The liability of shareholders of French companies

Delphine Caramalli and Guilhem Bremond ask what liabilities shareholders of French companies are exposed to in cases of bankruptcy

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No statutory rules on shareholders liability as such exist under French law but, in certain circumstances, French judges can hold shareholders liable should the company they invested in be liquidated as a result of a bankruptcy proceeding.

Article L. 651-2 of the French Commercial Code[1] defines the liability exposure of a *de facto* director (as well as a *de jure* director[2]) who engaged in specific acts of mismanagement resulting in an excess of liabilities over assets of the underlying company. As *de facto* directors (as well as *de jure* directors) may be individuals, legal entities[3], or individuals who serve as legal representatives of legal entities (Article L. 651-1 of the French Commercial Code), shareholders can be qualified as *de facto* directors if it is demonstrated that they acted as directors of a company.

In this context, shareholders must be cautious to limit their liability exposure in case the company they own (in whole or in part) faces financial difficulties. Although shareholders must avoid taking any action or decision that could be qualified as management acts at the company's level, they should request exhaustive information on the company's situation. They also should formulate suggestions (but not instructions) to the company's *de jure* director such as filing a formal request before the President of the Commercial Court for the opening of amicable proceedings (*mandataire ad hoc* or *conciliateur*) or appointing an independent firm to conduct business reviews and management forecasts. Written correspondences (emails) are often provided to Courts to demonstrate a *de facto* management act of a shareholder in order to hold such shareholder responsible for mismanagement. Shareholders should further limit to grant loans to the debtor company (if the latter faces serious difficulties) outside the frame of an amicable proceeding.

From a strict legal prospective, a person is deemed to act as a *de facto* director, according to relevant French *jurisprudence* (case law) and *doctrine* (scholarly opinion), if it is first demonstrated that this person performed, directly or indirectly, *affirmative acts of management*. A person cannot be designated as a *de facto* director for failures or omissions to act. In addition, it has to be demonstrated that he/she performed these acts in an *independent* manner. For instance, a person cannot be considered a

de facto director where he/she acts on behalf of or under the direction of *de jure* directors.[4]

Hence, a shareholder can be qualified as a *de facto* director if he took management decisions or actions that are directly related to the company infringing the decision-making independence of the company's *de jure* directors. The act(s) of management must have been *imposed upon* the company, which must be found to have been *dominated* by the *de facto* director in some way.[5]

French Courts generally impose a strict and demanding standard before qualifying a shareholder as a *de facto* director, requiring proof that the shareholder was able to dominate the underlying debtor company.

In a decision dated 26 October 1999, the French *Cour de Cassation* upheld the decision of a Court of Appeal which ruled that a car manufacturer could not be qualified as a *de facto* director of a dealership distributing its products because (i) the manufacturer did not exceed its rights resulting from the dealership contract, and (ii) the acts of interference in the management of the car dealer by the regional manager of the car manufacturer was occasional, isolated and unspecific.[6]

In another case, the Court of Appeal of Paris required a "bundle" of converging elements establishing that the parent company ("**PC**") "*overpassed the limits inherent in the structure of a group of companies and committed repeated and affirmative acts of mismanagement in the management of its subsidiary, that it exercised a dominant influence over the decisions of the subsidiary in managing its affairs in a sovereign and independent manner, that it was the sole master of the economic and financial policies of its subsidiary.*"[7]

Before qualifying a parent company as the *de facto* director of its subsidiary[8], the French *Cour de Cassation* and Courts of Appeal verify and evaluate that the alleged acts of interference and domination (without general accusations) demonstrate that such a parent company has placed its subsidiary in a relationship of complete subordination[9]. For instance, French judges have ruled that the following actions collectively are deemed to constitute a situation of complete subordination:

(i) the CFO of the PC had a power of attorney over the subsidiary's account
(ii) the subsidiary's auditors reported directly to the PC
(iii) the survival of the subsidiary depended on its shareholder
(iv) the subsidiary was granted additional loans by the banks on the basis of its PC's creditworthiness
(v) the general meetings of the subsidiary took place at the registered office of its parent. ■

Footnotes

1 Article L. 651-2 of the French Commercial Code provides that: "Where the liquidation of a legal entity reveals an excess of liabilities over assets, the court may, in instances where management fault has contributed to the excess of liabilities over assets, decide that the debts of the legal entity will be borne, in whole or in part, by all or some of the de jure or de facto directors, who have contributed to the management fault. If there are several directors, the court may, by way of a reasoned ruling, declare them jointly and severally liable."

2 Under French law, *de jure* directors are the legal representatives of a legal entity, formally and regularly appointed, and whose mission is to manage the entity. *De jure* directors owe their duties to the company itself and do not report to any "superior" in the corporate hierarchy. *Hans Kelsen, Théorie pure du droit, 1934 ; Recueil Dalloz 2006, « L'ordre des sources ou le renouvellement des sources du droit », Valérie Lasserre-Kiessow.*

3 A legal entity may also be deemed a *de facto* director when that legal entity has acted "through intermediaries" (via its employees). (Cass. Com. 06/27/2006, n°04-15831); *Bull. Joly Sociétés 12/01/2006, n°12,p1372 François-Xavier Lucas.*

4 *Fasc. 2905 : REDRESSEMENT ET LIQUIDATION JUDICIAIRES – Dirigeants sociaux. Sanctions patrimoniales – Responsabilité pour insuffisance d'actif. Obligation aux dettes sociales, Charley Hannoun, 1er novembre 2006 ; Dictionnaire permanent, Dirigeants et Associés, §2 Dirigeant de fait, point 86.*

5 (Court of Appeal of Paris, 10/07/2008, RG n°07/13617)

6 (Cass. Com, 10/26/1999, n°97-19.026): In that case, the presence of the manufacturer's representatives at the dealer's offices was authorised by contract and the necessary level of control could not be found based upon the fact that the car manufacturer gave common directions to all its car dealerships regarding accounting, or from the fact that the manufacturer granted a loan to the car dealer more than 4 years before it went into bankruptcy.

7 (Court of Appeal of Paris, 10/07/2008, RG n°07/13617)

8 Cass. Com. 6/06/2000, n°96-21.134) (finding, *inter alia*, that the subsidiary had no autonomy other than for acts performed in the ordinary course of business); (Cass. Com. 11/23/1999, n°97-14693, RJDA n°3/00 n°270) (finding, *inter alia*, that the parent company continued to manage in an independent manner a business transferred to its subsidiary)

9 In a decision dated 6 April 2004, the Court of Appeal of Aix-en-Provence (Court of Appeal of Aix-en-Provence, 04/06/2004, RG n°02/20731) ruled that a parent holding company could be qualified as a de facto director of its subsidiary since (i) three board members of the subsidiary out of six were high level executives of the group, and the president of the board was an employee of the parent, (ii) the parent had a power of attorney over the subsidiary's bank account, (iii) the parent had the right to approve any credit operation of its subsidiary which was over 15,000 francs (i.e. US$3,300), (iv) the subsidiary was obliged to give a regular account to its parent of its operations and of all the important decisions to be taken, some of which had to be approved by the parent, (v) the parent authorised and financed the transfer of the subsidiary's registered office, (vi) executives of the parent attended the subsidiary's management meetings, (vii) the president of the board of the subsidiary reported to the parent regarding the situation of the company and communicated to it the letters he sent to the CEO, asked the parent to support the instructions he gave to the CEO, asked for directions from the parent regarding measures to be taken in order to turn around the situation, and held meetings at the parent's office, (viii) the parent directly participated in strategic choices of the subsidiary, (ix) the parent participated in the preparation of the plans to finance the new vehicles of the subsidiary in order to renew its fleet, (x) the parent decided to dismiss the CFO of the subsidiary and to replace him by one of its employees, (xi) the CEO of the subsidiary was not allowed to sign checks and to hire employees, (xii) the parent agreed to substitute its subsidiary if the latter was unable to reimburse the shareholder loan granted by one of its minority shareholders. According to the Court of Appeal, "together, those acts which exceed the limits of the legitimate right of information and of control of the main shareholder, characterise direct management conducted independently by the parent company which behaved like a de facto director of its subsidiary."

10 (Court of Appeal of Lyon, 07/02/1999, RG n°98/7888)

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