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A review of director liability in France

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Introduction

Director liability is a hot topic. Legal action against company management is increasingly the norm, bringing to light often flagrant abuses of company power and resources. As this storm continues to rage company directors are on the front line. Their powers are grouped into two realms: internal – to effectively manage a company on a day-to-day basis – and external – to represent the company before partners and other stakeholders. These powers are shaped and limited by general provisions of company law, company bylaws as well as the general notion of acting in the company's best interest. What are the risks of overstepping these limits?

We will begin our analysis with a high-level overview of how a company director can incur civil liability and then focus on the criminal liability aspects (uniquely considering French legal provisions, which are similar in many respects with other civil law jurisdictions in the EU). We avoid the extreme cases as currently being played out under the Ghosn affair and instead stay focused on the average company director generally operating in good faith but who may not be fully aware or simply underestimate the risks inherent in his or her position. We will also share a case of how a company director can face criminal liability for data protection violations – the General Data Protection Regulation (GDPR) is not just about significant administrative fines.

For the sake of simplicity, we will focus on two common commercial limited liability companies under French law: the *Société à responsabilité limitée* (SARL) and the *Société anonyme* (SA). Generally speaking, this covers the small, family-run company compared to a big, multinational, respectively.

PART I

I. The case of civil liability

A. Company and its shareholders on the attack

1. La faute de gestion

There are primarily three reasons in which a director may be held liable to the company or its shareholders[1]: 1) an infringement of legislative or regulatory provisions; 2) an infringement of the company's bylaws or 3) mismanagement or *faute de gestion*.

The first two are fairly straight-forward but the third one – *faute de gestion* – requires particular attention, especially since it's a gray area in which the limits have been largely shaped by case law.

Determining if a director has committed such a fault requires the courts to weigh the criteria of prudence, diligence and business activity. The fault may be intentional or caused by carelessness or simple negligence, which is often assessed in light of the company's corporate interest: do the actions or inactions of the director go against the company's interest? Decisions rendered by the French Supreme Court (*Cour de cassation*) provide insight.

For example, the qualification of mismanagement could be retained in the case of passive management when the business is operating at a loss.[2] There could also be mismanagement in the event of incomplete financial documentation[3] or of failure to fulfil contractual obligations towards a contracting partner.[4]

2. Shareholder action

Shareholder action aims to repair the damage suffered by the company and restore its balance sheet. It may take two forms.

The first is initiated by the company itself, know under the social action *ut universi* and carried out by the company's legal representatives. Since a director would not normally initiate legal action against him or herself, this scenario is instead intended to be used by a new director taking aim at the faults committed a the former director (rarely used in practice).

The second type can only be initiated by the company shareholders: known as *ut singuli* shareholder action.[5] This action must meet a specific legal requirement: for a SARL, the shareholders must represent at least 10 % of the company's share capital; for an SA, the shareholders must represent at least 5 % of the share capital. In addition, any clause in the company's bylaws that would make such action subject to prior notice or authorisation by a shareholder meeting would be considered null and void (for the obvious reason that the company directors would not be able to block shareholders from taking action since the directors would usually convoke a shareholder meeting).

[1] Article L223-22 paragraph 1 (SARL) and article L225-251 (SA) of the French Commercial Code
[2] Com. 5 juin 1961
[3] Com. 12 octobre 1993, n°91-17629
[4] Com. 20 janvier 2015, n°13-28521
[5] Article L223-22 paragraph 3 (SARL) and article L225-252 (SA) of the French Commercial Code

In the event the company director is eventually found guilty of a *faute de gestion*, then any monetary damages awarded would go directly to the company's social capital (and could potentially take the form of a dividend if agreed by company management).

3. Individual action by a shareholder

Shareholders may also initiate legal action on a personal level. There is one requirement, however: they must be able to demonstrate a personal harm distinct from that suffered by the company.

For example, the loss in value of shares as a result of the reduction in the share capital is not considered to be a separate personal loss.[6] On the other hand, a shareholder of a company who has been induced to invest in the securities issued by the company and to hold them following false, inaccurate or misleading information provided by the directors[7] would be considered as a personal injury. A fine line.

B. <u>Company vs director liability</u>

In principle, in the event of harm suffered, an interested party would have to take legal action against the company as opposed to against the company director or directors. Only as an exception to the rule may the director be specifically singled out for personal liability.

For a director to face personal liability it must be proved that he or she has committed a fault separate from his or her duties. This key distinction of separate misconduct was introduced by the Commercial Chamber of the *Cour of Cassation* from a 20 May 2003 decision: "The director intentionally commits a fault of a particularly serious nature incompatible with the normal exercise of social functions."[8]

For example, such conduct would include a director who resells a vehicle to the buyer of his company, whereas the vehicle was leased (with an option to purchase) and should have been returned to the leasing company.[9] The same applies to a director who allows an employee to use a vehicle without insurance and without informing him.[10]

If an interested party cannot demonstrate the existence of separate fault, then the only option is to initiate legal action against the company as a corporate entity. But in this (more common) scenario, the company could then take legal action against its director for mismanagement.

C. <u>Statute of limitations</u>

[6] Com. 12 juin 2012, n°11-14.724
[7] Com. 9 mars 2010, n°08-21.547
[8] Com. 20 mai 2003, n°99-17092
[9] Com. 15 mars 2017, n°15-22889
[10] Com. 4 juillet 2006, n°05-13930

The statute of limitations for director liability claims is 3 years starting from when the harmful event or its disclosure is revealed. This limitation period may extend to 10 years if the acts committed by the director are qualified as a crime.[11]

[11] Article L223-23 (SARL) and article L225-254 (SA) of the French Commercial Code