Top 7 Legal Considerations for Shareholder in French company

By Luis Wolff Kono[1]

December 2020

If you are (or are going to become) a shareholder in a French company, there are legal issues that you must consider, regardless of the size of the company, the nature of its activity, and the amount of your investment. These legal considerations are valid whether you are starting your own company, or buying shares in an existing company with other shareholders.

Consideration #1: Limited liability

This is probably the most important legal consideration. As a shareholder, you most likely will want to avoid being "personally liable" for company debts. If your company sells a defective product which causes harm to a customer, you won't want to be personally liable for that harm. The company of course will be liable, but you as a shareholder are a different person from the company. You probably will not want the injured customer to sue you and recover damages from your personal assets.

So a key requirement is to make sure the type of company you use provides for "limited liability" of shareholders. This means shareholders are only liable up to the amount of their investment in the company, and not more. So if you invested, say 10,000 euros in buying shares in the company, you stand to lose your 10,000 euro-investment in a worst-case scenario, where the company has to be dissolved and liquidated.

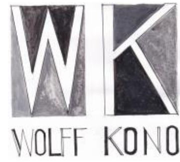
French company types providing for limited liability of shareholders include:

- SARL (société à responsabilité limitée) or its single-shareholder variant, EURL (entreprise unipersonnelle à responsabilité limitée)
- SAS (société par actions simplifiée)
- SA (société anonyme)

So why would a shareholder ever not go for limited liability? The drawback from limited liability is that the company has a more limited set

[1] Luis Wolff Kono is a corporate and commercial attorney based in Paris, France. He is admitted in Paris, New York and New Jersey, USA. Email: luis@wolffkono.com. Internet site : http://wolffkono.com.

©2020 Luis Wolff Kono. All rights reserved.



of assets to use, in fulfilling its obligations, as its owners' personal assets cannot be used. This can limit the company's attractiveness to creditors and customers, who may determine corporate assets are insufficiently valuable to back up the company.

In some sectors, particularly professional services like law, older company types did not provide for limited liability of shareholders. But the modern trend is that even these sectors are increasingly turning to newer limited-liability company types.

Consideration #2: Exit options

When you are starting your shareholder adventure, you should be thinking about exit options. It is like when you get married, you think about a prenuptial agreement.

You need to understand how your future exit from the company will work out. Can you sell your shares? How? Can you choose the buyer? Do other shareholders need to approve the buyer? What happens if they don't approve? These questions will help determine your exit scenarios and options, which are key to the return on your investment and the risks you may take on.

In a privately-held company, shares are not publicly traded on a market. This means your ability to sell your shares will be limited by restrictions set forth in the company charter or in the law. Selling your shares will take some time and effort, as a buyer needs to be found and (in most cases) approved by the other shareholders.

As the sale price will be a critical element in valuing not only your shares, but the entire company's value, this topic will be of great importance to other shareholders.

One thing you will likely want to have is a "right of preemption" (or "right of preference") in case another shareholder in your company decides to sell his or her shares. To avoid the uncertainty and risks from having a new third party as a shareholder, a right of preemption will allow you and other existing shareholders to have priority in buying the exiting shareholder's shares.

Another provision that often makes sense to have, is a prohibition on sale of shares for a limited period of time (say, 2 years) after company creation. No one wants to go through the trouble of forming a company and then hear that the other shareholder wants to exit 6 months later. The period of time of prohibition cannot be too long, so as not to restrict too much the right to sell the shares, which is a fundamental right.

Consideration #3: Beware the majority or minority shareholder

If you are a minority shareholder, you need to pay close attention to the thresholds applying to shareholder decisions, to see how much power the majority shareholder has. For example, if decisions are by simple majority, and you hold a minority stake, then you need to be prepared to accept decisions over which you will not have a

©2020 Luis Wolff Kono. All rights reserved.

veto right. It will be the majority shareholder calling the shots, and you will need to accept that.

You will likely want to retain a veto power, even as a minority shareholder, over certain decisions. For example, in a SARL the law requires a "double majority" (majority of shareholders holding a majority of shares) to approve a new shareholder. If you own a minority stake, you will enjoy a veto power over this kind of decision only if there is only one other shareholder (as your veto would prevent a majority of shareholders approving). If there are two other shareholders, you won't have a veto power unless you negotiate it in the company charter, which can provide for a higher majority threshold than the legal double majority.

If you are the majority shareholder, you need to think about minority veto rights. There are decisions which will require consent from the minority shareholder (such as those requiring unanimous consent). Examples are any decision increasing the shareholder commitment (such as requiring shareholders to inject more capital) or moving the company headquarters outside France.

Be careful with allowing new minority shareholders into the company. Small company owners, short on cash, may be tempted to pay vendors with equity. This represents a loss of control, as now the majority owner will need to share control with a vendor, and be at risk of the vendor blocking a decision or not cooperating. This loss of control needs to be very carefully considered. A small saving in the short term may turn into a big headache in the long term.

The decision to join up as shareholders with another party should be driven by a common, long-term vision, common interests, and a desire to share profits and risks. It should never be driven by a desire to save money.

Consideration #4: Segregation of property

Company funds and property must be kept separate from shareholder funds and property. As a separate "person", the company should have its own separate property kept apart from shareholder property. This separation requires discipline and financial management, but is important to respect, for a number of reasons.

First, failure to keep company property separate, which happens when a shareholder uses company property indiscriminately for his or her personal purposes, can lead to cancellation of the company. This cancellation then opens the door to shareholder liability for company debts.

Even if cancellation of the company does not result, the appropriation of company funds by a shareholder could be a "fictitious dividend", which is a criminal act. Dividend distribution, even in a single-shareholder company such as EURL, is governed by a strict procedure.

Another reason to keep segregation is to avoid disputes later at the time of company dissolution, when shareholders may disagree on how much each contributed to the company. If detailed records are not kept on contributions made by a shareholder to the company, either in the form of

©2020 Luis Wolff Kono. All rights reserved.

capital or loans, it will be difficult to determine a fair distribution of company property upon dissolution.

Transactions between the company and its insiders (such as shareholders or managers) are strictly regulated, even in single-shareholder companies. Some types of transactions are forbidden, such as company loans to insiders or company guarantees of insider commitments to third parties. Other types of transactions must be approved by shareholders or mentioned in public filings.

Consideration #5: General manager powers

It is obvious that as a shareholder you will be extremely careful about whom you appoint as general manager of your company. It is without a doubt one of the most important decisions a shareholder makes.

What may be less obvious is that, once the general manager is appointed and in place, he or she disposes of certain powers and prerogatives, conferred by law. Don't be fooled into thinking that as a shareholder you can control how the company is run.

For example, in a SARL the manager has the right and duty to call shareholder meetings; a shareholder, even a majority shareholder, cannot do it directly. In situations where the manager improperly fails to call a shareholder meeting (such as an annual assembly), a shareholder has legal recourse through a judicial action, but this is surely a burdensome process.

Another area to pay attention to is revocation of a manager. If a manager is doing a poor job in managing the company, shareholders may revoke him or her. But in practice, this may take time, effort and money. Even calling a shareholder meeting to decide on the revocation may be tricky as the manager will be calling the meeting! Revocation without just cause may entitle the manager to seek damages.

As a shareholder you will want to review carefully the provisions of the company charter (statuts) dealing with these topics, as well as the legal rules depending on the company type. Some of these manager prerogatives can be somewhat limited by the charter, but some of them cannot.

Consideration #6: Director or officer (D&O) liability

If you will be active in the management of the company, as a director or officer, you need to think about the liability you could incur in that capacity. A modern trend in the law (both civil and criminal) is to increasingly hold directors and officers personally liable for company misbehavior. Not only is the company liable for its misdeeds, but a victim or the government could also pursue the responsible director or officer who was

©2020 Luis Wolff Kono. All rights reserved.

involved in the misdeed, or who failed to stop it. This risk of D&O liability is so high in some countries that insurance policies covering this risk are available.

The fact that as a shareholder you have limited liability (as discussed above) will not necessarily protect against D&O liability. When the shareholder is also a director or officer, he or she could be the subject of a lawsuit based on his or her acts as a director or officer (rather than his role as shareholder).

Consideration #7: Tax liability

This is probably obvious, but you must consider tax issues in becoming a shareholder. For shareholders who are individuals, a threshold issue is how the company income will be taxed: will it be subject to "corporate tax" (impôt sur les sociétés) or will it simply be added to other income of the shareholder and taxed together with that other income (impôt sur le revenu)? Different company types will allow for different tax treatment. You need to choose the company type most appropriate to the company situation as well as your own personal situation.

©2020 Luis Wolff Kono. All rights reserved.