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Pre-emption right in the by-laws on share donations: the risks of inapplicability and the importance of the drafting

In a decision rendered on March 17, 2009[1], followed much later by legal commentaries, the Commercial Chamber of the *Cour de Cassation* (French Supreme Court) recalled the importance of the drafting of the clauses of the by-laws that contain restrictions on the free disposal of shares.

In the case in question, the petitioner disputed the applicability of a pre-emption clause in the by-laws of a *société anonyme* (publicly-held corporation). Pursuant to this clause, any contemplated share transfer was supposed to be notified to the other shareholders, indicating the number of shares to be transferred, **the price of such shares and any other terms and conditions of the contemplated transfer.** The clause specified that the notification shall be deemed **an offer to sell such shares to all the shareholders at the price and conditions indicated.**

One of the shareholders had donated two of his shares to his children without implementing the shareholder pre-emption procedure set forth in the by-laws.

The Court of Appeals had found that failure to comply with this procedure rendered the donation unenforceable with regard to the other shareholders.

The *Cour de cassation* reversed on this issue, reasoning that the **pre-emption procedure set forth by the by-laws was, in absence of price, not applicable to free transfers.**

Although the purpose of this decision, on principle, is not to exclude the application of the pre-emption clause to free transfers of titles, i.e. through a donation, the *Cour de cassation* insisted upon the fact that the drafting of such a clause restricting shareholders' liberty must be precise.

In this case, it can be inferred that, for the pre-emption clause to be applicable, a sale price should have been included for the shares concerned.

The exercise of the offer to sell by one of the shareholders would have resulted in the sale of the shares in consideration for the sale price communicated by the selling shareholder.

Yet, the donation is an act that is free of charge, which results in a transfer of title to the donee for no consideration due to the donor.

As such, the *Cour de cassation* held that the absence of a price, which is inherent to a donation, obstructed the pre-emption right procedure set forth in the by-laws.

However, this decision does not mean that a pre-emption clause may not lay down rules governing contemplated share transfers for valuable consideration as well as contemplated share transfers free of charge. In the case of a transfer free of charge, it is advisable to adapt such clause to specify an absence of price.

Nevertheless, legal commentary interprets this decision with caution[2]. In fact, French law on *sociétés anonymes* prohibits recourse to a clause in the by-laws requiring approval in the case of inheritance, liquidation of matrimonial property, or **share sales to a spouse, ascendant or descendant by a shareholder[3].**

The majority of legal commentaries maintains a broad concept of the notion of sale and considers that the donation falls within the scope of this prohibition[4].

The issue, therefore, is whether, in a *société anonyme,* subjecting the donation of shares to a spouse, ascendant or descendant to a pre-emption right is legal, when such a donation cannot be subject to an approval procedure. Based on current French law, legal commentators doubt it[5].

On the other hand, in view of the commentaries on the decision, a pre-emption right may validly be exercised in the case of a donation for the benefit of persons who may be subject to an approval procedure.

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[1] Cass. Com., March 17, 2009, no. 08-11268 (no. 235 FD), X. and a. v. A. and a.

[2] See B. Saintourens, *Bull. Joly Sociétés*, ed. Joly, October 2009, no. 10.

[3] Article L. 228-23 of the French Commercial Code.

[4] See M. Germain, *Traité de droit commercial, Les sociétés commerciales*, LGDJ, 2009, 19e ed., no. 1618-1; M.Cozian, A. Viandier and F.Deboissy, *Droit des sociétés*, Litec, 2008, 21e ed., no. 721; P. Le Cannu, *Droit des sociétés*, Précis Domat, 203, 2e ed., no. 1054.

[5] See B. Saintourens, *Bull. Joly Sociétés*, ed. Joly, October 2009, no. 10.