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Mandatory Bonus Due to Employees Upon Certain Distributions of Dividends

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Following President Sarkozy's decision to require French companies to share their profits upon certain distributions of dividends to their shareholders, a bill[1] creating a mandatory bonus for value-added sharing (*prime dividendes*) to be paid to employees was adopted by the French Parliament on July 13, 2011 (the Bill). The Bill was enacted on July 28, 2011. An Administrative Order[2] dated July 29, 2011 was issued in order to provide guidelines for the practical implementation of the Bill. The Bill is effective until December 31, 2013.

This new legislation is important as it impacts distribution policies for companies or groups located outside France that do business in France through a French subsidiary (or group of subsidiaries).

At this time, scholars and practitioners are still wondering about certain interpretations of the new Bill and the Administrative Order. Discussions and debates are going on within various circles and authorities (e.g., National Association of Limited Liability Companies (ANSA), French ministry of employment) seeking clarification and legal certainty. In this LawFlash, we have chosen to adopt a conservative approach to this new scheme.

The key article of the Bill (article 1) provides that all French commercial companies with more than 50 employees must negotiate the principle and modalities of a bonus to be paid to their employees at the time they would distribute dividends to their shareholders the amount of which per share would be higher than the average amount of dividends distributed during the previous two years.

Key provisions

Qualifying distributions are those decided as of January 1, 2011 (usually at the time of approval of the 2010 annual accounts, that is, around May or June 2011) as well as certain distributions that would be decided by shareholders by December 31, 2011 (for example, in September or October 2011).

For qualifying distributions already decided between January 1, 2011 and the date of enactment of the Bill (July 28, 2011), the mandatory bonus payment amount agreement (see item 3 below) must be in place *no later than October 31, 2011*. In all other cases, the agreement must be in place within three

1. Bill n°2011-894 of July 28, 2011; J.O., July 29, 2011, p. 12,922.

2. Circulaire NOR: ETST1121460C of July 29, 2011.

months of the date of the meeting at which the relevant corporate body approved the qualifying distribution.

The amount of the mandatory bonus is not prescribed by the new scheme but rather must be negotiated with unions and employees' representatives toward reaching an agreement thereon.

Please find below a brief analysis on the following issues:

(1) Which French companies are actually within the scope of the law?
(2) Which distributions will actually trigger the application of the law?
(3) What is the negotiation process?
(4) Which employees will benefit from the mandatory bonus?
(5) What is the cost estimate?
(6) What is the applicable penalty?

1 Companies falling within the scope of the law

1.1 Commercial companies with 50 employees or more on their payroll

The mandatory bonus is applicable to "all business companies which usually employ fifty employees or more, within the meaning of articles L. 3322-2 and L. 3322-4 of the French Labor Code." This covers legal entities or sole economic and social units of 50 employees or more. Employees of entities with less than 50 employees on their payroll will not benefit from the mandatory scheme. For these companies, the bonus is optional.

Companies that have granted another form of noncompulsory financial benefit related to the increase of dividend payments to their employees (through a companywide collective agreement entered into after May 25, 2011) are not required to negotiate the payment of such mandatory bonus.

1.2 Group submitted to the obligation to constitute a group committee

Article 1 II second paragraph of the Bill provides that when a French company having more than 50 employees on its payroll is part of a group found to constitute a group committee (*comité de groupe*) in application of article L. 2331-1 of the French Labor Code, such company will have to pay a bonus to all of its employees if the French-dominant company (*entreprise dominante*) to which it belongs were to decide to make a qualifying distribution.

The domination criterion is actually that of "control" whether it be direct or indirect (combination of articles L. 233-1, L. 233-3, and L. 233-16 of the French Commercial Code).

The debtor of the obligation to pay remains in all cases the legal employer; however, in a group context, the dividend distribution criterion must be assessed at the level of the French-dominant company, if any. The payroll requirement (50 employees or more) must be assessed at the level of each French subsidiary of the French-dominant company.

The French-dominant company will indeed remain the one targeted by the new scheme (in respect of assessing whether or not a qualified distribution took place) in a group context, irrespective of the fact that (i) it has no employees, (ii) no group committee has been constituted at the level of the dominant company, or (iii) distribution does take place or does not take place at the level of any of the dominant company's subsidiaries.

In case no French-dominant company exists but where French entities would simply have foreign shareholders (be they legal or natural persons), said French entities would no longer be considered in a group context but, rather, would be treated on a stand-alone basis to determine at their respective levels whether a qualifying distribution has taken place or will take place.

2 Qualifying distribution triggering the application of the new scheme

Article 1 II first paragraph of the Bill states that the obligation would be triggered at the time of the distribution of dividends the amount of which per share is higher than the average amount of dividends distributed during the previous two years, in application of article L. 232-12 of the French Commercial Code.

The critical question is which kinds of distributions are considered under the new scheme, i.e., whether distributions of premiums, reserves, and interim dividends are concerned as well. Neither the Bill nor the Circular addresses all possibilities with the same level of clarity. At this stage, a conservative view would lead us to understand the new scheme as follows:

- Qualifying distributions are distributions of dividends or interim dividends (whether in cash or in kind).
- Nonqualifying distributions are distributions of issuance, contribution, or merger premiums.
- Questionable distributions are distributions of reserves or exceptional distributions of reserves. A conservative approach would treat them as qualifying distributions, although arguments do exist to treat them as nonqualifying distributions, with some possible nuances between distributions of reserves and exceptional distributions of reserves.

3 Process of negotiation

Article 1 III of the Bill states that the bonus shall be determined after an agreement (whether for a definitive or indefinite duration) is reached following the process defined in articles L. 3322-6 (n°1 to 4) and L. 3322-7 of the French Labor Code.[3] This agreement needs to be reached, at the latest, within three months after the date of the meeting at which the relevant corporate body decides the qualifying distribution, and, in respect of a decision already adopted between January 1 and July 28, 2011, no later than October 31, 2011.

If, at the end of the negotiations, no agreement is reached in compliance with the process described above, a report establishing the absence of agreement shall be made. This report shall provide for the initial proposition made by the employer, the last propositions made by both the employer and the body representing the employees and the bonus the employer is unilaterally proposing following the notice to the works council or, if there is no such council, the notice to the employees' delegate. The agreement or the unilateral decision made by the employer shall be registered with the administrative authority.

3. Articles 3322-6 (n°1 to 4) and L. 3322-7 of the French Labor Code provide that the agreement may be negotiated with the union representatives (at group or at company level) or the works council, or proposed by the employer and approved by a majority vote of two-thirds of the employees.

As a result, in case of a failure to reach an agreement, the employer will unilaterally decide the bonus amount to be paid.

In respect of the form, it should be possible to distribute the bonus in cash or through a collective benefit for the employees undertaken by the company (such as, for example, the subscription of a mutual insurance for the employees, the distribution of stock to the employees, or an increased participation in profit sharing).

4 Employees benefiting from the mandatory bonus

As already indicated above, only employees of entities having 50 or more employees on their payroll (whether considered on a stand-alone basis or as part of a group headed by a French-dominant entity) will benefit from the mandatory bonus.

The distribution of the amount of the bonus may be modulated from one employee to another in compliance with article L. 3324-5 of the French Labor Code. Accordingly, the bonus amount may differ from one subsidiary to the other in a group context.

5 Cost estimate

At an initial stage of negotiation, the government wanted to impose the obligation to award a mandatory bonus of 1,000 Euros per employee, in case of distributions of increased dividends. The idea of a mandatory amount has been abandoned. Therefore, it is difficult to assess at this stage the amount of the bonus that will actually be paid to benefiting employees.

Article 1 VIII of the Bill states that employers paying the mandatory bonus to their employees should benefit from a reduction of social security charges up to 1,200 Euros per employee per year (by contrast, CSG, CRDS, and social security lump sum (*forfait social*) payments will remain due). The bonus will also be taxable for the benefiting employees.

Based on the impact survey attached by the government to the Bill before it was discussed by Parliament, the government expects that the average amount of the bonus will be 700 Euros per employee.

6 Penalty

Article 1 V of the Bill states that the failure to enter into the mandatory process of negotiation will be qualified as a hindrance tort (*délit d'entrave*) and subject to the penalty provided by article L. 2243-2 of the French Labor Code. Such article provides for a penalty of one year in prison and a fine in the amount of 3,750 Euros.

If you would like more information or have any questions about the issues discussed in this LawFlash, please contact either of the following Morgan Lewis attorneys:

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