Read this post online

Valuation of equity shares: the french supreme court confirms that article 1843-4 of the french civil code also applies to private instruments

Article 1843-4 of the French Civil Code stipulates that "*In all cases concerning the transfer of a shareholder's shares or the buyback of such shares by the company, the value of the shares shall be determined, in case of a dispute, by an expert appointed either by the parties or, in the absence of an agreement between the parties, pursuant to an order of the summary judge that will be considered as final and definitive.*"

The above is a **public policy rule**[1] : such an expert valuation is mandatory wherever the share transfer or buyback is **imposed** and the value of shares **disputed**. The appointed third-party expert must assess the value of the shares based on criteria that he/she considers appropriate to the circumstances of the case[2]. His/her decision is binding upon the parties and the judge, unless he/she has made a **gross mistake**[3] in the valuation.

Since 2007[4], the *Cour de Cassation* (French Supreme Court) has systematically extended the scope of application of the above provisions **in disregard of the parties' will**, by granting any and all requests for expert valuation, even in cases where the parties had agreed on a price determination clause.

The decision commented herein[5] is fully in line with this widely criticized court-made doctrine.

The facts of the case: as owner of 11,274 shares in Comptafrance Holding under an employee savings plan, the salaried manager of a subsidiary of this company undertook, pursuant to an irrevocable commitment letter signed in the framework of the "*Shareholders' Charter of the Comptafrance Group*", to transfer his shares in case of termination of his employment with the subsidiary at a price to be calculated according to a pre-determined valuation formula.

A few years later, the salaried manager resigned and, forced to sell his shares in Comptafrance Holding, challenged the transfer price and requested the appointment of a valuation expert as per Article 1843-4 of the French Civil Code.

In a judgment dated April 1, 2010, the Paris Court of Appeals ruled that the former manager "*improperly relied on Article 1843-4 of the French Civil Code since* ***the parties had not agreed, in case of a dispute, to appoint an expert for the purpose of determining the transfer price***."

The former manager lodged an appeal before the *Cour de Cassation*.

In the commented decision, the *Cour de Cassation* overturned the judgment and considered that the Court of Appeals had violated the aforementioned Article by refusing to apply it.

Applicable case-law shows that the current trend is as follows:

- **Clauses set forth in by-laws or private instruments that determine the price of shares** in case of a mandatory transfer or buy-back **do not preclude the application of the provisions set forth in Article 1843-4 of the French Civil Code**[6], insofar as the **dispute predates** the contemplated transfer[7];
- **The expert may deviate** from the valuation method initially agreed upon by the parties[8].

As such, the future of **so-called "*bad leaver*" and "*good leaver*" clauses** seems increasingly uncertain.

The primary objective of these types of clauses, usually set forth in private instruments such as shareholders' agreements, is to define in advance the conditions in which shareholding managers or key executives will leave the company, depending notably on their behavior. As such, the "*bad-leaver*" clause aims at sanctioning a shareholding manager / key executive who resigns or who is terminated (for example) for misconduct, through the buyback of his/her shares at a price fixed according to a pre-determined valuation method and after the application of a **discount**.

Conversely, the "*good leaver*" clause serves as a reward for shareholding managers / key employees who are terminated in circumstances not covered by the "*bad leaver*" clause, through the purchase of their shares at a price intended to be fair.

---

[1] Established case-law: see in particular decision of the 1st Civil Chamber of the *Cour de Cassation* dated November 25, 2003 and decision of the Commercial Chamber of the *Cour de Cassation* dated December 4, 2007.

[2] Established case-law: see in particular decision of the Commercial Chamber of the *Cour de Cassation* dated May 5, 2009 and decision of the Paris Court of Appeals dated December 9, 2008.

[3] Established case-law: see in particular decision of the 1st Civil Chamber of the *Cour de Cassation* dated November 25, 2003 and decision of the 1st Civil Chamber of the *Cour de Cassation* dated January 25, 2005.

[4] Decision of Commercial Chamber of the *Cour de Cassation* dated December 4, 2007.

[5] Decision of the Commercial Chamber of the Cour de Cassation dated December 4, 2012, *commented decision*.

[6] Decision of the Commercial Chamber of the *Cour de Cassation* dated December 4, 2012, *commented decision*.

[7] Decision of the Commercial Chamber of the *Cour de Cassation* dated November 24, 2009.

[8] Decision of the Commercial Chamber of the *Cour de Cassation* dated May 5, 2009.