France Makes U-Turn on Corporate Successor Criminal Liability

November 27, 2020

On November 25, 2020, the French Court of Cassation (France's Supreme Court) issued a landmark decision[1] whereby public limited liability companies may now be held criminally liable for the prior criminal conduct of the companies they acquire through "mergers by acquisition."[2] This decision departs from existing case law. It will likely create an increased post-merger criminal liability risk for acquiring companies and a correlative incentive to enhance their pre-merger due diligence efforts.

The Context at a Glance. Company B was named as a defendant in a criminal case of unintentional burning of property. The alleged criminal conduct only involved Company A, and had occurred prior to its merger into Company B. As a defense, Company B argued that its criminal conviction would violate the French criminal law principle that one can only be held criminally liable for his or her own actions. The argument was in-line with the Court of Cassation's well-established jurisprudence on corporate successor criminal liability.

France's highest courts had already ordered acquiring companies to pay civil or regulatory fines for pre-merger breaches of competition, capital markets or tax regulations committed by an acquired company. But in the context of criminal matters, the Court of Cassation had always decided that an acquiring company cannot be prosecuted for the criminal conduct of a company it had acquired by merger. In the Court's reasoning, the acquiring company was to be viewed as a different legal entity.

In recent years, however, the Court of Justice of the European Union ("CJEU") and the European Court of Human Right ("ECHR") rendered two important decisions that impacted the Court of Cassation's long-standing reasoning.

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[1] Cass. Crim., November 25, 2020, No 18-86.955 (available here).

[2] Article 89 of Directive (EU) 2017/1132 relating to certain aspects of company law defines such "merger by acquisition" as "the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10 % of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value."

On March 5, 2015, the CJEU ruled that the Directive (EU) 2017/1132 must be interpreted as meaning that a merger by acquisition results in the transfer to the acquiring company of the obligation to pay a fine imposed by a final decision issued post-merger for infringements of employment law committed pre-merger by the acquired company.[3]

On October 24, 2019, the ECHR held that a company merged by acquisition was not truly "another" entity in relation to the surviving company. The ECHR concluded that in ordering the acquiring company to pay a fine for pre-merger acts committed by the acquired company, French courts had not breached the rule that a sanction should be imposed on the offender only and not to third parties.[4]

The Court of Cassation's ruling. Drawing on these decisions, the Court of Cassation reconsidered its longstanding case law. The Court acknowledged the existence of an "economic and operational continuity" between merged companies. It decided that an acquiring company should therefore not be deemed different from an acquired company. Consequently, an acquiring company may be held criminally liable for an acquired company's pre-merger criminal conduct.

The Court also noted that the absence of prosecution of the acquiring company would come into contradiction with the nature of the merger by acquisition. According to the Court, such merger consists of the transfer of the acquired company's entire assets and liabilities to the acquiring company. The Court also noted that if the transfer of such liability were excluded, a merger would constitute a means for a company to avoid criminal liability by reorganizing.

The main takeaways of that important decision are as follows:

- The ruling covers merger by acquisitions closed after November 25, 2020 of public limited liability companies falling within the scope of Directive (EU) 2017/1132. In France, the very commonly used *sociétés anonymes* and *sociétés par actions simplifiées* are covered.

- The acquiring company may raise any defense that would have been available to the acquired company.

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[3] Judgment of the Court (Fifth Chamber) of 5 March 2015 (request for a preliminary ruling from the Tribunal do Trabalho de Leiria—Portugal)—Modelo Continente Hipermercados SA v Autoridade para as Condições de Trabalho—Centro Local do Lis (ACT), Case C-343/13 (available here).

[4] ECHR *Carrefour France v. France*, case No 37858/14 (available here).

- The "only" criminal sanctions that can be imposed on the acquiring company are fines and forfeiture, to the exclusion of the various other criminal sanctions available under French law, including the disbarment from public procurement.

- Where the purpose of a merger was to escape criminal liability, courts may always impose all available criminal sanctions on the acquiring company, irrespective of the date of the merger and the corporate form of the companies.

In a context where French enforcement authorities are eager to prosecute companies for white-collar crimes – in particular corruption, tax fraud and money laundering – and where French criminal courts now impose blockbuster criminal fines, corporations contemplating merger by acquisition deals should now factor this additional risk of criminal sanctions when performing their due diligence and negotiating disclosure and warranties clauses.

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Please do not hesitate to contact us with any questions.

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