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Interference and appearance in corporate groups

"Appearances can be true" according to French poet Eugene Guillevic. In a decision dated February 3, 2015, the *Cour de Cassation* (French Supreme Court) endorsed this oxymoron by ruling that a parent company that interferes in the commercial relationship of one of its subsidiaries, thereby suggesting that it has substituted itself for the latter in the performance of a contract, can be held liable for the sums due by the subsidiary under such contract.

In a litigation concerning the recovery of a claim, a company decided to sue the holding company of the group to which its debtor belonged as it considered that the holding company had substituted itself for the subsidiary in the performance of the contract by becoming involved in the pre-litigation phase in trying to negotiate an out-of-court settlement. As a counter-argument, the holding company relied on the principle that legal entities are autonomous and argued, therefore, that a company may not be held liable for the debts of another, even if both companies belong to the same group. The Court of Appeals ruled against the holding company and ordered it to meet the liabilities of its subsidiary because of the confusion between it and its subsidiary that it had instilled in the mind of the subsidiary's co-contractor. This judgment was upheld by the *Cour de Cassation* in a decision issued on February 3, 2015[1].

The principle is well-known: a corporate group is not in itself a subject of law and, as such, has no legal personality. Consequently, a subsidiary, as opposed to a branch, is an autonomous legal entity that is independent from its parent company, even if they have the same registered office and common corporate officers. In a series of landmark decisions, the *Cour de Cassation* has ruled that the companies of the same group are distinct from each other and that no legal provision can justify the transfer of rights and obligations from one company to another, absent fraud or fictitious legal entities[2]. As such, because companies are autonomous, they are liable for their own debts and, despites any link that may exist between them, the property of any such company may not be used to honor the commitments made by the parent company or a sister company[3].

There are, however, exceptions to this principle of independence, as recalled by the Commercial Chamber of the *Cour de Cassation* in the decision commented herein.

First, the principle according to which legal entities are autonomous sometimes conflicts with the theory of appearance. Indeed, judges may depart from this principle to preserve the interests of creditors misled by the behavior of co-contracting companies. As such, judges have considered that the identicality of the registered office, logo and letterhead of a parent company and its subsidiary was likely to create an appearance to such an extent that, misled by this appearance and not contradicted on this point, several subcontractors had sent their invoices sometimes to the parent company, sometimes to the subsidiary, which suggested that both companies were acting in close interdependence under the same supervisory and management authority[4].

In addition to the theory of appearance, French courts also rely on the concept of "interference in management" to depart from the above principle. Wherever the various companies of a corporate group present themselves as a single entity, the lack of autonomy of any of the subsidiaries and the interference by the other companies in the management of that subsidiary can lead to the situation where the parent company will be found jointly and severally liable with the group, if so requested in court by a client of said subsidiary[5]. Consequently, as an example, a subsidiary that has been involved in the performance of a contract can be made subject to the arbitration clause set forth in such contract even though it had been entered into solely by the parent company and not by the subsidiary itself[6].

In the commented decision, the *Cour de Cassation* noted that the holding company did not directly interfered in the conclusion and in the performance of the contract but held that it had actually become actively involved in the pre-litigation phase at the time the creditor was about to initiate recovery proceedings, thereby leading the creditor to believe that the holding company had substituted itself for the subsidiary in the performance of the contract. This interference, combined with numerous common elements between the two companies, including identical registered office, email address and manager, created a legitimate appearance that the parent company had substituted itself for its subsidiary, thereby entitling the creditor to seek payment from the holding company.

As a result of this line of decisions, when it comes to commercial relationships between companies of the same group, it is absolutely necessary to clearly delineate the role of each entity and to limit the role played by the holding company in negotiations conducted by its subsidiaries. Indeed, the parent company may experience a "backlash" if it elects to preserve the interests of its subsidiary by acting directly with their contractual partners. If the parent company wishes to become involved in order to weigh on the negotiations, it will be advisable to highlight that it plays only a supportive role in the negotiations – as opposed to being the main party to the negotiations – i.e. a role distinct from that of its subsidiary, in order to set aside any risk of being ultimately considered as the debtor of its subsidiary's contractual partner.

[1]Commercial Chamber of the *Cour de Cassation*, February 3, 2015, n°13-24.895

[2]Commercial Chamber of the *Cour de Cassation*, May 24, 1982

[3]Commercial Chamber of the *Cour de Cassation*, November 4, 1987

[4]Commercial Chamber of the *Cour de Cassation*, November 18, 1994

[5]Commercial Chamber of the *Cour de Cassation*, March 4, 1997

[6]Court of Appeals of Paris, November 30, 1988