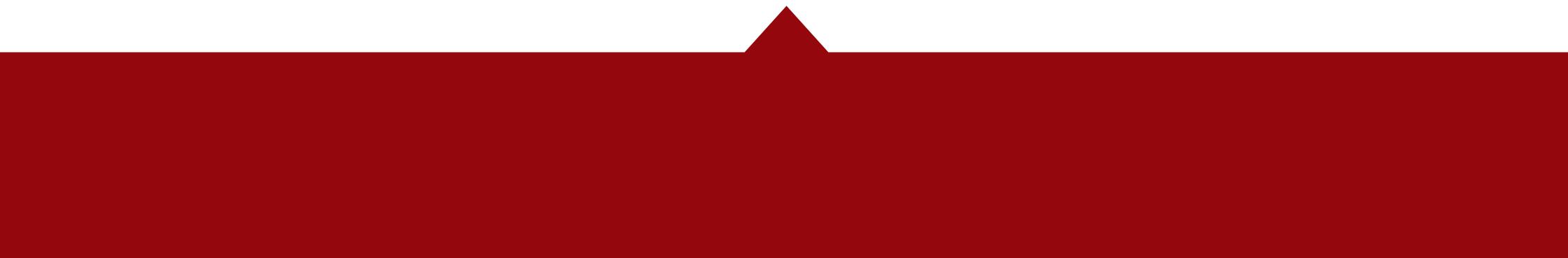




French practice regarding fairness opinions: The role of independent appraisers in tender offers and squeeze-outs according to the AMF General Regulation

Olivier Péronnet

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- Step 1** **The main rules of the AMF General Regulation: Summary**
 - Step 2** **Who can be appointed as an independent expert?**
 - Step 3** **By whom are the independent appraiser to be appointed?**
 - Step 4** **What work does the independent appraiser have to do?**
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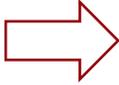
The main rules of the AMF General Regulation: Summary

- Ten years ago, the Naulot Report was produced by a working group appointed by the AMF to make recommendations on the development of fairness opinions and independent appraiser reports, in order to improve shareholder information in the event of tender offers or transactions involving listed companies where conflicts of interest may arise
- Firstly, AMF General Regulation states **when** independent appraisers have to be appointed – in the context of tender offers (art. 261-1), dilutive capital increases (art. 261-2), or voluntarily (art. 261-3) – along with general principles regarding independence (art 261-4)
- Secondly, the AMF's General Regulation has been supplemented by an instruction issued in September 2006 that defines independence, the content of the appraiser's report, and the work to be done by appraisers and described in their reports

The main rules of the AMF General Regulation: Summary

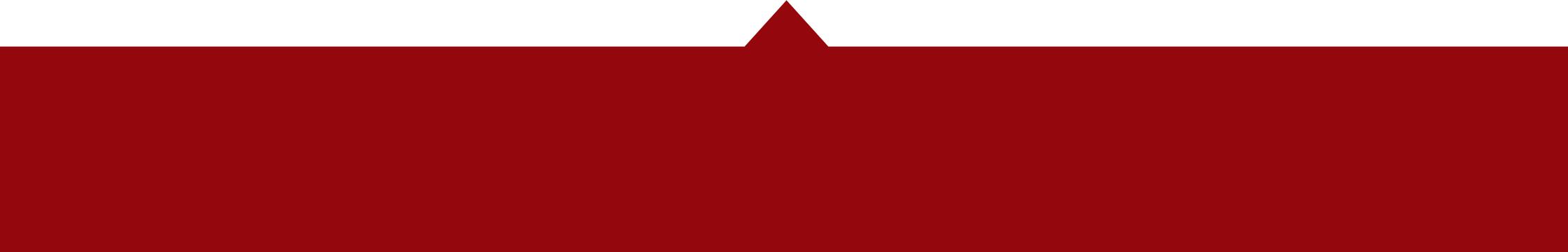
- Thirdly, the AMF issued a recommendation in September 2006, supplemented in October 2006, which provides guidance for a company's Board of Directors or ad hoc committee, sets out the resources required and ethical rules, and describes the work to be performed by appraisers, i.e. valuation methods, the basis of valuation and the principles of critical review, transparency of sources, consistency and relevance
- Fourthly, the AMF issued a recommendation in June 2015, regarding the framework on disposal of material assets or acquisition of material assets
- Together, these represent a body of AMF rules that cover all principles to be applied regarding when and by whom appraisers have to be appointed, who can be appointed and also how appraisers have to deal with their appointment as independent appraiser in such situations
- [This part will be treated in further detail by Guillaume Jan]

Introduction – Situations when an appraiser is to be appointed

- Conflict of interest: various cases
- Squeeze-outs: expropriation procedure  no choice for the shareholder
- Reserved capital increase
- Disposal of main assets

In the context, we will discuss:

- Who can be appointed as independent appraiser?
- By whom are the independent appraiser have to be appointed?
- What diligence he has to perform?

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Who can be appointed as an independent expert?

1. *The appraiser has to be independent (art. 261-4)*

I. - The independent appraiser must not be placed in a conflict of interest in relation to the parties concerned by the public offer or transaction and their advisors. An AMF instruction (dated September 2006) shall describe situations in which the independent appraiser is considered to be placed in a conflict of interest, although this shall not constitute an exhaustive list

- 1) *“Has legal or ownership links with companies concerned by the public offer or transaction, or their advisors, capable of compromising his/her independence*
- 2) *Valued the company that is the target of the public offer or that is carrying out the transaction in the 18 months preceding the date of his/her appointment, except if the valuation carried out within that timeframe takes place as part of an assignment that is an extension of the previous one*
- 3) *Advised one of the companies concerned by the offer or any entity that those companies control within the meaning of article L. 233-3 of the French Commercial Code in the 18 months preceding his/her appointment*
- 4) *Has a financial interest in the success of the offer, a receivable or a debt with respect to one of the companies concerned by the offer or any entity controlled by those companies within the meaning of article L. 233-3 of the French Commercial Code, capable of compromising his/her independence”*

The independent appraiser shall not work repeatedly with the same sponsoring institution(s) or within the same group if the regular nature of such work could compromise his independence

In practice, we will see the obligation and duties of boards to address this matter of “repeatedly” with the ad hoc committee in charge of appointing the expert [Guillaume Jan will comment on this]



Who can be appointed as an independent expert?

2. *The appraiser has to make a formal statement / disclosure*

II. - The appraiser shall prepare a statement certifying that there are no known past, present or future ties between him and the parties concerned by the offer or transaction and their advisors that could compromise his independence or impair the objectivity of his assessment when carrying out the appraisal

If there is the risk of a conflict of interest but the appraiser deems this unlikely to compromise his independence or impair the objectivity of his assessment, he shall mention this risk in his statement, including relevant supporting information

Who can be appointed as an independent expert?

3. The independent appraiser must have the capacity to act as an appraiser

Independent appraisers must always have the **necessary skills and human and material resources** to carry out their assignments. In particular, they must have access to a financial database

Independent appraisers must have **sufficient insurance or financial capacity** to cover any risks relating to their independent appraisal work

4. His or her remuneration must not depend on the issue of the tender offer or whatever

The appraiser's remuneration must be on a flat fee basis, and must not be related to the outcome of the offer or transaction. It must be determined by the scale and complexity of the assignment. It must be paid exclusively by the company to which the report relates



Who can be appointed as an independent expert?

5. *Independent appraiser have to comply with ethical rules (1/2)*

Independent appraisers must abide by a code of conduct that defines:

- the principles of integrity, independence, skill and organisation with which they must comply
- the procedures according to which they accept and carry out appraisal assignments

The code of conduct must be available for consultation by anyone who wishes to do so at the appraiser's registered office. It must also be posted on the appraiser's website, if he/she has one

Independent appraisers must submit their reports to quality controls according to the arrangements set out in the code of conduct

Those controls must relate to the consistency and appropriateness of the methods used by appraisers

In addition, in accordance with article 231-20 of the AMF General Regulation, the AMF may ask the appraiser, when examining the compliance of a public offer, for any information that may be useful to assess the ways in which the appraisal report was prepared, including the implementation of quality controls and the report's results

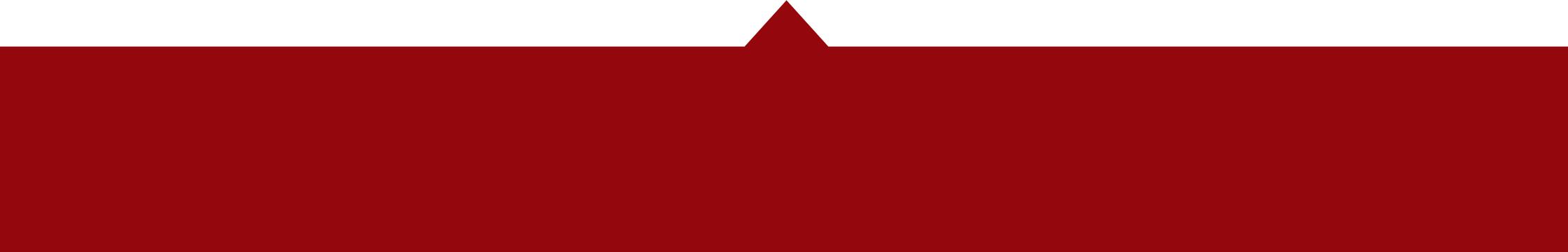
Who can be appointed as an independent expert?

5. Independent appraiser have to comply with ethical rules (2/2)

In practice, there are two key associations agreed by AMF. We are member of “APEI” (Association Professionnelle des Experts Indépendants) which :

- Has several working groups on specific topics that issue guidances and
- Organize an independent quality control process to the benefit of their members (which is mandatory)
“APEI” has issued guidance and recommendations like :
 - o What are the special deals or related party transactions? “accords connexes”
 - o The Business plan
 - o The consultation process to choose and independent appraiser in the process of a public offer
 - o The excluded criterions
 - o Synergies in valuation



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By whom are the independent appraiser to be appointed?

- **The principles are mostly defined by guidance issued by the AMF, which provides (recommendations issued on 28 September 2006)**

Title VI of Book II of the AMF's General Regulation defines the obligations of listed companies with respect to independent appraisals. The provisions of that title are divided into three chapters, and require a company that is the target of a public offer to appoint an independent appraiser where the offer in question is capable of creating a conflict of interest or of damaging equality between shareholders or holders of the financial instruments to which the offer relates. An issuer carrying out a reserved capital increase at a large discount must also appoint an independent appraiser

In addition, these provisions define the content of the independent appraiser's report. The AMF's General Regulation allows the AMF to recognise professional associations that comply with precise specifications, at their request (like APEI mentioned before)

The AMF also recommends that listed companies and independent appraisers comply with certain principles regarding both the resources and work that should be involved in these appraisal assignments

By whom are the independent appraiser to be appointed?

- **The appraiser should be appointed by the ad hoc committee of independent directors (1/2)**

The independent appraiser's report allows the board of directors, supervisory board or competent body of the target company to assess the financial terms of the offer in order to give a reasoned opinion

Given that's body's responsibility for selecting and monitoring the work done by the independent appraiser, the AMF recommends that the following principles be applied by the board of directors, supervisory board or competent body:

- appoint, as the case may be, a committee of independent directors or supervisory board members to supervise the independent appraiser's assignment
- select an independent appraiser whose skills, resources and professional reputation appear to be appropriate for the assignment
- appoint the independent appraiser as soon as possible
- define the independent appraiser's assignment
- carry out the work required to support the independent appraisal assignment, under the responsibility, as the case may be, of the aforementioned independent committee. That work must be suited to the scale and complexity of the transaction, and must include the following stages:

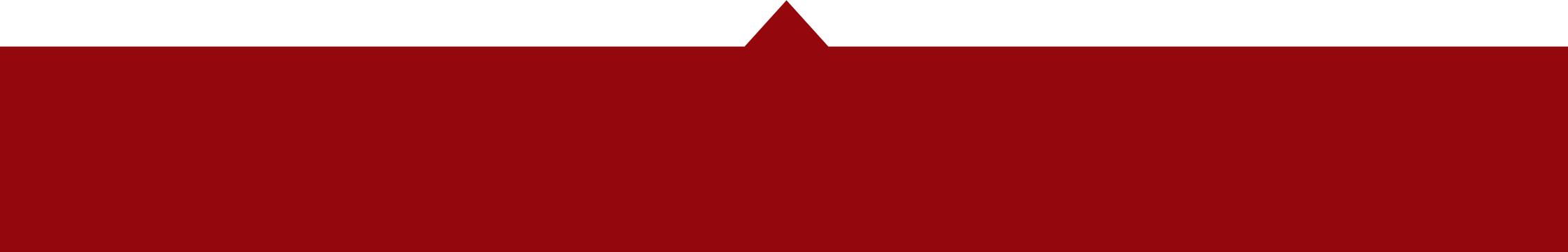
By whom are the independent appraiser to be appointed?

➤ The appraiser should be appointed by the ad hoc committee of independent directors (2/2)

[...]

- validate, according to the usual procedures, the company's business plan and then submit it to the independent appraiser
- define, in conjunction with the independent appraiser, the time required to study the dossier
- ensure that the appraisal assignment and the work that the independent appraiser is required to do run smoothly
- ensure that the information provided by management and the audit committee is of satisfactory quality
- once the reasoned opinion relating to the offer has been made public, **enable minority shareholders who wish to do so to obtain additional information by asking questions of the board of directors, supervisory board or competent body**
- In many cases, the minority shareholders will contact the independent appraiser; this situation needs for the independent appraiser to listen what they have to say, in order to make sure there is nothing missing, and adequately treat this in the report, in case it needs to.



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What work does the independent appraiser have to do?

1. Work to be done according to art. 261-4 and 262-1, article 3 defines the appraiser's work as follows:

When preparing the report mentioned in article 262-2 of the AMF's General Regulation, the appraiser must do at least the following:

- 1) Discuss the company's financial statements and business plan with its management teams and, as the case may be, with the initiator
- 2) Discuss the transaction with advisor banks and critical analysis of the assumptions presented
- 3) Draft of the report, emphasising any areas of disagreement with the initiator or its advisor banks

The report must be presented by the independent appraiser to the Board of Directors, Supervisory Board or competent body of the company concerned

In practice, as of today, Independent appraisers have to:

- Prepare a valuation on a multicriterion approach
- Review the related parties agreements (“accords connexes”), special deals
- In case of a squeeze-out, review a few specific points of attention



What work does the independent appraiser have to do?

- **Appraisers must have extensive access to the target company's management and to the initiator, if he or she considers it necessary**

Independent appraisers must have access to all information that is useful to the performance of their assignments, and to senior management and management committee members of the target company and, as the case may be, of the initiator. They must also have access to valuation work done by the offer's presenting banks

In addition, they must have access to data needed to assess the expected synergies arising from the transaction in question, particularly if the amount of those synergies has been made public, or in the event of a public exchange offer

What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (1/6)

➤ Valuation work to be done

The independent appraiser's report must contain a valuation of the company that is the target of the offer or that is carrying out the capital increase. That valuation must be based on a multi-criterion approach that includes the implementation of valuation methods and the examination of valuation references

➤ Valuation methods

There are two types of valuation methods:

- comparative methods consist of valuing a company with reference to comparable companies whose value is known, either because they are listed or because they have been involved in a recent transactions whose terms have been made public
- intrinsic methods consist of determining a company's value based on its specific profitability and risk factors (based on cash flows, dividend flows and in certain cases adjusted net assets)

What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (2/6)

➤ Valuation references (1/5)

Valuation references supplement the independent appraiser's analysis by comparing it with value indicators such as:

- the book value of assets
- the company's share price
- material transactions involving the securities of the company being valued
- analyst target prices

Independent appraisers must justify in their reports any decision to exclude references to historical share prices or share price averages

For each valuation, independent appraisers must define, depending on the relevance of the available information, the method or methods best suited to the company concerned. Independent appraisers must apply both types of methods defined above where they are appropriate. They must compare the results obtained using available references and clearly explain the approach that led them to favour or exclude any given method or reference by comparison with another



What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (3/6)

➤ Valuation references (2/5)

When doing their work, independent appraisers must also comply with the following principles:

i) Critical examination

Under this principle, independent appraisers must objectively examine the relevance of all data provided by management or external sources. Independent appraisers must assess whether the business plan prepared and validated by the company's management is reasonable. Appraisers must ask management to amend their forecasts where they appear unrealistic on the basis of the information seen by the appraisers. Independent appraisers must also ensure that they are informed of any recent changes made by management to the business plan along with the reasons for such changes

In practice, this is possibly an issue: First, the expert has to understand the process followed by the company to prepare the B/P. Second, it is difficult to adjust the B/P prepared by the management and approved by the board. If the flows are not adjusted, the risk premium will need to include the risk of non achievement of an ambitious B/P, another possibility is to prepare sensitivity analysis



What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (4/6)

➤ Valuation references (3/5)

ii) Transparency

The information sources and data used by independent appraisers must be clearly indicated and any discrepancies noted between different sources must be mentioned in their reports. When using comparative methods, independent appraisers must explain the composition of the sample and any adjustments they have made in order to ensure that the data being used are homogeneous

When using intrinsic methods, independent appraisers must:

- present an overview of the business plan's key aspects (average growth during the period, average return on invested capital etc.)
- state how they have factored in specific risks (generally included in the business plan) and systematic risks (by determining the discount rate)
- make a detailed presentation of assumptions used to calculate terminal value
- present and comment on all tests measuring sensitivity relative to the central assumptions



What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (5/6)

➤ Valuation references (4/5)

When doing their work, independent appraisers must also comply with the following principles:

iii) Consistency and relevance

When applying a valuation method, independent appraisers must ensure that parameters are consistent with each other and with the external sources and information available to them. As the case may be, they must ensure that those data are consistent with those used in valuation work that may have been done previously

When using comparative methods, independent appraisers must ensure that:

- companies in the sample are sufficiently comparable in terms of risk, profitability and growth
- multiples take into account the specific features of the company and comparable companies to be valued
- the sample of listed peers is made up of companies whose securities are sufficiently liquid
- the comparable transaction method involves a sample of recent transactions; it is especially important that transactions have taken place recently when stockmarket valuations have changed greatly in the last two years

What work does the independent appraiser have to do?

2. Implementation of a multi-criterion approach (6/6)

➤ Valuation references (5/5)

When using intrinsic methods, independent appraisers must ensure that:

- The business plan covers a sufficiently long period so as to reduce the terminal value's importance in the total valuation
- The risk-free discount rate used is the market rate for the period covered by the business plan and financial projections
- The terminal value factors in the company's competitive situation
- A given risk is taken into account only once, either in the business plan or in the discount rate
- The perpetual growth rate is consistent with the long-term growth rate assumed for the national economy
- Cash flow figures available for calculating terminal value reflect a normal situation



What work does the independent appraiser have to do?

4. *Review of Presenting Bank Report: Comments and major differences on the valuation*

The Expert has to review and comment on the presenting bank report:

- Criteria
- Parameters used in the valuation
- Major differences

What work does the independent appraiser have to do?

5. *“Accords connexes” – Related party agreements, special deals: Are they implying a different treatment to certain categories of shareholders?*

There is no list of what “related party agreements” or “special deals” are.

As mentioned, “APEI” has issued a working/discussion paper which drafts a tentative list on where they usually can be found:

- Agreements before the tender offer (shareholder’s agreements)
- Agreements after the tender offer (shareholder’s agreements)
- Management packages
- Liquidity arrangements (on vesting periods for managers or certain categories of shareholders)
- Agreements on the financing of the tender offer and issuance of the Newco holding

The objective is to assess whether they lead to a possible higher price than the offer price, that could be an issue in terms of fairness opinion

What work does the independent appraiser have to do?

6. *Squeeze-out specific point of attention*

Squeeze-out is an expropriation of the remaining shareholders. The procedure is possible if the offeror holds more than 95% of the share capital

The minority shareholder has no choice

Usual practice is to consider a premium on the value of shares, or at least a price which gives the full value of the shares as resulting from the DCF approach

What work does the independent appraiser have to do?

7. *The report of the independent appraiser*

The report is a long form report this implies:

- To find the adequate format according to the global practice of listed companies not to issue forecasts but just a guidance.
- Not to disclose secret information
- To be self explanatory on the valuation

What work does the independent appraiser have to do?

8. *Relationship with AMF, our regulator:*

Our practice is to have a free open discussion on each matter in order to avoid issued on the expectations of the AMF, which will review the report

A contact is to be taken, and the sooner, the better

AMF can help in certain circumstances to improve the process and the dialog if necessary. Discussions may also involve the offeror and the target representatives



Conclusion on French practice of Independent appraisers

A practice which is now mature but can always be improved and expanded to the unlisted companies

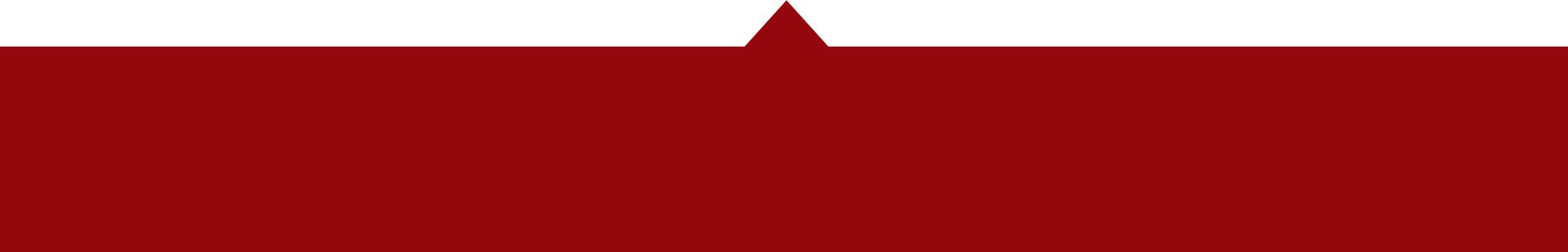
The AMF role and rules on public offers or other situations where a conflict of interest may arise, has led to an improvement on the practice of valuation in France.

This practice has influenced global practice on unlisted companies and small businesses, even if the same standards are difficult to apply in those circumstances; but principles like, no wild average between various methods, but a sound choice of the most appropriate criteria, or the need to review various methods and identify the strengths and the weaknesses of a business in order to have a relevant approach, is now common practice.

Many Practicians, Regulator, various professional associations have organized working groups:

- statutory Auditors have a commission working on valuations, for issuing guidance for mergers appraisers, whose common practice is very close to the AMF rules for independent appraisers, as described.
- Chartered accountants, mostly for tax purposes
- Other organizations like “CCEF”

Even if there is not in France a “valuer profession” as such, practice on listed companies can be considered as compliant with IVS, and every professional within those organizations is heavily involved on the improvement of the quality of our practice

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Exhibits 1: Example of content of an appraiser report

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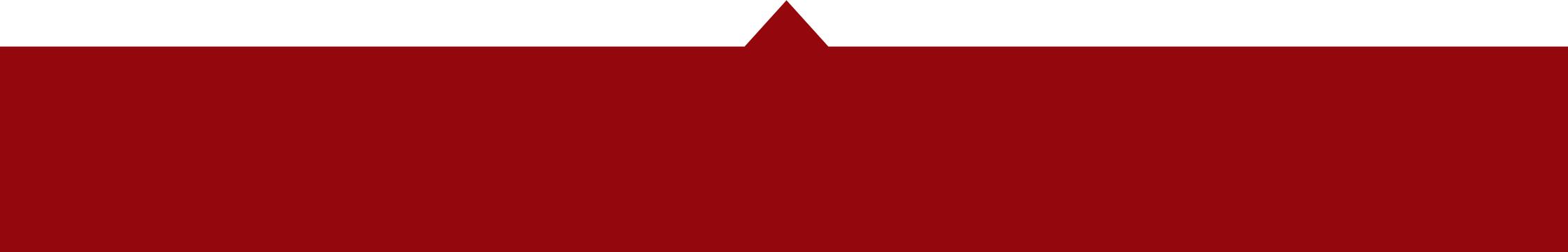
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Exhibits 2: Regulation rules

➤ Article 261-1 (1/2)

I. - The target company of a takeover bid shall appoint an independent appraiser if the transaction is likely to cause conflicts of interest within its Board of Directors, Supervisory Board or governing body that could impair the objectivity of the reasoned opinion mentioned in Article 231-19 or jeopardise the fair treatment of shareholders or bearers of the financial instruments targeted by the bid

The situations described below, in particular, constitute such cases:

- 1) if the target company is already controlled by the offeror, within the meaning of Article L. 233-3 of the Commercial Code, before the bid is launched
- 2) if the senior managers of the target company or the persons that control it, within the meaning of Article L. 233-3 of the Commercial Code, have entered into an agreement with the offeror that could compromise their independence
- 3) if the controlling shareholder, within the meaning of Article L. 233-3 of the Commercial Code, does not tender its securities to a buyback offer launched by the company for its own securities
- 4) if the offer is related to one or more transactions that could have a significant impact on the price or exchange ratio of the proposed offer
- 5) if the offer pertains to financial instruments in multiple categories and is priced in a way that could jeopardise the fair treatment of shareholders or bearers of the financial instruments targeted by the bid
- 6) if the non-equity financial instruments mentioned in Point 1 of Part II of Article L. 211-1 of the Monetary and Financial Code (Order of 30 July 2009) that give or could give direct or indirect access to the capital or voting rights of the offeror or of a company belonging to the offeror's group are provided as consideration for the takeover of the target company

Exhibits 2: Regulation rules

II. - The target company shall also appoint an independent appraiser before implementing a squeeze-out, subject to the provisions of Article 237-16



➤ Article 261-2

Any issuer that carries out a reserved capital increase at a discount to the market price greater than the maximum discount authorised for capital increases without pre-emptive subscription rights and giving a shareholder, acting alone or in concert within the meaning of Article L. 233-10 of the Commercial Code, control over the issuer within the meaning of Article L. 233-3 of the aforementioned code, shall appoint an independent appraiser who will apply the provisions of this title

➤ Article 261-3

Any issuer or offeror carrying out a takeover bid may appoint an independent appraiser who will apply the provisions of this title



Exhibits 2: Regulation rules

➤ Article 237-14

Without prejudice to the provisions of Article 237-1, following any public offer and within three months of the close of the offer, securities not tendered by minority shareholders may be transferred to the offeror, provided that they represent not more than 5% of the shares or voting rights, in return for compensation

Similarly, securities that give or could give access to capital may be transferred to the offeror, provided that the equity securities that could potentially be created, through conversion, subscription, exchange, redemption or any other means, from untendered securities that give or could give access to the company's capital, plus existing but untendered equity securities (Order of 20 August 2010) *"do not represent more than 5% of all the equity securities that exist and that could be created"*

Implementation of the squeeze-out procedure provided for in this article is subject to the provisions of Articles 237-4 to 237-7 and to the following provisions



Exhibits 2: Regulation rules

➤ Article 237-15

When it files the draft offer, the offeror informs the AMF whether it reserves the right, depending on the result of the offer, to implement a squeeze-out

➤ Article 237-16 (1/2)

I. - The AMF rules on whether the proposed squeeze-out is compliant, in accordance with Articles 231-21 and 231-22, (Order of 10 July 2009, in force since 1 October 2009) *"except in one of the following two cases and provided that the squeeze-out includes the cash settlement proposed in the last offer"*:

- 1) The squeeze-out follows a public offer subject to the provisions of Chapter II
- 2) The squeeze-out follows a public offer for which the AMF has the valuation mentioned in Part II of Article L. 433-4 of the Monetary and Financial Code and the report by the independent appraiser mentioned in Article 261-1

II. - Where the AMF rules on whether the squeeze-out is compliant, the offeror provides, in support of its proposed squeeze-out, a valuation of the securities of the target company, carried out using the objective methods applied in cases of asset disposals, that takes into account the value of the company's assets, its past earnings, its market value, its subsidiaries, if any, and its business prospects, according to a weighting appropriate to each case

Exhibits 2: Regulation rules

➤ Article 237-16 (2/2)

Where a squeeze-out is to be implemented, the parties concerned must draw up a draft squeeze-out document in accordance with the conditions and procedures set out in Articles 231-16 to 231-20, except for the description of the offeror's intentions for the next twelve months. The squeeze-out document(s) are submitted to the AMF for approval in accordance with Articles 231-20 and 231-26 and made available to the public in accordance with Article 231-27

Disclosures providing information on the legal, financial, accounting and other characteristics of the target company are filed with the AMF and made publicly available in accordance with the conditions and procedures set out in Articles 231-28 to 231-30. Content requirements for these disclosures are stipulated in an AMF instruction

III. - Where the AMF does not rule on whether the squeeze-out is compliant, the offeror informs the AMF of its intention to implement the squeeze-out. The AMF publishes the implementation date for the squeeze-out. The offeror publishes a news release (Order of 4 January 2007) *"in accordance with Article 221-3"* and is responsible for its distribution. Content requirements for these news releases are stipulated in an AMF instruction

Exhibits 2: Regulation rules

➤ Article 237-17

Where the AMF declares a draft squeeze-out to be compliant or where the AMF does not rule on whether the squeeze-out is compliant when the majority shareholder or group informs the AMF of its intention to proceed with a squeeze-out, the shareholder or group shall place a notice informing the public of the squeeze-out in a newspaper carrying legal notices published in the vicinity of its registered office

➤ Article 237-18

The statement of compliance shall specify the date on which it becomes enforceable. The time period between the release and the enforcement of the statement cannot be less than the time period referred to in Article R. 621-44 of the Monetary and Financial Code

The statement shall result in the delisting of the relevant securities from the regulated market where they are traded. The freezing of funds and crediting of compensation to holders that have not tendered their securities to the public offer takes place at the date on which the AMF's statement becomes enforceable

Where the AMF does not rule on whether the squeeze-out is compliant, the provisions of the preceding paragraph shall apply as from implementation of the squeeze-out

Custody account-keeping institutions transfer any securities not tendered to the last offer into the name of the majority shareholder or group, which pays the corresponding compensation into a reserved account opened for this purpose in accordance with the provisions of Article 237-5



Exhibits 2: Regulation rules

➤ Article 237-19

(Order of 10 July 2009, in force since 1 October 2009)

"As soon as the statement of compliance becomes enforceable, or, if the AMF does not rule on compliance, as soon as the squeeze-out is implemented, the relevant securities shall be delisted from the regulated market(s) where they were traded and, where appropriate, from the multilateral trading facilities where they were traded." At the same date, the custody account-keeping institutions transfer any securities not tendered to the buyout offer into the name of the majority shareholder or group, which pays the corresponding compensation into a reserved account opened for this purpose in accordance with the provisions of Article 237-11

