 223-20, 225-39, L. 225-87, l. 226-10, L. 227-11.

(9) See, to this effect, F. Deboissy & G. Wicker, Chron. Droit des sociétés, JCP E 2017, 1087, n° 2.

(10) See in particular A. Reygrobellet, *L'exception d'inexécution préventive*, BJS, 2017, p. 544.

(11) Cass. ch. mixte, 26 May 2006, n° 03-19.376, Dalloz 2006, p. 1861, note P.-Y. Gautier; Rev. Sociétés 2006, p. 808, note J.-J. Barbieri; RTD civ. 2006, p. 550, obs. J. Mestre et B. Fages; Bull. Joly 2006, p. 1072, note H. Le Nabasque

(12) Cass. 3e civ. 15 December 1993, n° 91-10.199; Dalloz 1994, p. 507, note F. Bénac-Schmidt; RTD civ. 1994, p. 584, obs. J. Mestre; JCP 1995, II, 22366, note D. Mazeaud.