SHEET 18 b

What damage is caused to minority shareholders in the case of shareholder oppression?

Shareholder oppression is an abuse of voting rights committed by one or several shareholders at the general meeting. This very specific type of abuse corresponds to a decision which is taken "*contrary to the interests of the company, with the sole aim of providing an advantage for the members of the majority, to the detriment of the minority*", according to case law. The court examines whether the act giving rise to the claim has undermined equality between the shareholders and whether this undermining of equality is unjustified with regard to the company's interests. This approach, which has been followed more than 50 years by the Court of Cassation (Court of Cassation, Commercial Chamber, 18 April 1961, S. 1961, p. 257), is at times somewhat mishandled by judges, but it seems that there are only a few examples of this. Most commonly, Court of Cassation judgments require both of these conditions to be fulfilled (Court of Cassation, 1st Civ., 19 May 2021, no. 18-18896). There has been much speculation as to the legal basis for this praetorian creation. Some authors believe that the basis is misuse of power, whilst others suggest that the basis is liability for fault on the part of the majority. The second approach seems the more realistic – indeed, in the case law this idea is often used with reference to Article 1382 (now Art. 1240) of the Civil Code (Court of Cassation, Commercial Chamber, 10 April 2019, no. 17-14790). This being the case, compensation for damage caused by majority shareholders quite naturally takes the form of annulment of the unlawful decision and/or payment of damages.

Shareholder oppression can lead to the adoption or rejection of a resolution at the general meeting.

This sheet covers three common cases of shareholder oppression: failure to distribute dividends, "accordion" capital reorganisation and capital increase.

1 – Damage caused to minority shareholders via unlawful refusal to distribute dividends

There are two different situations to highlight here:

- The case in which the majority imposes the rejection of a resolution to distribute dividends.

- The case in which the majority imposes the adoption of a resolution to place the distributable profit in the reserve or to carry it forward.

Regardless of which situation applies, the results are the same: annulment of the decision does not provide a definitive solution, as the minority shareholders still do not receive dividends. In all probability, a new round of discussions would be held after the annulment, but there is no reason to believe that the majority shareholders would change their vote. The decision to annul a decision must therefore be followed up with an order to pay damages.
The purpose of these damages is to compensate for the damage caused by the failure to distribute dividends - but does this damage correspond to the amount of the dividends not received? In order to uphold the principle of full compensation, several points must be examined, including the following:

- Determination of the amount of the dividends which should have been paid.
- Consideration of the specific taxation of dividends in the situation at hand.
- Increase in the value of minority shares due to dividends not being distributed.

2 – Damage caused to minority shareholders via an unlawful "accordion" capital reorganisation (*coup d'accordéon*)

An "accordion" capital reorganisation is a technique often used to recapitalise a company which has lost more than half of its share capital. It involves reducing the capital to zero, wiping out all existing shares and then carrying out a capital increase. In some cases, it can constitute shareholder oppression (Court of Cassation, Commercial Chamber. 28 February 2006, no. 04-17566).

There are two cases to be examined, depending on whether or not the court to which the case is referred accedes to the minority shareholder's request for annulment of the operation.

a) The court annuls the operation

In this case, returning to the previous state of affairs restores the rights of the minority shareholders. They recover the corporate rights which they had before the annulled operation.

As well as having their rights restored, minority shareholders can also request annulment of all subsequent meeting decisions, particularly any decision on distribution of dividends.

If the court accedes to this request, the majority shareholders and all other shareholders will be obliged to return the dividends to the company in which the minority shareholders have recovered their shareholding. The economic rights of the minority shareholders are thus restored to their status before the "accordion" capital reorganisation.

b) The court does not annul the operation

In this case, minority shareholders definitively lose the corporate rights they held before the operation and must therefore be compensated for the damage suffered.

Their damage corresponds to a loss equal to the value of the shareholders' rights concerned the day before the operation took place.

To determine the value of these corporate rights, two benchmarks may prove useful to minority shareholders: the benchmark sales price of the same shares as sold to a third party on a date very close to the "accordion" capital reorganisation, and the benchmark value of these shares in the majority shareholders' records, which can then be invoked against them.

Alternatively or cumulatively, the minority shareholder can also call upon a financial expert to produce an expert's report based on standard criteria for business valuation (multicriteria method: multiples approach, discounted future cash flow, comparative analysis, etc.). See **sheet 22** (What role can non-judicial expert evidence play in assessing economic damage?) for best practices to adopt in submitting a report from a non-judicial expert.

The court must assess the relevance of the evidence provided by the minority shareholders and any documents produced in defence by the majority shareholders (often a second expert opinion).

The difficulty in valuing shareholders' rights and therefore the damage caused lies in the fact that companies concerned by an "accordion" capital reorganisation are normally experiencing financial difficulties. These difficulties, which gave rise to the capital reorganisation intended to replenish the company's capital, and the company's ability to overcome these difficulties are key elements to be considered in the valuation process.

3 – Damage caused to minority shareholders via an unlawful capital increase

A capital increase which minority shareholders are unable to keep up with may constitute shareholder oppression in some cases (Court of Cassation, Commercial Chamber, 18 March 2020, no. 17-27150).

The consequence of the operation is dilution of the minority shareholder.

As previously, the situation differs depending on whether the court annuls the operation.

a) The court annuls the operation

The minority shareholder's percentage interest is restored, as are all rights pertaining to this.

As with an "accordion" capital reorganisation, minority shareholders can also request annulment of all subsequent meeting decisions, particularly any decision on distribution of dividends.

b) The court does not annul the operation

The minority shareholder’s percentage interest is definitively reduced due to the operation.

This dilution does not necessarily cause financial loss to the minority shareholder. If the capital increase is undertaken with a share premium which takes into account the value of the company, a minority shareholder who has not participated in the capital increase would hold, after the operation has been carried out, a shareholding of identical value after the share capital increase. In this case, damage is only of a non-financial nature and concerns the minority shareholder’s loss of power at general meetings.

The minority shareholder therefore only suffers financial loss linked to dilution in the case of a capital increase carried out with an insufficient share premium in relation to the value of the company.

In this case, this damage takes the form of a loss corresponding to the difference in value between the minority shareholder’s stake before and after the operation. To assess the damage, as with an “accordion” capital reorganisation, the minority shareholder’s corporate rights before and after the operation must be assessed.

This assessment of damage requires proof of undervaluation of the corporate rights which led to the establishment of the contested share premium, and determination of the real value of these rights.

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