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Directors' duties

French companies
Financial difficulties potentially resulting from the COVID-19 situation

This note sets out the duties of the following directors of French companies with a particular focus on the duties owed by such directors of companies in financial difficulties:

- the members of boards of directors (including chairman) (*conseils d'administration*) of French joint-stock companies (*sociétés anonymes* or **SA**);
- the members of supervisory boards (*conseils de surveillance*) of SA which are organized with a management board (*directoire*) and a supervisory board (*conseil de surveillance*);
- members of ad hoc corporate bodies of French simplified joint-stock companies (*sociétés par actions simplifiées* or **SAS**).

This note does not deal with the specific duties and liability regimes of:

- chief executive officers (CEO), general managers (*directeurs généraux*), deputy general managers (*directeurs généraux délégués*) or members of management boards (*directoire*) of SA;
- presidents, general managers (*directeurs généraux*) and deputy general managers (*directeurs généraux délégués*) of SAS;
- managers (*gérant*) of limited liability companies (*sociétés à responsabilité limitée*) and partnerships limited by shares (*sociétés en commandite par actions*).

Being a director, am I also a manager (dirigeant)?

Corporate bodies which are de jure managers under French law

A manager (*dirigeant*) encompasses a number of different positions in French companies, depending on the corporate form, and includes the members of boards of directors (including chairman and members of sub-committees) (*conseils d'administration*) of a SA.

Supervisory and advisory bodies which are not deemed to be de jure managers under French law

Members of supervisory boards (*conseils de surveillance*) of SA which are organized with a management board and a supervisory board and members of *ad hoc* boards or committees of a SAS deprived of any management powers (as further detailed below) are not deemed to be *de jure* managers (*dirigeants*) and, to the extent they have not acted as *de facto* managers (*dirigeants*), should not, as a matter of principle, have any primary liability in connection with acts of management or the results thereof under corporate or insolvency laws.

Specific rules applying to ad hoc corporate bodies set up in SAS – case by case analysis depending on the scope of such bodies' powers

SAS often organize *ad hoc* boards and committees vested with bespoke powers, which shall be set out in the articles of association. Such powers are often to supervise the company's management and, accordingly, approve certain important or strategic actions or transactions prior to their implementation. Boards who have merely supervisory or advisory powers should not, as a matter of principle, be qualified as managers (*dirigeants*).

Courts may however consider (based on a case-by-case analysis) that members of ad hoc corporate bodies of SAS shall, regardless of title (and even if such bodies are

referred to as "supervisory" or "advisory" bodies in the articles of association) be qualified as managers (*dirigeants*) due to the nature and scope of the powers granted to them under the articles of association. A person to whom the articles of association grant, in effect, the power to manage the company may always be considered as a manager (*dirigeant*) of a SAS by French courts.

French courts considered for example that members of an SAS' supervisory board may be qualified as managers (dirigeants) when:

- the powers granted to them under the articles of association are the same as those of a board of directors (*conseil d'administration*) of a SA under French law (i.e. among others, the powers to determine the orientations of the company's activities and ensures their implementation, and to deal with any matter concerning its proper operation); or
- the SAS' president does not have enough power to act independently due to the importance of the powers granted to the supervisory board, enabling it to interfere with the company's management (e.g. the materiality threshold (amount / value above which transactions are required to be approved by the board) considered too low and/or scope of the reserved matters considered too wide given the nature of the company's business activities).

Qualification as de facto manager

Members of corporate bodies which are not *de jure* managers (*dirigeants*) (as well as third parties) and which, consequently, should not be deemed to be managers (*dirigeants*) under French law, may still be qualified by French courts (based on a case-by-case analysis) as *de facto* managers (*dirigeants*) if such courts consider that they have, in effect, run the company.

French courts have defined *de facto* managers (*dirigeants*) as those who carry out (directly or through an intermediary) positive acts of management freely and independently, despite not having been formally appointed as manager (*dirigeant*) (as defined by French law).

Individuals acting as representatives of entities appointed as directors

Where a legal entity is appointed as director, the representatives of that legal entity shall be subject to the same conditions and obligations and shall incur the same liability as if they were directors in their own name, without prejudice to the joint and several liability of the legal entity which they direct.

Directors' duties generally

The duties of directors are not clearly defined under French law. Generally speaking, a director must:

- manage (if they are managers (*dirigeants*)) or, as applicable, supervise the management of, a company pursuant to its corporate interest, taking into account the social and environmental issues of its activities;
- act as a reasonably diligent, cautious and active director;
- act loyally towards the company and its shareholders;
- not act contrary to the company's interest and act in accordance with the articles of association of the company;
- avoid a situation in which it has, or may have, a direct or indirect interest or duty that conflicts or may conflict with the company's interests.

Particular points of attention when the company faces financial difficulties?

French law imposes various duties and requirements on directors that are designed to protect the interest of the company if the company is or is likely to become insolvent, including:

- preparing or having prepared contingency and restructuring plans and, as necessary, considering alternative sources of financing;
- obtaining adequate professional advice as regards the feasibility of the restructuring effort and continuing to regularly monitor the chances of success of the restructuring effort and adjusting their strategy accordingly;
- strictly comply with the governance rules applicable to the company (including allocation of responsibilities among the various corporate bodies); and
- being particularly careful when incurring new obligations on behalf of the company, granting security interests or guarantees or disposing of assets of the company.

In addition, the legal representative of a company is required to apply for the opening of insolvency proceedings within 45 days of such company becoming cash flow insolvent (*cessation des paiements*), unless a conciliation proceeding is ongoing. The French insolvency test (*cessation des paiements*) is a pure cash flow test, defined as the relevant company's inability to pay its debt as they fall due (taking into account moratoria and grace periods) with its immediately available assets (taking into account available credit facilities). This is unlike many other jurisdictions which also refer to a "balance sheet" insolvency test.

Irrespective of the above, when directors act diligently, in good faith and in the interest of the company and do not act contrary to the company's articles of association, the

risk of liability, even in distressed situations, should not cause undue concern. Note, however, there are no automatic "safe harbours" for directors under French law.

In contrast to certain other jurisdictions, under French law, the interest of the company:

- shall not be confused with, and does not include the interests of other stakeholders e.g., creditors, employees or shareholders (and, in furtherance thereto, directors should never prioritize the interests of shareholders or creditors over the interests of the company by, for instance, repaying shareholders' loans or expunging debts owed by shareholders); and
- shall always be taken into account and not be superseded by interests of companies belonging to the same group (or of the group itself) when assessing whether a transaction was in the company's best interest, unless in limited exceptions. Directors should therefore be very careful when taking decisions which could be deemed to favor one member of the company's group to the detriment of the company itself.

Directors' civil liability generally

Directors being managers (dirigeants)

A director being a manager (*dirigeant*) may incur civil liability in the performance of its duties in the event of:

- failure to comply with any legal provision applicable to the relevant form of company, the provisions of the articles of association and/or the board of directors' internal rules (if any) and/or
- mismanagement (*faute de gestion*) of the Company. There is no legal or regulatory definition of mismanagement. The concept is relatively broad and ranges from a lack of care or caution to committing fraudulent acts. The standard of care required to defend any alleged mismanagement is generally that of a "diligent" director.

Actions may be brought against directors being managers (*dirigeants*) by the company itself (i.e. through its legal representative) or by one of its shareholders acting on behalf of the company through a derivative claim known as the *ut singuli* claim.

Third parties may also bring a claim in the event of a loss and/or damages distinct those suffered by the company and if the relevant action or omission was separable from the directors' offices (*faute détachable des fonctions*) (i.e. a willful misconduct so severe that it is exclusive from the normal performance of their offices).

Directors not being managers (dirigeants)

Directors not being managers (*dirigeants*) may also incur general civil liability for individual negligence committed in the performance of their duties (e.g. if they lack to exercise supervisory functions or do not act in the best interest of the company but in the interest of a shareholder) if a loss and a link of cause and effect between the negligence and the loss can be evidenced.

Directors being managers' specific liability in case of insolvency proceedings

Where judicial liquidation proceedings have been initiated, directors being managers (*dirigeants*) may be held personally liable to contribute to the shortfall in the company's assets where the judicial liquidation proceedings reveal a net liability position (*responsabilité pour insuffisance d'actifs*) if mismanagement is found.

In limited circumstances, additional sanctions may be ordered against directors being managers (*dirigeants*) when judicial restructuring or liquidation proceedings are commenced against a company. For example, having used "ruinous means" to obtain funds to avoid or delay the commencement of judicial restructuring or liquidation proceedings, may lead the court to (i) issue an order of personal bankruptcy (*faillite personnelle*) or (ii) impose a ban on managing (*interdiction de gérer*).

Available contingency options when the company faces financial difficulties

The company should stop trading once there is no reasonable prospect of avoiding liquidation.

However, before reaching this stage there are several proceedings available under French insolvency law that a director may or, in certain cases, must request if the company is in difficulty:

- *mandats ad hoc* or conciliation proceedings: confidential and amicable restructuring proceedings by which the court appoints a third party (usually a qualified insolvency practitioner) to help managers negotiate with one or several creditors or potential sponsors to put an end to the company's difficulties;
- safeguard proceedings: court-driven proceedings inspired by the US Chapter 11 proceedings, the purpose of which is to draw up a restructuring plan that provides for the restructuring of the company's business and/or indebtedness so that it can continue its activity as a going concern;
- (under certain conditions) accelerated safeguard proceedings or financial accelerated safeguard proceedings: these proceedings allow the debtor to implement a restructuring plan agreed by the majority creditors (or, as the case may be, financial creditors) in

conciliation within three months following the opening of the proceeding.

Ultimately, when the company is insolvent (as evidenced by the cessation des paiements test described above) and when no conciliation proceedings are ongoing, it is the legal representative's duty to request the initiation of judicial reorganisation proceedings (*redressement judiciaire*) or judicial liquidation proceedings.

Practical guidance when the company faces financial difficulties

Seek professional advice

Directors should seek appropriate legal and accountancy advice on a regular basis to ensure they are complying with their responsibilities.

Seek advice to consider the initiation of confidential and amicable restructuring proceedings (mandat ad hoc or conciliation proceedings) to reach an agreement with certain creditors and/or sponsors that would resolve the company's difficulties. Alternatively, when no such agreement can be reached seek advice to consider the initiation of safeguard proceedings to draw up a restructuring plan in collaboration with the French Commercial Court, that may be enforced against dissenting creditors under certain circumstances.

Closely monitor the financial health of the company

- cash flow solvency position of the company and cash flow forecast should be regularly assessed so as to consider the various options available (and anticipate, as may be needed, the opening of insolvency proceedings); and
- if the company's articles of association provide for a prior approval right of any collegiate body in respect of the opening of any insolvency proceedings and the company becomes cash flow insolvent, said collegiate body should be convened within the time period allowed to declare such insolvency and should not oppose the initiation of any such proceedings.

More generally, the collegiate body should act in a very prudent manner in relation to such matters and should not oppose the opening of an insolvency proceedings where such opening, while not mandatory under French law, would be in the company's best interests.

Be active, act diligently and keep records of activity

Beyond directors' specific duties, members of bodies involved in the company's management or supervision should generally:

- take part in and hold board meetings regularly (regular meetings demonstrate the intent to consider all possibilities to preserve the company);
- closely and diligently monitor the management, and challenge the management decisions where there is a risk that any such decision be adverse to the company's interests;
- ensure that their decisions are well documented;
- vote against any decision which they deem not to be in the company's interest and state their reasons for disagreeing with such measure; and
- ensure that the meetings are duly formalized in precise minutes, which shall in particular (A) evidence that the aforementioned standards are duly complied with, (B) identify the members who voted against the decision (and set out the reasons given by such members to explain the grounds of their dissenting opinion) and (B) highlight the circumstances under which decisions are taken and the considerations from the viewpoint of the company for taking a decision (including why the decision is believed to be in the company's best interests).

As a general principle, directors who are members of collegiate bodies should actively take part in meetings of such collegiate bodies and a vote against a certain measure should be prioritized over a "no-show". In particular, please note that not attending to a specific meeting will not shield a director from liability issues arising from decisions taken at that meeting, as the case may be.

Review dubious transactions

When a company's solvency is in question, the review of any transaction that might be perceived as preferential or at an undervalue must be conducted with particular care.

If directors authorize a transaction that is subsequently reversed (because it is deemed preferential or at undervalue), such directors' authorization may be annulled in subsequent insolvency proceedings and could put such directors at a risk of liability.

Should I resign?

As a general rule, under French law directors are free to resign from their offices even in distressed situations. However, in some cases, a given resignation may be qualified as wrongful (e.g. malicious intent, sudden at an inconvenient time). Resignations should always be completed with care, courtesy and proper explanations should be provided, as well as notified in compliance with the applicable (or, in absence thereof, a reasonable) notice period.

Review your D&O insurance policy

Companies should review the D&O insurance policy contracted for the benefit of their directors. Depending on the insurance provider, such policies may differ in coverage and extent and companies should ensure that directors have adequate policies in place. However, a D&O insurance would not necessarily shield a director in case such director's personal liability is engaged for mismanagement.

This material is for general information only, is not intended to provide legal advice and does not contemplate the specificities related to listed companies nor any criminal or tax liability regime.

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