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Pre-emption clause held inapplicable to the contribution of company shares

In a decision dated December 15, 2009[1], the Commercial Chamber of the *Cour de Cassation* (French Supreme Court) recalled the importance of the drafting of pre-emption clauses and ruled that such clauses would not apply in case of contribution of shares.

Please recall that a pre-emption clause gives shareholders a priority right to acquire any shares offered for sale by a selling shareholder. If none of the existing shareholder wishes to acquire the shares, the selling shareholder is then free to sell such shares to any other person of his choosing.

In the case in question, the shareholders of several companies belonging to the same group entered into an agreement providing for a 5-year reciprocal pre-emption right in case of "sale" of the shares they respectively held in the group companies.

Subsequently, one such shareholder formed a Newco and contributed to this Newco the shares he held in the group companies.

The other group shareholders initiated legal proceedings against the selling shareholder, claiming that the pre-emption procedure set forth in the pre-emption clause should have been applied, and requested payment of a penalty.

The Versailles Court of Appeals indicated that the contribution of shares was to be considered a legal transaction by which the contributor had transferred assets from his personal property to the Newco in formation and, in return, received shares for a value corresponding to the contributed assets (i.e. the company shares).

The Court of Appeals concluded that the contribution of shares resulted in a transfer for valuable

consideration of the shares to another company and, as such, that the contribution of shares was to be considered a "sale" within the meaning of the pre-emption clause.

Therefore, the Court of Appeals held that the contribution of shares should have been previously notified to the other group shareholders to give them the possibility to exercise their pre-emption right.

The Commercial Chamber of the *Cour de Cassation* reversed this decision, pursuant to Article 1134 of the French Civil Code that stipulates "*Agreements lawfully entered into take the place of the law for those who have made them*".

In the case in question, the pre-emption clause only expressly referred to the "*sale*" of shares, which led the *Cour de Cassation* to consider that the parties wished to limit the effect of such clause to sales – the counterpart of which is the payment of a price – and to exclude from its scope of application contributions of shares – the counterpart of which is the allocation of corporate rights.

This decision of the *Cour de Cassation* is in the same line as a previous decision dated March 17, 2009[2] where the French Supreme Court ruled that a pre-emption clause set forth in the by-laws of a company was not to be applied to the shares donated by a shareholder to his children. The *Cour de Cassation* held that the absence of a price, which is inherent to a donation, excluded the application of such pre-emption right procedure according to which any sales price for the shares were to be notified in advance to the shareholders.

As such, in order to avoid any interpretation issue, a pre-emption clause needs to be drafted in such a manner as to either expressly list the transactions that will be subject to the pre-emption procedure (sale, free transfer, contribution of shares, merger, demerger, contribution of assets, etc.) or be drafted in general terms to include any transfer of shares of any nature whatsoever.

While this decision of the *Cour de Cassation* recalls that clauses containing restrictions on the free disposal of shares – such a pre-emption clause – must be strictly construed, it also seems to challenge long-established case law[3] that considers that contributions and sales of shares should be treated similarly when it comes to applying approval clauses included in by-laws.

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[1] *Cass. Com., December 15, 2009*, n°08-21.037 (n°1240 F-PB) Le Boursicot c/Parrain

[2] *Cass. Com., March 17, 2009,* n°08-11268 (n°235 FD), X et a. c/ A. et a., cf. our October 2009 e-newsletter

[3] *Cass. Com., January 21, 1970* : Bull. Civ. IV n°28

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