What can Minority Shareholders expect from Controlling Shareholders? — 
A Comparative Approach: the United States and France

Abstract

This paper explores the duties that controlling shareholders owe to minority shareholders, either directly or indirectly. Whereas controlling shareholder’s rights are quite vast, their duties tend to be very limited. This paper affirms that a balance between controlling shareholders’ rights and duties is needed and analyzed the equilibrium developed by two legal systems: the US common-law system and the French civil law system. Whereas controlling shareholders seem to be submitted to higher duties in France than in the US, the enforcement rules and case law mitigate this observation.
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1. **Introduction**

*When asked what the shares in his company were worth, a prominent newspaperman replied, “There are 51 shares that are worth $250,000 and there are 49 shares that are not worth a ---.”*

The corporate governance framework “describes whom the organization is there to serve and how the purposes and priorities of the organization should be decided”. Under the majority rule, the imbalance of power in corporate governance is inherent and favors the majority whenever there is one. Minority shareholders are extremely susceptible to the majority's abuse of control. The majority allows minority shareholders to participate in the decision making process “purely at the grace or acquiescence of the majority.”

Consequently, under the guise of a shareholders' vote, majority shareholders dictate the direction of a corporation. Traditionally shareholders have been thought to have far more limited fiduciary duties than corporate officers and directors. Recognizing the potential for abuse, state legislatures have promulgated laws and most courts impose a fiduciary duty on majority shareholders of corporations to protect the interests of minority shareholders.

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Besides majority shareholders, other shareholders may control or attempt to control the corporation, depending on the circumstances, mainly by exercising power over a *de facto* majority to be subject to fiduciary duties.\(^8\) Regulation and case law are less clear on what the duties of those controlling shareholders are. Although they should be similar to the ones of majority shareholders, regulation and case law then to retain a narrow definition of controlling or majority shareholders.

Today, in the US and abroad, there are divergences on what the definition of controlling shareholders should be and how extensive those fiduciary duties are.

This paper aims to analyze whether this balance is achieved in theory and in practice in two distinct legal systems: the US common law legal system and the French civil law legal system.

According to Professor Wymeersch, when “looking for complementary forces of harmonization, one can confidently point out that international capital markets powerfully drive the homogenization of governance structures in company law. Opinion leaders in this respect are, most often, institutional investors from the United States.”\(^9\) Despite this convergence of the theoretical and business-oriented proposals, empirical evidence on western countries suggests contrasted situations. Broadly, two models could

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be distinguished: the Anglo-Saxon model of corporate governance, and on the other hand, the continental European model.  

The Anglo-Saxon model focuses on the stock market as the central element of the system of governance. Most of the larger, publicly owned companies’ source their capital there, and in these countries, shareholding is largely in the hands of smaller shareholders with the result that shares are broadly dispersed.

In the continental European model of corporate governance, corporations tend to be embedded in a network of a small number of large investors, among which banks play a major role. Within this network of mutually interlocking owners, the central focus is the long-term preservation of influence and power. For the purpose of sourcing capital, banks and their loans, rather than just the market, are still of major importance for continental European corporations.

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12 M. Becht and A. Roell, *Blockholdings in Europe: An international comparison*, European Economic Review, 43(4-6): 1049-1056, 1999. See also Luca Enriques and Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, Journal of Economic Perspectives, vol. 21, no. 1, pp. 117-140, 2007: In fact, the empirical evidence shows that dispersed share ownership is prevalent only in two countries, the US and the UK. “According to indicators of ownership concentration reported by Enriques and Volpin for the 20 largest listed companies at the end of 1995 in France, Germany, Italy, the United Kingdom and the United States, widely held companies (...) are very common (...) in the US, with (...) France (...) in between. Moreover, looking at the median fraction of votes owned by the largest shareholder across all listed companies, ownership appears (...) diffused in the Anglo-Saxon countries, with France falling in between.” See also Randell K. Morck, *Introduction*, in *Concentrated Ownership Structure*, 1, Randell K. Morck ed., 2000; Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy*, 119 Harv. L. Rev. 1641, 1645-1650, 2006; both are summarizing cross-country evidence.
In these contexts, this paper suggests controlling shareholders’ fiduciary duties own to minority shareholders should balance controlling shareholders’ rights in the Anglo-Saxon and the Continental European model of corporate governance respectively. As there tend to be more controlling shareholders in the Continental European model of corporate governance, with greater rights, controlling shareholders in these legal systems should also own higher duties to minority shareholders. Whereas this seems to be the case in theory, the conclusion needs to be mitigated when looking at the enforcement rules and case law.


Part II discusses how controlling shareholders’ fiduciary duties are enforced. This is certainly where the US system is the most different from the French system. Although in theory, minority shareholders have a certain number of ways to enforce their rights, in practice, they tend to be costly and not so frequently used.
2. Controlling Shareholders’ Fiduciary Duties

Where shareholders are not passive and use of their power to exercise some kinds of control on corporations, duties should come to limit their power. Different legal systems may adopt different standard to limit shareholders’ power, but to the extent shareholders are increasingly powerful, it is difficult to conceive that shareholders have no duties at all towards the corporation and their fellow shareholders. Controlling shareholders’ fiduciary duties in the US legal system are presented and put in perspective with controlling shareholders’ fiduciary duties in the French legal system.

2.1 The US Fiduciary Duties

Shareholders’ fiduciary duties are hardly addressed by corporate codes. Nonetheless, courts have considered them for years.\textsuperscript{13} The definition of controlling shareholders varies from a state to another as well as what fiduciary duties they should comply with.

2.1.1 Shareholders’ Fiduciary Duties Left Out by the Corporate Codes

As Professor Robert Art pointed out,\textsuperscript{14} one would expect that corporate codes would establish the principles determining duties of shareholders, the same way as they specify the duties of directors and officers. In reality, corporate codes tend to have little concern for shareholders’ duties. For instance, both the Delaware General Corporation Law


(“DGCL”) and the Model Business Corporation Act (“MBCA”) makes no mention at all of the “fiduciary duty” theory or its underlying concepts with regards to shareholders.

In the DGCL, only two sections make a reference to potential conflict of interests between the corporation and its shareholders: §203 as well as §245 that refers to §203.\textsuperscript{15} Section 203 limits transactions between the corporation and interested shareholders. It provides that “corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the time that such stockholder became an interested stockholder” and lists several categories of qualifying transactions that might be employed to increase a shareholder’s proportionate interest in the company, along with several exceptions. The statute provides the definitions of “control” and “interested shareholders”. It defines “control” extensively by considering that control means “possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise. A person who is the owner of 20% or more of the outstanding voting stock of any corporation, partnership, unincorporated association or other entity shall be presumed to have control of such entity, in the absence of proof by a preponderance of the evidence to the contrary (…).”\textsuperscript{16} An interested shareholders means “any person (other than the corporation and any direct or indirect majority- owned subsidiary of the corporation) that (i) is the owner of 15% or more of the outstanding voting stock of the corporation, or (ii) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any

\textsuperscript{15} Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §203.

\textsuperscript{16} Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §203 (c) (4).
time within the 3-year period immediately prior to the date on which it is sought to be
determined whether such person is an interested stockholder, and the affiliates and
associates of such person (...).” 17 The statute continues with a set of exception to this
definition. Although both of these definitions could be quite interestingly used in an
encompassing approach of controlling shareholders’ fiduciary duties, none of them are.
Some scholars, such as Professor Robert B. Thompson, call for a Delaware corporation
code that would better address shareholders’ powers and responsibilities. 18 Although I
believe DGCL addresses shareholders’ powers quite well in comparison to their duties, 19
the requested revision of the DGCL should certainly include controlling shareholders’
fiduciary duties. Professor Lawrence A. Hamermesh, 20 while commenting on Professor
Thompson’s article, notices that “this is a most interesting challenge, given the well
recognized conservative tendency in Delaware corporate law to allow evolution more
through judicial decisions than through statutory definition.” 21 Nonetheless, the DGCL, at
least partially, addresses directors’ fiduciary duties. Hence, it could be reasonably
considered that the DGCL could similarly address controlling shareholders’ fiduciary
duties.

17 Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §203 (c) (5).
19 See e.g. Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §121.
21 See, e.g., Lawrence A. Hamermesh, The Policy Foundations of Delaware Corporate Law, 106 Colum. L. Rev. 1749, 1776-78, 2006: “Delaware corporate lawmakers embrace the idea that legal issues that depend for their resolution on complex facts cannot and should not be reduced to black letter codification.”

See also, Marcel Kahan and Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573, 1611, 2005: They note a preference for “incremental legislation”. 
Similarly to the DGCL, the MBCA does not include a fiduciary theory relating to shareholders. One connection between shareholder dissension case law and the statute is in a remedies section, authorizing judicial dissolution if “the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent.”22 “Those in control” and “oppressive” are not defined in the statute. Another connection is in the right of appraisal section, which deal with controlling shareholders who may have conflicting interests that could, if not dealt with appropriately, adversely affect the shares’ consideration that otherwise could have been expected.23 For the purpose of this section only, shareholders are considered controlling by virtue of ownership of a substantial amount of voting stock (20 percent)24 or ability to exercise control, through contract, stock ownership, or some other means, over at least one fourth of the board’s membership.25

Overall, the Delaware General Corporation Law and the MBCA is more concerned by shareholders’ rights than shareholders’ duties, which have been developed by case law. Fiduciary duties basically apply to officers and directors, but, to the extent that a shareholder holds the power to control the corporation, courts have shown some willingness to apply these duties to such a shareholder as well.26

22 MBCA, Section 14.30 (2) (2007).
23 MBCA, Section 13.02(b)(4) (2007).
24 MBCA, Section 13.02(b)(4)(i) (A) (2007).
25 MBCA, Section 13.02(b)(4)(i) (B) (2007).
The next issue is to understand whom courts have considered controlling shareholders. The following question is what fiduciary duties those shareholders should comply with.

2.1.2 Defining Controlling Shareholders

State courts usually agree that controlling shareholders owe fiduciary duties but a debate exists between them as to what extent controlling shareholders owe fiduciary duties. As more that 60 per cent of US corporations, including the largest ones, are incorporated in Delaware,\(^{27}\) this paper focuses on Delaware case law.

Professors Anabtawi and Stout\(^{28}\) pointed out that, under Delaware case law, the “archetypal “controlling” shareholder” remains “a shareholder who own more than 50 percent of the company’s outstanding shares” in particular “because shareholders generally elect and remove directors by a majority vote.”\(^{29}\) Where a shareholder does not own a majority of the corporation's share, the court will look at whether this shareholder has exercised actual domination and control of the corporation. In \textit{re PNB Holding Co. S'holders Litig.}, a controlling shareholder is defined as one who “(1) owns more than 50% of the voting power of the corporation; or (2) exercises control over the business and affairs of the corporation.”\(^{30}\) Based on this definition provided, it could seem that any

\(^{29}\) Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §§211 (b), 141 (k), (2005).

See also \textit{Kaplan v. Centex Corp.}, 284 A.2d 119, 123, Del. Ch., 1971.
shareholder can be considered a “controlling shareholder” depending of the circumstances. This is certainly not the case under Delaware case law. In *re PNB Holding Co. S'holders Litig.*, the court continues with a more specific definition of what ‘exercising control over the business and affaires of the corporation’ means. According to the court, “the second test exists to allow the law to impose fiduciary obligations on stockholders who, although lacking a clear majority, have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control.”

Hence, Delaware state courts have drawn a narrow definition of ‘controlling shareholders’ by setting a high standard review for a non-majority shareholder. To be considered a controlling shareholder, he or she should hold “formidable” power to compensate for a lack of “clear” majority. This restrictive definition of ‘controlling shareholder’ can be found in a number of cases. For instance, in *Tomczak v. Morton Thiokol, Inc.*, the court held that a share-ownership of 8.23 percent did not approach the threshold of control of the corporation and accordingly, the shareholder did not owe any fiduciary duties to the remaining shareholders.

Also, in *Ivanhoe Partners v. Newmont Mining Corp.*, the court held that “a shareholder owes a fiduciary duty only if it owns a majority interest or exercises control over the business

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*Siegman v. Tri-Star Pictures, Inc.*, C.A. No. 9477, Del. Ch. May 5, 1989, revised May 30, 1989: at 8, “For a shareholder to occupy the status of a fiduciary, it must either have majority stock control or exercise actual domination and control over the corporation's business affairs.”

*Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70, Del., 1989: “For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct.”


affairs of the corporation” and concluded that a 26 percent shareholder “owed no fiduciary duty to the other shareholders.”

As pointed out by Professors Anabtawi and Stout, “when a shareholder has a less than 50 percent stake, courts tend to engage in cautious, detailed factual analysis of whether that particular shareholder, individually or together with associates, owns enough shares to give the shareholder clear voting power to replace the board of directors.” For example, in one case, the Delaware Supreme Court held that a 43 percent holder effectively exercised control, while in another the Court held that a 47 percent holder did not necessarily have control without some particularized facts showing domination.

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35 *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113, Del., 1994. The Delaware Supreme Court used a cautious approach in “analyzing whether Alcatel, the minority shareholder alleged to be controlling in that case, “did exercise actual control over Lynch by dominating its corporate affairs.” (at 1115). The Court concluded that Alcatel, which owned more than 43 percent of Lynch, did “dominate” Lynch because it was able to substitute its own judgment for that of the Lynch board. (at 1113-1114). As evidence, the court quoted an Alcatel-nominated director’s admonition to Lynch’s other board members: “You must listen to us. We are [sic] 43 percent owner. You have to do what we tell you.” (at 1114) The court took such statements, together with evidence that the board’s independent directors voted with Alcatel’s directors, to uphold the lower court’s finding that Alcatel exercised actual control over Lynch and dominated its corporate affairs. (at 1114-1115)” (Iman Anabtawi and Lynn A. Stout, 2008).

36 See also *In re Cysive, Inc. Shareholders Litigation*, 836 A. 2d 531, Del., 2003: “Nelson Carbonell owned approximately 35 percent of Cysive, Inc., a publicly traded company. When associates’ holdings and options to purchase additional stock were taken into account, Carbonell controlled as much as 40 percent of Cysive’s voting equity. In deciding whether this made Carbonell the “controlling” shareholder of Cysive, the Delaware Chancellor focused on Carbonell’s ability, should he become disenchanted with Cysive’s directors, to elect a new board “without having to attract much, if any, support from public stockholders.” (at 552). The Chancellor emphasized that “100% turn-out is unlikely even in a contested election,” (at 552 n30) and that “a 40% block is very potent in view of that reality.” (at 552 n30)” (Iman Anabtawi and Lynn A. Stout, 2008). The Chancellor determined that “Carbonell is a controlling stockholder” and concluded his analysis by holding that “the analysis of whether a controlling stockholder exists must take into account whether the stockholder, as a practical matter, possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes. Carbonell has that capability and would be perceived as having such capability by rational independent directors, public stockholders, and other market participants.”


See also *In re W. Nat'l Corp. S'holders Litig.*, C.A. No. 15927, Del. Ch., May 22, 2000: slip op. at 15-16, finding a 46 percent shareholder not controlling because the possibility that it could obtain a majority of the
The Delaware case law indicates that “when a shareholder does not control an absolute majority of the votes of a corporation, it must exercise power over a de facto majority to be subject to fiduciary duties.”

It then becomes necessary to understand whether courts analyze ‘de facto majority’ globally or on a context-specific basis. Case law is relatively ambiguous on this issue. A certain number of cases consider that “allegations of control over the particular transaction at issue are enough.” This would mean that a shareholder could be deemed controlling over one transaction and not another. Supporting this view, certain courts do seem to engage in an analysis highly specific to the transaction at hand. In particular, *In
Kahn v. Lynch Communications Systems, Inc.,\textsuperscript{39} the Supreme Court of Delaware insisted on the fact that its analysis of the shareholders’ controlling issue was specific to “the testimony and the minutes of the August 1, 1986 Lynch board meeting.\textsuperscript{40} Similarly, In re Primedia Inc. Derivative Litig.,\textsuperscript{41} the court considered the discussions between the potential controlling shareholder and the other shareholders as well as the course of dealing for the specific transactions.\textsuperscript{42}

Nonetheless, it is unlikely that those contextual elements would have been by themselves enough for those shareholders to be considered controlling without a high percentage of share ownership and a corporate governance structure controlled by the defendant shareholder. In fact, because case law focuses on shareholders’ voting powers\textsuperscript{43} and corporate governance structure\textsuperscript{44}, and sets a high standard of review for “actual

\textsuperscript{39} In Kahn v. Lynch Communications Systems, Inc. 638 A.2d., Del., 1994.

\textsuperscript{40} In Kahn v. Lynch Communications Systems, Inc. 638 A.2d, at 1114-1115, Del., 1994: “Based upon the testimony and the minutes of the August 1, 1986 Lynch board meeting, the Court of Chancery concluded that Alcatel did exercise control over Lynch's business decisions.” Also: “(...) Alcatel did control the Lynch board, at least with respect to the matters under consideration at its August 1, 1986 board meeting.”

\textsuperscript{41} In re Primedia Inc. Derivative Litig., 910 A.2d 248, 257, Del. Ch., Nov. 15, 2006.

\textsuperscript{42} In re Primedia Inc. Derivative Litig., 910 A.2d 248, 257, Del. Ch. Nov., 15, 2006: “The discussions of KKR’s contained in Primedia's SEC filings indicate that KKR was the influential force behind the stock redemptions.” Also: “The course of dealing present here suggests that KKR enjoyed actual control over the stock redemptions.”

\textsuperscript{43} See e.g. In re Primedia Inc. Derivative Litig., 910 A.2d 248, 257, Del. Ch., Nov. 15, 2006: “When the dust settles, this web of entities allegedly gives KKR Associates and KKR 1996 GP voting and investment power over 61.25% of Primedia’s common stock.”

\textsuperscript{44} See e.g. In re PNB Holding Co. S'holders Litig., C.A. No. 28-N, Del. Ch., Aug. 18, 2006: “The CEO of PNB, Ed Vogelsinger, owned only 4.6% of the stock. (...) There are no voting agreements between directors or family member.”
control”, courts’ analysis tend to assess shareholders’ control globally rather than consider it in function of its context. For instance, to decide whether a defendant is a controlling shareholder, courts consider, among other criteria, the number of affiliates the defendant appointed on the corporation’s board, an issue more likely to be general rather than context specific.

As analyzed by Professors Anabtawi and Stout, “the conventional approach to shareholder fiduciary duties accordingly seem to frame the issue of shareholder control in terms of whether a particular shareholder has absolute control over all corporate conduct general partner of KKR Associates 1996 and thus possesses sole voting and investment power over KKR 1996 Fund.”

See also In Kahn v. Lynch Communications Systems, Inc. 638 A.2d 1110, Del., 1994: stressing the following facts - “In 1981, Alcatel acquired 30.6 percent of Lynch's common stock pursuant to a stock purchase agreement. As part of that agreement, Lynch amended its certificate of incorporation to require an 80 percent affirmative vote of its shareholders for approval of any business combination. In addition, Alcatel obtained proportional representation on the Lynch board of directors and the right to purchase 40 percent of any equity securities offered by Lynch to third parties. The agreement also precluded Alcatel from holding more than 45 percent of Lynch's stock prior to October 1, 1986. By the time of the merger which is contested in this action, Alcatel owned 43.3 percent of Lynch's outstanding stock; designated five of the eleven members of Lynch's board of directors; two of three members of the executive committee; and two of four members of the compensation committee.”

45 See e.g. with regards to a controlling group of shareholders: St. Clair Shores General Employees Retirement System v. Paul Eibeler, United States District Court, S.D. New York., No. 06 Civ. 688, RJS, Sept. 8, 2010: Applying Delaware law, the Court held that “with respect to Plaintiff's assertion that Defendants constituted a control group, Delaware law will not easily label a group of persons a controlling group of shareholders. (…) Feldman v. Cataia, 956 A.2d 644, 657, Del.Ch., 2007 (quoting In re PNB Holding Co. S'holders Lit., No. Civ.A. 28– N, 2006 WL 2403999, at * 9, Del.Ch., Aug. 18, 2006).”

46 In re Primedia Inc. Derivative Litig., 910 A.2d 248, 257, Del. Ch., Nov. 15, 2006: “the number of KKR associates on Primedia's board supports an inference of actual control. The fact that an allegedly controlling stockholder appointed its associates to the board of directors is certainly an important factor that provides a court with insight when evaluating whether actual control is pleaded adequately.”

In re Western Nat’l Corp. S'holders Litig., 2000 WL 710192, at *20, Del.Ch., May 22, 2000: “There also is no evidence to suggest that American General directly or indirectly participated, or was in any way involved, in the functioning of the Western National board of directors before the merger. In other words, to use the familiar language deployed in non-majority shareholder control inquiries, no evidence indicates that American General dominated the Western National board of directors.”

Williamson v. Cox Communications, Inc., 2006 WL 1586375, Del.Ch., June 5, 2006: “The fact that an allegedly controlling shareholder appointed its affiliates to the board of directors is one of many factors Delaware courts have considered in analyzing whether a shareholder is controlling. (…) The fact that Cox and Comcast nominated directors to the At Home board does not, without more, establish actual domination or control. (…) As discussed below, plaintiff also points to Cox and Comcast's (…) control over At Home board decisions.”
as a routine matter. The inquiry is not issue-specific." And this remains the case even though certain courts claim that “allegations of control over the particular transaction at issue are enough” and others that the question of whether shareholders are “controlling” should not focus on mathematical calculations but, instead, should focus on whether they have the power to work their will on others and whether they have done so improperly.

Instead of the limited approach developed by case law, courts could extend their definition of ‘controlling shareholder’ by considering that any shareholder in a position to dictate to a corporation’s business decision could be deemed “controlling” for this specific decision. As Professors Anabtawi and Stout pointed out, cases indicate that “controlling shareholders analysis, as currently performed, looks to whether a shareholder or group of affiliated shareholders owns enough voting shares to allow it to dictate membership on the board. This approach ignores entirely the possibility that shareholders with smaller stakes - that is, shareholders who do not have voting power clearly sufficient to determine who sits on the board of directors - might still be able to influence corporate officers or directors in less obvious ways (for example, by threatening a distracting and costly proxy fight, or an embarrassing media relations campaign). It also ignores the power that the marginal impact of a shareholder’s vote can have on the outcome of a

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corporate decision.”\textsuperscript{52} As observed by Gordon, managements are never happy to reject a recommendation that has substantial shareholder support.\textsuperscript{53} Hence, in response to the increase of shareholder powers, an extensive and context-specific definition of controlling shareholders would be more appropriate than the current approach, which drastically limits the definition of controlling shareholders.

Hence, a more rational approach would probably be where the circumstances surrounding the transitions or the votes dictate the degrees of fiduciary duty imposed by courts,\textsuperscript{54} the controlling shareholders’ intended effect constituting the breach.

2.1.3 Controlling Shareholders’ Fiduciary Duties

The next issue is to know what fiduciary duties controlling shareholders are responsible for. As officers and directors, controlling shareholders may owe a fiduciary duty of care, and loyalty to the minority shareholders and to the corporation. This principle has been established in the close corporation context as well as for publicly traded corporations.


See also Iman Anabtawi and Lynn A. Stout, \textit{Fiduciary Duties for Activist Shareholders}, UCLA School of Law, Law-Econ Research Paper No. 08-02, Stanford Law Review, Vol. 60, 2008: “The shareholder control test should be context-specific, meaning it determines whether a shareholder is a controlling shareholder by referring to the role that the shareholder played with respect to a particular corporate decision.”
Professors Iman Anabtawi and Lynn Stout pointed out that “shareholders have been held, in some circumstances, to have a duty of care. In particular, a few cases have held that a controlling shareholder may breach its duty of care if it knowingly sells control of the corporations to a “looter” (that is, a controlling shareholder that plans to breach its duty of loyalty and expropriate corporate assets for itself).”

For directors and officers, the duty of care is very limited by the business judgment rule. The business judgment rule is “usually described as a legal presumption that the directors and officers of the corporation have exercised due care by acting on an informed basis, in good faith, and in the honest belief that their actions are in the best interests of the corporation. Unless a plaintiff can produce persuasive evidence rebutting one of these three elements, corporate directors and officers are effectively insulated from liability for breach of the duty of care”. The question is to know whether it applies to controlling shareholders. Courts have not been consistent on this issue. Sinclair Oil used the business judgment rule to analyze a controlling shareholder's receiving improper dividends where the controlling shareholder did not receive a benefit causally related to the minority's


detriment.\textsuperscript{58} That analysis is quite different from the analysis in \textit{Kahn v. Lynch Communication Systems}, which held that the “exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness.”\textsuperscript{59} This tension in Delaware law is still being worked through by the courts,\textsuperscript{60} “the determination of the appropriate standard of judicial review [being] frequently determinative of the outcome of derivative litigation.”\textsuperscript{61} As a general rule, to the extent that it is more relevant to develop a fiduciary theory for controlling shareholders similar to the one developed for directors and officers, shareholders who do not have a personal economic stake in an outcome should benefit as


See also \textit{Getty Oil Co. v. Skelly Oil Co.}, 267 A.2d 883, 887, Del., 1970: holding that the business judgment rule applied where the parent got no benefit from its control over its subsidiary. “Since there is no proof of self-dealing on the part of Sinclair, it follows that the expansion policy of Sinclair and the methods used to achieve the desired result must, as far as Sinclair’s treatment of Sinven is concerned, be tested by the standards of the business judgment rule. Accordingly, Sinclair’s decision, absent fraud or gross overreaching, to achieve expansion through the medium of its subsidiaries, other than Sinven, must be upheld. Even if Sinclair was wrong in developing these opportunities as it did, the question arises, with which subsidiaries should these opportunities have been shared? No evidence indicates a unique need or ability of Sinven to develop these opportunities. The decision of which subsidiaries would be used to implement Sinclair’s expansion policy was one of business judgment with which a court will not interfere absent a showing of gross and palpable overreaching. \textit{Meyerson v. El Paso Natural Gas Co.}, 246 A.2d 789, Del.Ch., 1967.” at 11;

\textit{Meyerson v. El Paso Natural Gas Co.}, 246 A.2d 789, 794, Del. Ch., 1967: holding that the business judgment rule applied where the subsidiary did not suffer a detriment.

But cf. \textit{In re Primedia Inc. Derivative Litig.}, 910 A.2d 248, 259-61, Del. Ch., 2006: refusing to apply the business judgment rule where the controlling shareholder received a benefit causally related to the detriment to the minority. “On the facts alleged in the complaint, the court can reasonably infer that KKR exercised actual control over \textit{Primedia} and used that control to cause \textit{Primedia} to enter into an unfair self-dealing transaction without any procedural safeguards to protect the minority stockholders. These allegations of fact, if proven at trial, suffice to remove the protection of the business judgment rule.” citing: \textit{Sinclair Oil}, 280 A.2d at 720; \textit{Tooley v. AXA Fin., Inc.}, 2005 WL 1252378, at *5, Del.Ch., May 13, 2005: noting that the plaintiffs’ allegation of facts are barely sufficient to rebut the presumption of the business judgment rule.

\textsuperscript{59} 638 A.2d 1110, 1117, Del., 1994.

\textsuperscript{60} See Balotti and Finkelstein, \textit{Delaware Law of Corporations and Business Organizations}, Volume 1, Chapter 4, Part Two, § 4.16, 2010.

directors and officers do of the protection of the business judgment rule. The shareholders’ duty of care would then be minor compared to their duty of loyalty.62

- **The Duty of Loyalty**

The duty of loyalty is the most important for directors. It is probably the most important for controlling shareholders as well. Courts have imposed fiduciary duties of loyalty on certain types of shareholders. As analyzed by Professors Iman Anabtawi and Lynn Stout, when courts do impose a duty of loyalty on shareholders, the analysis tends to follow the application of loyalty duties in officer and director cases. “In particular, courts have held that majority shareholders, like corporate officers and directors, owe a fiduciary duty of loyalty to minority shareholders that precludes them from using their positions as controlling shareholders to extract material economic benefits from the firm at the minority’s expense.63 As articulated by the California Supreme Court in the famous case of *Jones v. H.F. Ahmanson & Co.*,64 “Majority shareholders may not use their power to

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62 As for directors and officers, it would be very difficult for a plaintiff to establish that shareholders were not “informed”, acted in “bad faith” (but without having a conflict of interest), or with the belief their decision would harm the corporation.

See Iman Anabtawi and Lynn A. Stout, 2008, with regards to the difficulty of proving a breach to the duty of care for directors and officers.


64 *Jones v. H.F. Ahmanson & Co.*, 1 Cal.3d 93, 81 Cal. Rptr. 592, 460 P.2d 464, 1969. Here, the defendants held about 85 percent of the common shares of a savings and loan association. They exchanged these shares for the shares of a new corporation that they formed and owned and then began to sell their shares of the new corporation to the public at a great profit. The effect was that the majority created a public market for their shares while the minority (the remaining 15 percent of the initial shareholders, including the plaintiff) had no market in which they could sell for anywhere near the same price. This was held to be a breach of the majority’s fiduciary obligation to the minority, despite the fact that the case involved no exercise of control over the corporation itself (that is, over the operation of the business) and no use of a position as an officer or director.

control corporate activities to benefit themselves or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately (…).”

Thus, in most instances the duty of loyalty should apply to controlling shareholders. This arises by virtue of controlling shareholders (1) serving as a director or in place of the directors and violating the duty of loyalty that the director owes the corporation, (2) unfairly profiting as a result of a self-serving transaction that they enter into with the corporation, or (3) usurping a corporate opportunity or competing with the corporation and thereby unfairly profiting at the expense of the corporation. The following development will focus on the two last situations, as considering the first one would result as analyzing directors’ fiduciary duties, which is not the focus of this paper.

- **Intrinsic Fairness and the burden of proof**

Delaware courts typically apply the deferential business judgment rule when reviewing corporate decisions that do not involve a potential conflict of interest. In situations involving a potential conflict of interest, however, they will employ the more stringent entire fairness standard. The choice of which standard of review governs a transaction is crucial because, in practice, it often determines the outcome of litigation. Application of the business judgment rule will likely results in victory for the corporate fiduciaries,

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whereas entire fairness review will almost assure their defeat.\(^ {68}\) A further effect of applying entire fairness review is that courts cannot dismiss claims at the pleadings stage. This means that all claims will have some settlement value, regardless of merit.\(^ {69}\) In order to invoke entire fairness review for a breach of a controlling shareholder’s fiduciary obligation, a challenger must first show majority control or domination but also that the controlling shareholder engaged in self-dealing.\(^ {70}\) The Delaware courts have stated that “traditionally, the term ‘self-dealing’ describes the ‘situation when a [corporate fiduciary] is on both sides of a transaction.”\(^ {71}\) The showing of those two elements (majority control or domination as well as self-dealing) is likely to effectively discourage frivolous litigation against shareholders accused of breaching their fiduciary

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\(^ {68}\) Nonetheless, when minority shareholders may lose on their claim relating to controlling shareholders’ breach of fiduciary duties, they may still have other claims. For instance, with regard to minority freeze-outs, minority shareholders have a remedy if they believe the price to be paid in a cash-out merger is too low: an appraisal proceeding with the same measure of value as that adopted by the Weinberger court (Weinberger, 457 A.2d at 703-04). But under the Delaware appraisal procedure, a shareholder must jump through a number of procedural hoops, including not voting for the transaction and not accepting payment, in order to retain the right to bring an appraisal action (see Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, § 262(a)). More importantly, the Delaware corporate statute does not authorize a class appraisal procedure (see Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, § 262(a)). See Gordon, J. N., Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy, Vanderbilt Law Review Symposium, 2008.


\(^ {70}\) See e.g. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720, Del., 1971: “[Entire fairness review] will be applied only when the fiduciary duty is accompanied by self-dealing—the situation when a parent is on both sides of a transaction with its subsidiary.”. See also 18A Am. Jur., 2d, Corporations, § 654, 2009: “The invocation of the intrinsic-fairness standard is predicated upon the existence of two factors: (1) majority control and domination; and (2) majority self-dealing.”


duty of loyalty. As Professors Anabtawi and Stout suggested, “the number of cases in which a plaintiff can make both showings is likely to be small, and also likely to involve circumstances where judicial scrutiny is appropriate and desirable”.72 In fact those restrictive measures are similar to the ones employed in cases involving officers and directors accused of breaching their duty of loyalty.73

Under the entire fairness standard of review, in *Weinberger*,74 the court held that directors or majority shareholders have the burden of demonstrating the “entire fairness” of the transaction, which has two aspects: fair dealing (or procedural fairness) and fair price.75 The fair dealing prong “embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and stockholders were obtained.”76 Fair price “relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.”77 The Delaware Supreme Court found that the deal and the surrounding circumstances have to be viewed in their entirety.78

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76 *Weinberger v. UOP, Inc.*, 457 A.2d 701, Del., 1983: at 710-11. See also e.g. *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, Del., 1987: “When a majority shareholder stands on both sides of a transaction, that shareholder must establish the entire fairness of the undertaking in terms of fair price and fair dealing, as well as disclosure of all material facts of the transaction to minority shareholders.”
The burden of proof can shift back to the challenging shareholder if either a special committee or an informed majority of minority shareholders (i.e. a majority of the remaining minority shareholders who did not have a conflict of interest\(^79\)) approved the transaction. For the burden of proof to shift back to the plaintiff, the controlling shareholders need to show they adopted an arm’s-length bargaining procedure. For instance, the burden remains on the controlling shareholders to show that they completely disclosed all facts relevant to the transaction.\(^80\) Also, in a case where the Delaware Supreme Court evaluated the fairness of a court-approved sale of part interest in a corporation controlled by an individual shareholder to a second corporation controlled by the same shareholder, the court concluded that use of independent directors to evaluate the sale proposal did not shift the burden of persuasion on the issue of whether the transaction was entirely fair from the defendants to the plaintiff, as the board was not sufficiently diligent.\(^81\) Nonetheless, Professors Anabtawi and Stout\(^82\) pointed out that “certain Delaware case law suggests that if a transaction involving a controlling shareholder is approved by a special board committee comprised of disinterested directors with “real bargaining power” and that deals with the majority shareholder “on an arm length basis,” this shifts the burden of showing unfairness back to the plaintiff.”\(^83\)


\(^81\) *Kahn v. Tremont Corp.*, 694 A.2d 422, Del., 1997.


\(^83\) *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n7, Del., 1983: “Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length. See, e.g., Harriman v. E.I.
The rationale behind the approval of the interested transaction by the majority of the minority is similar to the one behind special committees: to allow the disinterested shareholders the power to reject the proposed transaction. Because this power to reject the proposed transaction is key to a disinterested shareholder vote, the courts have held that the burden of proof will only shift to the plaintiff to prove lack of entire fairness if the transaction is expressly contingent upon approval by the majority of the minority (disinterested) shares. However, even in the absence of a provision in the agreement conditioning the transaction on approval, such a stamp of approval from the minority shareholders might still be considered as an indicia of fairness.

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**duPont de Nemours & Co.** 411 F.Supp. 133 (Del.1975). Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued. **Johnston v. Greene**, Del. Supr., 121 A.2d 919, 925 (1956). Particularly in a parentsubsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness. **Getty Oil Co. v. Skelly Oil Co.**, Del. Supr., 267 A.2d 883, 886 (1970); **Puma v. Marriott**, Del. Ch., 283 A.2d 693, 696 (1971).

84 Thomas A. Gottschalk, Warren G. Andersen, R. Flanklin Balotti and Lisa A. Schmidt, Chapter 46: Corporate Governance, §37: Entire Fairness – Approval by a majority of the minority shares—Conditioning the transaction upon approval by the majority of the minority, Successful Partnering Between Inside and Outside Counsel, 2011.


Thomas A. Gottschalk, Warren G. Andersen, R. Flanklin Balotti and Lisa A. Schmidt, Chapter 46: Corporate Governance, §37: Entire Fairness – Approval by a majority of the minority shares—Conditioning the transaction upon approval by the majority of the minority, Successful Partnering Between Inside and Outside Counsel, 2011: In re Pure Resources, Inc., Shareholders Litigation, 808 A.2d 421, Del. Ch., 2002, “Vice Chancellor Strine of the Delaware Court of Chancery found that tender or exchange offers by controlling stockholders will be deemed noncoercive when the offer is subject to a nonwaivable minority tender condition, the controlling stockholder promises to promptly consummate a short-form merger at the same price if it obtains 90% of the shares, and the controlling stockholder has made no retributive threats. In applying those principles to the facts, the court enjoined the exchange offer at issue on grounds that the majority of the minority provision was defective insofar as the minority was defined to include the management of Pure whose motivation for tendering was different from the other public stockholders.”

Again, as for the initial proof requirements bare by the plaintiff, this shifting back of the burden of proof to plaintiff is very similar to the rules applying to directors and officers. In fact, Section 144 of the Delaware corporation code provides for “two procedures that courts have deemed are so significant that, if officers and directors follow them properly, they shift the legal burden of demonstrating unfairness back to the plaintiff. In particular, a corporate officer or director can shift the burden of demonstrating unfairness by showing that the transaction in question, although admittedly self-interested, was nevertheless approved after full disclosure by either (1) a majority of the company’s disinterested directors or (2) by a majority of the company’s disinterested shareholders.”

As for controlling shareholders’ fiduciary duties proceedings, if either showing is made, the burden of demonstrating unfairness reverts to the plaintiff.

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87 Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §144 provides in pertinent part:

(a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if:

(1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders.

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the shareholders.


89 See Delaware Code, Title 8 Corporations, Chapter 1 – General Corporation Law, §144.
2.1.4 Applying fiduciary duties to controlling shareholders – Three situations

Professors Gilson and Gordon, observed that “controlling shareholder may extract private benefits of control in one of three ways: by taking a disproportionate amount of the corporation’s ongoing earnings, by freezing out the minority, or by selling control”.

They pursue by pointing out that Delaware Chancery Court decisions should be consistent for those three situations because they are in substantial respects substitutes, but unfortunately they are not. Benjamin Klein also alleged this point more recently in response to the case *In re John Q. Hammons Hotels Inc. Shareholder Litigation.*

The following discusses briefly the rules for the three situations where controlling shareholders’ self-dealing may occur.

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See also, Iman Anabtawi and Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, UCLA School of Law, Law-Econ Research Paper No. 08-02, Stanford Law Review, Vol. 60, 2008: “When there is disinterested director or disinterested shareholder approval, most case law suggests that the defendant may not be immunized from a loyalty claim. Instead, the burden of proving the substantive unfairness of the transaction may simply shift back to the plaintiff. See *Weinberger*, 457 A.2d at 703; *In re Wheelabrator Techs. Inc. Shareholders Litig.*, 663 A.2d 1194 (Del. Ch. 1995). Nevertheless, there is some authority suggesting that, in certain circumstances, disinterested director or disinterested shareholder approval can effectively insulate a defendant from loyalty claims. See *Lewis v. Vogelstein*, 699 A.2d 327, 334 (Del. Ch. 1997) (discussing the question).”


For the corporation's ongoing earnings, *Sinclair*\(^{93}\) applies, which sets out the general standards for the conduct of controlled corporations.\(^{94}\) The Delaware Supreme Court makes a distinction between the business and strategic decisions of the corporations and the controlling shareholder’s direct dealings with the controlled corporation, such as the unfair transfer pricing, the transfer of assets from the controlled corporation to the controlling shareholder, and the use of the controlled corporation’s assets as collateral for a controlling shareholder’s debt.\(^{95}\) Professors Gilson and Gordon pointed out that “in general, courts treat business and strategic decisions that even-handedly affect the controlling and non-controlling shareholders essentially as business judgments.”\(^{96}\) In contrast, if the controlling shareholder appears to benefit at the expense of the controlled corporation, the intrinsic fairness standard, where the controlling shareholder bears the burden of proving that the terms of the transaction were intrinsically fair, applies.\(^{97}\)

For freezeout mergers, the Delaware Supreme Court held, in *Lynch*, that the exclusive standard of judicial review is entire fairness.\(^{98}\) As detailed above, the burden of proof may shift if the controlling shareholder can show that either a special committee or an

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\(93\) *Sinclair Oil Corp. v. Levien*, 280 A.2d, Del., 1971): “self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.”


\(96\) Ronald J. Gilson and Jeffrey N. Gordon, *Controlling Controlling Shareholders*, University of Pennsylvania Law Review, 2003: “Thus, the Delaware Supreme Court handled the dividend decision in Sinclair, as well as the related claim that the controlled corporation's business was limited to the development of oil opportunities in Venezuela (presumably why the controlled subsidiary was in a position to pay such *791 large dividends), as business judgments, and thereby outside the realm of intrusive judicial review” (280 A.2d. at 722).


informed majority of minority shareholders approved the transaction. But even if the burden of proof shifts, in the case of freeze out mergers, the entire fairness review continues to apply. Benjamin Klein noted that “academics and practitioners alike have urged the Delaware Supreme Court to overrule Lynch and apply the business judgment rule to freezeout transactions that are approved by both a special committee and a majority of minority shareholders (...) This proposal would bring consistency to the law governing freezeout transactions and require an optimally efficient level of procedural safeguards for minority shareholders. Whereas this proposal may be too drastic, its main objective, i.e. to bring consistency in rules applying to the different situation where controlling shareholders may extract private benefits of control, is highly relevant.

For third-party mergers, challenging shareholders may still invoke entire fairness review by proving the same two elements than for freezeout mergers, i.e majority control or domination by controlling shareholders as well as self-dealing. For instance, in McMullin

99 See e.g. *In re John Q. Hammons Hotels Inc. S'holder Litig.*, Civil Action No. 758-CC, 2009 WL 3165613 Del. Ch., Oct. 2, 2009: The court notes that Lynch mandate that the entire fairness standard of review apply notwithstanding any procedural protections that were used when the controlling shareholder stood on both sides of the transaction.

See also Benjamin Klein, *The Right Solution to the Wrong Problem: the Status of Controlling Shareholders after Re John Q. Hammons Hotels Inc.*, 120 Yale L.J. 1251, 2011: “The Lynch decision clarified a previously ambiguous area of Delaware law and opted to apply what many commentators believe is an overly stringent standard for freezeout transactions,” quoting Guhan Subramanian, *Post-Siliconix Freeze-Outs: Theory and Evidence*, 36 J. Legal Stud. 1, 11-12, 2007, “corporations are more likely to form a special committee because it is less onerous than obtaining approval from a majority of the minority and there is no added benefit from the latter course of action.”


v. Bran,$^{103}$ the challenging shareholders alleged that the controlling shareholder has created a conflict of interest for the board.$^{104}$ Contrarily to freezout mergers, if the controlling shareholder can show that both a special committee and an informed majority of minority shareholders approved the transaction, the business judgment rule should apply.$^{105}$

The primary concern that arises in a third-party merger is that the controlling shareholder may attempt to structure the merger in a way that provides his or her with excess consideration at the expense of the minority shareholders (although the payment of a control premium is permissible, it should not come at the expense of the fair market value

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$^{104}$ See Ronald J. Gilson and Jeffrey N. Gordon, Controlling Controlling Shareholders, University of Pennsylvania Law Review, 2003: “In McMullin, a controlling shareholder negotiated the sale of the entire corporation with all shareholders receiving the same price. While recognizing that the board of the controlled subsidiary lacked the power to block or even influence the transaction, the court nonetheless held that the controlled subsidiary board had violated its fiduciary duty by failing to fully inform itself about whether the transaction price exceeded the subsidiary’s going concern value. Consequently, the subsidiary board could not discharge its disclosure obligation to minority shareholders who had to decide whether or not to seek appraisal.”

$^{105}$ See In re John Q. Hammons Hotels Inc. S’holder Litig., Civil Action No. 758-CC, 2009 WL 3165613, Del. Ch., Oct. 2, 2009: “Business judgment would be the applicable standard of review if the transaction were (1) re- commended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.” (at *12)

The court added in footnote the following: “Of course, it is not sufficient for the special committee to merely be disinterested and independent. Rather, the committee must be given sufficient authority and opportunity to bargain on behalf of the minority stockholders, including the ability to hire independent legal and financial ad- visors. Moreover, neither special commit- tee approval nor a stockholder vote would be effective if the controlling stockholder engaged in threats, coercion, or fraud. As explained below, plaintiffs contend that the price of the minority shares was depressed as a result of Hammons's improper self- dealing conduct and that as a result the special committee and the minority stock- holders were coerced into accepting the Merger. If a plaintiff were able to make such a showing, even special committee approval and a majority of the minority vote would not invoke the business judgment standard of review. Similarly, a stockholder vote would not be effective for purposes of invoking the business judgment standard of review if it were based on disclosure that contained material misstatements or omissions.”

See also Benjamin Klein, The Right Solution to the Wrong Problem: the Status of Controlling Shareholders after Re John Q. Hammons Hotels Inc., 120 Yale L.J. 1251, 2011: “Contrary to the decision in Hammons, prior precedent suggests that the business judgment rule should apply to third-party mergers if either a special committee or a majority of the minority approved the transaction, but not both.”
of the minority shares). But in a third-party acquisition (such as *Hammons* merger), the controlling shareholder is cashed out along with the minority and many of the concerns that arise in the freezout context (such as price manipulations) are avoided. Because the risk of self-dealing is lower in third-party mergers than in freezeout mergers, one could expect a lower standard of review of the specific procedures set up to protect the interests of the minority shareholders. This is not the case, probably due to what is at stake. For freezout mergers, either a special committee or the approval of the majority of the minority is enough. But it only allows shifting the burden of proof. In the case of third-party mergers, both a special committee and the approval of the majority of the minority are required. But if the controlling shareholder can show both, the court will give the “business judgment rule” protection to the transaction, meaning a likely success of the controlling shareholder in the litigation. The case law does not acknowledge the simultaneity of the three doctrinal lines. This makes creating and maintaining the symmetry between the three alternatives methods by which private benefits of control may be extracted through ongoing operations, by a sale of control, or by a freeze-out much harder. Professors Gilson and Gordon argue that the Delaware doctrine tends to reflect a sensible symmetry between the three alternative methods, the levels of restriction applied are sometimes not appropriate, and thus mainly because the three methods of extraction are not evaluated simultaneously.

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2.1.5 Summation

Similarly to the rules applied to directors and officers, the rules relating to controlling shareholders' fiduciary duties, when recognized by courts, tend to balance controlling shareholders' powers. To the extent those fiduciary duties are easily enforceable (see section 3), controlling shareholders have to answer for their acts, mainly whenever they have a conflict of interest. The efficacy of these rules is offered by Professors Johnson, La Porta, Lopez-de-Silanes and Shleifer as an explanation for the absence of pyramidal structures in the United States. They suggested that “Perhaps the reason that pyramidal group structures are relatively rare in the United States and the United Kingdom [yet ubiquitous elsewhere in Europe] is that many transactions inside a group would be challenged on fairness grounds by minority shareholders of subsidiaries, who would get a receptive hearing in court.”

With the increase of shareholders’ power, courts may tend to recognize more extensive fiduciary duties to shareholders. For a more comprehensive approach, one may recommend that corporation statutes such as the Model Business Corporation Act or the

See also Ronald J. Gilson and Jeffrey N. Gordon, *Controlling Controlling Shareholders*, University of Pennsylvania Law Review, 2003: Professors Gilson and Gordon argue that *In re Digex, Inc. Shareholders Litigation* (789 A.2d 1176, Del. Ch., 2000) and *In re Siliconix Inc. Shareholders Litigation* (No. 18700, 2001 WL 716787, Del. Ch., June 19, 2001) were wrong decisions with regard to the symmetry of the three situations (i.e. taking a disproportionate amount of the corporation's ongoing earnings, freezing out the minority, or selling control).


Delaware General Corporation Law do include specific provisions with regards to shareholders’ fiduciary duties, as they do for directors and officers.

To better understand the balance between shareholders’ rights and duties developed in the US legal system, we will put it into perspective with the one developed into the French legal system.

2.2 The French Fiduciary Duty – The Fiduciary Duty to Act in the Best Interest of the Corporation

Many countries borrow heavily from U.S. corporate law in an attempt to signal to those investors that they comply with U.S. domestic legal standards. Against this background, it is not surprising that developments have occurred in France, where the legislative branch and also corporations increasingly feel the pressure of institutional investors to adapt their rules and articles of associations to the U.S. blueprint. As articulated by Professor Fleischer, when “distinguishing actively initiated and passively tolerated transplantations it is fair to say that corporate transplants for the most part fall into the second category: national legislators are only occasionally the driving force of company law transfers; more often they are themselves driven by the mighty winds of

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113 Holger Fleischer, Legal Transplants in European Company Law - The Case of Fiduciary Duties, 2005.
See also Storck, ECFR 2004, 36; Freedman, Arch. phil. droit 45, 207, 2001: “Devant l'importance accrue des investisseurs institutionnels etrangers, entreprises et institutions financieres adaptent leurs structures pour mieux repondre a leurs criteres.”
globalization: capital markets make law! In Europe, the concept of fiduciary duties proved highly influential.

In France, the courts have not only taken recourse to the notion of duty of loyalty but also to traditional domestic concepts through which foreign legal ideas can trickle in. Professor Freedman describes the infiltration process as follows. “The US fiduciary duties (duty of loyalty, duty of care, business judgment rule) expand in French law under traditional law concepts, specific to French law such as the good faith (la bonne foi), the trust (la confiance), the loyalty (la loyaute). According to Professor Fleisher, “general concepts like fiduciary duties are especially suitable candidates for legal transformation since they are flexible enough to adapt to local particularities. To put it differently, legal transplants will have greater success insofar as they can be presented as a result of evolutionary legal development: jurists prefer incremental rather than radical reform steps.”

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114 In this sense Ebke, in FestschriftLutter, 17, 2000.
115 Holger Fleischer, Legal Transplants in European Company Law - The Case of Fiduciary Duties, 2005.
116 Nowadays, most civil law jurisdictions impose a general duty of loyalty upon directors. See, for a detailed analysis: Holger Fleischer, WM, 145, 2003, with many comparative references and Holger Fleischer, Legal Transplants in European Company Law - The Case of Fiduciary Duties, 2005.
117 Holger Fleischer, Legal Transplants in European Company Law - The Case of Fiduciary Duties, 2005.
120 See Cotterrell, Adapting Legal Cultures, in Nelken and Feest (eds.), no 94, 70, 81 et seq., 2001: “What is important, it seems, is that new developments need to be seen as consistent with tradition; they should, as far as possible, appear as organic developments appealing to traditional understandings of legal excellence, appropriateness, justice or practicality.” Similarly Daniel Berkowitz, Katharina Pistor and Jean-Francois Richardo, 51 Am. J. Comp., L. 163, 179, 2003: “Our argument is that a voluntary transplant increases its own receptivity when it makes a significant adaptation of the foreign formal legal order to initial conditions, in particular to the preexisting formal and informal legal order.”
121 Holger Fleischer, Legal Transplants in European Company Law - The Case of Fiduciary Duties, 2005.
Hence, with regard to the reception of fiduciary duties in France, they are *dissociated* from their Anglo-American roots and engrained in their new legal environment. U.S. and English precedents on the subject are, at the most, persuasive authorities before French courts, leaving the domestic judges free to attach a different meaning to the 'naturalized' legal transplant. Holger Fleischer, *Legal Transplants in European Company Law - The Case of Fiduciary Duties*, 2005.

Watson's medical metaphor, alluding to hazardous surgical operations, is especially illuminating: "A successful legal transplant - like that of a human organ - will grow in its new body, and become part of that body just as the rule or institution would have continued to develop in its parent system." Watson, *Legal Transplants - An Approach in Comparative Law*, 1st ed. 1974, 27, 2nd ed., 1993.


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123 See Kahn-Freund, 37 Mod. L. Rev. 1, 5, 1974: "As soon as one mentions the word 'transplantation' one conjures up inevitably the image of those often complicated and sometimes hazardous surgical operations by which part of a human body is transferred from one human being to another."


128 In the first case, the president of a public, but unlisted company bought shares from shareholders for 3,000 F. each and sold them a few days later for 8,800 F. The French Supreme Court (*Cour de Cassation - Chambre commerciale*) held that, by not disclosing the shares' true value, he had violated his duty of loyalty which a president or manager owes to each individual shareholder. See Cass. com., 27.2.1996, JCP ed. E 1996 II, 838 with the key sentence: Mr. Bernhard V. breached his duty of loyalty that every president or manager owes to shareholders (M. Bernhard V. a manque au devoir de loyaute qui s'impose au diregeant d'une societe a l'egard de tout associe).
directors and officers, academics emphasized the general convergence between American and French corporate governance principles. This convergence is less clear with regards to the duty of loyalty of shareholders. A duty of care and a duty of loyalty could be found through other more traditional French legal concepts, as developed below.

- The Traditional Concepts of Interest of the corporation and Equality of Shareholders

Although not directly linked to controlling shareholders, two concepts are part of the foundations of corporate French law and cannot be ignore in an analysis of controlling shareholders’ duties. First there is the interest of the corporation (l’intérêt social) and second the equality of shareholders.

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129 Although the governance major principles remain the same, in a matter of clarity, this article focuses on the predominant one-tier structure. Since the 1966 reforms, French corporate law has alternatively offered a German-style two-tier structure with a directoire and a conseil de surveillance. As of 2002, 6491 among 150,000 sociétés anonymes had a dualistic structure, but about 25% of the CAC 40 stock index. See Philippe Merle and Anne Fauchon, Droit Commercial. Sociétés Commerciales, 417, 10th ed., 2005.


For a comprehensive analysis, see Dion, Les obligations fiduciaires des dirigeants de societes commerciales: droit des Etats-Unis d'Amerique et droit francais, 1994.

See also Cozian Viandier Deboissy, Droit des societes, 170 ed., 2004.
The interest of the corporation (*l’intérêt social*)

One major principle of French corporate law is that shareholders, directors and officers should govern the corporation in the best interest of the corporation (*l’intérêt social*).\(^{131}\) The best interest of the corporation, under French law, is distinct from the interest of shareholders.\(^{132}\) Hence, every decision needs always to be justified under this criterion first.

As there is no legal or judicial definition of the best interest of the corporation, this concept remains ambiguous and largely debated.\(^{133}\) According to some courts, academics and practitioners, the best interest of the corporation is the interest of the company

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\(^{131}\) Article 1833 of the French Civil Code and Article L. 242- 6 of the French Commercial Code refers to the corporation interest.


\(^{132}\) See e.g. CA Paris 54-2002 n# 00-4851: RJDA 3/03 n# 270.

\(^{133}\) See e.g. A. Constantin, «*L’intérêt social: quel intérêt ?*», in *Etudes offertes à Barthélémy Mercadal*, éd. Francis Lefebvre, 2002.


transcending the interest of its shareholders.\textsuperscript{134} Others argue that the best interest of the corporation should be understood as the interest of shareholders, under the principle of shareholders’ wealth maximization.\textsuperscript{135} The remaining positions lie in between the two previous ones. For instance, according to Professor Bertrel, the notion of corporate interest depends on the circumstances, i.e. the corporate long-term and short-term

\textsuperscript{134} See e.g. CA Paris 22 May 1965, \textit{Fruehauf}, JCP II n\# 14274 bis, 1965, D. 1968, p. 147, note Contin. In this case, the court held the following: corporate interest, which should not be confused with that of shareholders or directors of the company, cannot be reduced to the various interests just analyzed. Not is it simply their sum. Both an economic reality and a social reality, situated at a crossroads, the company is a forum for a multitude of interests. To simply lump these interests together does not enable us to define the interest of the company as a whole.

See also Tchotourian, \textit{Management renewal? Consequences of the current evolutions of the “best interests of the corporation” in North American and French Corporate Law}, working paper series, 2011: “For Professor Despax, these interests should be the interest of the company transcending the interest of its shareholders, this constitutes the limit of sacrifice of shareholders or employees (Despax, 1957). Similarly, Paillusseau states that “best interests of the corporation” are the company’s long-term interests. They extend to assuring the prosperity and continuity of the firm (Paillusseau, 1967). Directors and the majority control should therefore act for the benefit of the economic organism that the company represents.” Also, “some authors stress the legal entity in order to define the best interests of the corporation[;] (…) the legal entity has a catalyzing effect that shows the distinct interests of each of its members (Bézard, 2004; Constantin, 1999).”


See also Tchotourian, \textit{Management renewal? Consequences of the current evolutions of the “best interests of the corporation” in North American and French Corporate Law}, working paper series, 2011: “Based on articles 1832 and 1833 of the [French] Civil Code, Professor Schmidt considers that a company is not created for any other interest except that of its shareholders, who have the sole purpose of taking a share in the corporate earnings among themselves (Schmidt, 1995). The company’s highest objective is the interest of its shareholders while respecting legal and statutory obligations (Schmidt, 2000; Bissara, 2003; Bissara, 2002; Schmidt, 1995).”


Thus, the notion of interest of the corporation could have a variable meaning and could either mean the sole interest of shareholders or the whole interests of the corporation.\textsuperscript{137}

- **Equality of Shareholders**

Another major principle is the one of the equality of shareholders.\textsuperscript{138} Under this principle, the rights attached to a same category of actions need to be the same.\textsuperscript{139} By granting shareholders a right to be treated equally by the corporation, the French legal system might prevent the corporation from granting unjustified benefits to its controlling shareholders.\textsuperscript{140}

  - **The Abuse of Voting Right (Abus de Droit de Vote) - The Abuse of Majority Powers**

Another standard in place restricts the ability of controlling shareholders to exercise control powers to the detriment of other shareholders. France provide for “abuse of majority powers” (abus de majorité) doctrine that restrict majority shareholders’ freedom to vote as they wish at general meetings. In fact, not only they have to exercise their voting rights in such a way as to pursue the company’s interest (see above), but also they


\textsuperscript{138} Article 1833, French Civil Code.

\textsuperscript{139} Article L. 228-11, French Commercial Code.

\textsuperscript{140} This is made explicit by Article 42 of the Second Directive; Article 1832 French Civil Code.
cannot exercise their voting rights to the detriment of fellow shareholders.\textsuperscript{141} Case law considers that there is an abuse of majority when a majority shareholder votes against the ‘corporate interest’ of the company, in order to pursue her own personal interest and to detriment of the minority shareholders. A policy that annoys the minority are not sufficient for there to be an abuse of power; for the abuse to be found, there must be a diversion of power in an illegitimate interest or an unjustifiable breach of equality among shareholders.\textsuperscript{142} Tunnelling, and excessive director or manager remuneration decided by shareholder meeting (with the decisive vote of controlling shareholders), have been frequently found to constitute abuse.\textsuperscript{143} If a court find that there is an abuse of majority, it may rescind the decision violating the interest of the corporation.\textsuperscript{144} Courts may also require majority shareholders to pay monetary damages to minority shareholders.\textsuperscript{145}


\textsuperscript{142} See e.g. CA Paris November 11, 1972: JCP 1973 II n° 17448 note Y. Guyon;

\textsuperscript{143} See e.g. T. Com. Paris, June 6, 2006, n° 2004-50246: RJDA 3/07 n° 273;


See also the following decisions that the courts rescinded for abuse of majority:
Although this is not within the scope of this paper, it is important to note here that there is a counterpart to the abuse of majority, namely the abuse of minority. The abuse of minority is a court-made doctrine, by which minority shareholders may abuse of their voting powers where not only they do not exercise their voting rights in such a way as to pursue the interest of the corporation and the interest of all shareholders, but also to prevent a project necessary to the corporation. As a general rule, French courts tend to limit the abuse of minority shareholders to blocking minority shareholders. Where there is an abuse of minority, courts do not require specific performance. The remedies

- when setting too high level for managers’ wages (see e.g. CA Grenoble, May 6, 1964: Gaz. Pal. 1964 II p. 208; Cass. Com., July 1, 2003, n# 1077: RJDA 11/03 n# 1074);


See Cass. Com. July 15 1992, RJDA 8-9/92 n# 826 ; Cass. Com. May 5 1998: RJDA 7/98 n# 862. See also, Cass. Com. June 18, 2002 n#1180: RJDA 3/03 n# 262: It is considered an abuse of minority that a minority shareholder refused to vote favorably to a capital increase when it was necessary for the corporation in order to renew its concession rights.

See also, George A Bermann and Etienne Picard, Introduction to French law, Kluwer Law International, 2008: “Minority shareholders may be held liable for harassing the management of systematically obstructing the adoption of resolutions necessary for the survival of the corporation.”


are either monetary damages or the appointment of an agent who will represent the minority shareholders at the following shareholders’ meeting.\footnote{Cass. Com. March 9, 1993: RJDA 4/93 n# 323; Cass. Com. May 5, 1998: RJDA 7/98 n# 862; CA Paris July 6, 2005 n# 05-13969: RJDA 7/06 n#782 and Cass. Com. March 20, 2007 n# 5-19.225: RJDA 6/07 n# 617.}

- **Potential Self-Dealing Transactions (les Conventions Réglementées)**

In France, transactions concerning large corporations\footnote{Here Sociétés Anonymes.} in which a shareholder has more than ten percent of the voting rights are qualified to be ‘potential self-dealing transactions’. Those potential self-dealing transactions must be authorized ex-ante by the board of directors and ratified by the annual shareholder meeting, following a special report by the statutory auditors (commissaires aux comptes).\footnote{Articles L. 225-38 and L. 225-40, French Commercial Code.} The interested party must abstain from voting both within the board and at the shareholders meeting.\footnote{Article L. 225-40, French Commercial Code.}

These rules do not apply to “current transactions and entered into at normal conditions,” which only have to be disclosed by the interested party to the chairman of the board, who must then provide a list of such transactions to the board and to the auditors.\footnote{Article L. 225-39, French Commercial Code.}

Self-dealing transactions are voidable if they were not subject to a vote by the board of directors,\footnote{In order to protect minority shareholders, French law also prohibits some forms of self-dealing which are deemed to be too dangerous. For instance, there is a total prohibition against corporation making any loan, granting any overdraft protection for or otherwise securing owing to third parties by the management or directors of the corporations. See Articles L. 225-43 and L. 225-91, French Commercial Code.} or if the interested shareholder exercised his or her vote at the board of directors.\footnote{Article L. 225-40, French Commercial Code.}
directors’ meeting authorizing them, no matter whether the contract would have been authorized without his or her vote.\textsuperscript{156}

2.3 Conclusion – At the level of theory, how does the US and French principles compare?

As Professors Iman Anabtawi and Lynn Stout have cautioned, “the balance of corporate decision making power between managers and shareholders is shifting rapidly in the direction of shareholders. If that shift is to prove beneficial—if the move toward greater “shareholder democracy” is to increase shareholder value rather than destroy it—it must not take place without limitation. Rights must be coupled with responsibilities”. As Professor Bebchuk observed, in the US, the board must initiate all major corporate decisions.\textsuperscript{157} The only way for shareholders to introduce a new corporate decision is by rejecting incumbent directors with a team that is expected to make such a change. In the US, amendments to corporate charters, approvals of mergers and sale of company assets can only be done through board initiative, differently from what happens in France.\textsuperscript{158} In

\begin{itemize}
\item \textsuperscript{155} Article L. 225-42, French Commercial Code.
\item \textsuperscript{156} CA Aix-en-Provence, 15 may 1991, Dr. Sociétés 1991, n°279. See also Pierre-Henri Conac, Luca Enriques and Martin Gelter, Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany, and Italy, ECFR, 491–528, 2007.
\item \textsuperscript{157} Bebchuk, L. A., The Case for Increasing Shareholder Power, Harvard Law Review, vol. 118, 2005. For instance, Professor Bebchuk observed that: “The corporate laws of the U.S. start with a basic principle: Even though they are the ones supplying the funds, shareholders do not necessarily have the power to order the directors to follow any particular course of action.”
\item \textsuperscript{158} See Paolo Santella, Enrico Baffi, Carlo Drago and Dino Lattuca, A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US, MPRA paper 8929, University Library of Munich, Germany, 2008.
See also Martin Gelter, The Dark Side of Shareholder Influence: Toward a Holdup Theory of Stakeholders in Comparative Corporate Governance, Harvard International Law Journal, Vol. 50, No. 1, 2009:
\end{itemize}

“French law (…) allows shareholders to revoke the appointment of members of the conseil d’administration (board of directors) at any time (Article L. 225-18 al. 2 French Commercial Code.),
France, the powers of the board of directors are relatively restricted. Although the board has the power to review any issue pertaining to the corporate operations and to make any decision relating to the corporation’s affairs,\(^{159}\) its power extends only within the boundaries of the articles of incorporation, the corporate purpose as set forth in the articles of incorporation, and the powers expressly granted to the shareholders.\(^{160}\) Conversely, shareholders, under French law, are vested the ultimate power over the corporation.\(^{161}\) For instance, decision on dividend distribution in the US belongs exclusively to the board, whereas in France it is exclusively decided by shareholders.\(^{162}\)

\(^{159}\) Article L. 225-35, French Commercial Code.

\(^{160}\) Although the board of directors is precluded from usurping the powers expressly reserved by law to shareholders, specific matters are, by statute, within the sole competence of the board of directors: the calling of meetings of the shareholders (C.com., art. L.225-103), the preparation, review and approval of the financial statements and the preparation of the report on the activities of the corporation for each fiscal year. According to Benjamin Mojuye, “despite the board of directors’ title and the provisions of the statute, it appears, that, in most cases, the board has no real power in the management of the corporation. It is reduced to playing the role of an intermediary between the management, shareholders and the public.” (Benjamin Mojuye, French Corporate Governance in the New Millenium: Who Watches the Board in Corporate France?, Columbia Journal of European Law, 6, 73, 2000.)

\(^{161}\) French academics and practitioners point out that it is not the board, but the general shareholders’ meeting that is the “supreme organ” of the company. See e.g. Yves Guyon, Droit D’affaires, Tome 1: Droit Commercial General et Societes, no 289, 12th ed., 2003.

It is the shareholders, at the general shareholders’ meeting, who appoint and revoke the members of the boards, the managers, and the statutory auditors (commissaires aux comptes), who declare dividends, who approve the financial statements and who may decide to dissolve the corporation. See Articles L. 225-100, L. 232-1, L. 225-18, L. 225-75 and L. 225-40, French Commercial Code.


\(^{162}\) Shareholders decide whether to distribute dividends at a meeting called an ‘Ordinary General Meeting’ where the quorum is present if one-fifth of the voting shares are present or represented (Article L. 225-98,
Even for removal of directors the situation is less favorable for investors in the US than in France, where shareholders can request at any time a vote. Further, as observed by Hertig and McCahery,\textsuperscript{163} in France, minority shareholders have to approve all material transactions in conflict of interest.\textsuperscript{164}

Hence, it seems that, in the US, shareholders have fewer voting rights than in the EU, particularly with reference to their more limited possibility to express their binding vote vis-à-vis the company management.\textsuperscript{165} Considering that duties come to balance rights, it does not come as a surprise that controlling shareholders’ fiduciary duties in the French legal system are more extensive than shareholders’ fiduciary duties in the US legal system. In the US legal system, common law doctrine of shareholder fiduciary duties is the main standard controlling shareholders’ fiduciary duties need to comply with. On the other hand, in France, a large set of different concepts and rules have been developed to limit shareholders’ powers and to increase their duties both toward the corporation and their fellow shareholders. As the result, controlling shareholders’ fiduciary duties under French law seem to be more extensive than under US law. Being more extensive does not


\textsuperscript{164} Articles L. 225-38 to L. 225-40, French Commercial Code.

\textsuperscript{165} Paolo Santella, Enrico Baffi, Carlo Drago and Dino Lattuca, \textit{A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US}, MPRA paper 8929, University Library of Munich, Germany, 2008.
necessary means easier to enforce. To gain a better understanding of controlling shareholders’ duties, the quality of law enforcement needs to be analyzed.

3. **Controlling Shareholders’ Fiduciary Duties Enforcement**

Rules to enforce controlling shareholders’ fiduciary duties have a high impact on how effective those duties are. Minority shareholders’ motivation to enforce those duties may dissipate once they consider the cost of the litigation, its length and its potential outcomes. In turn, the litigation risk does influence controlling shareholders’ decisions.

The US procedural rules will be considered followed by the French’s. Those procedural rules will then be compared.

3.1 **The US Procedural Rules**

Under the US law, actions by shareholders may be divided into three general categories: (1) shareholders’ derivative actions, which are brought by one or more shareholders of a corporation to remedy or prevent a wrong against the corporation;\(^{166}\) (2) direct actions, which are brought by one or a few shareholders to remedy or prevent a direct wrong to the plaintiffs;\(^ {167}\) and (3) representative or class actions, which arise if the parties who


have a direct claim against a corporation are too numerous to be joined in a direct action.\textsuperscript{168}

\subsection*{3.1.1 Derivative Actions and Individual Actions}

A breach of a fiduciary duty owed to a minority shareholder by a controlling shareholder is a proper subject for a shareholder’s direct action against that controlling shareholder. However, if the duty is owed to the corporation rather than to an individual shareholder, the cause of action is derivative rather than direct. In a derivative action the shareholders are enforcing the rights of another, i.e. the corporation. The basic tests are: who suffers the most immediate and direct damage? And to whom did the defendant’s duty run?\textsuperscript{169}

In a shareholder direct action, any recovery is for the benefit of the individual shareholder, or, if the action was a class action, for the benefit of the class. In a derivative action recovery generally goes to the corporation rather than to the shareholder bringing the action. Hence, the two fundamental differences between a derivative suit and a direct suit is that in a derivative suit a plaintiff shareholder brings a claim on behalf of the corporation and seeks recovery for the corporation, whereas, in a direct suit, the plaintiff shareholder asserts her own cause of action and seeks recovery for herself.\textsuperscript{170} Hence, if the minority shareholder sued on behalf of the corporation in a derivative action, the

\begin{itemize}
\item \textsuperscript{168} 19 Am. Jur. 2d Corporations 2011, §§ 1934, 1936.
\item \textsuperscript{170} Franklin A. Gevurtz, Corporation Law, 387, 2000.
\end{itemize}
award would go to the corporation and may then be subject to the control of the very majority shareholder whose objectionable conduct caused the minority shareholder to initially file the legal action.

Further, although the derivative suit provides injured minority shareholders some form of redress, the shareholders usually must conform to quite strict legal statutory requirements. Depending of the states, the legal requirements that must be followed before a minority shareholder may file a derivative action usually include (1) making a written demand on the corporation and, through that written demand, requesting that the corporation take corrective action, and (2) then waiting up to ninety days for the corporation to respond to the written demand.  

A shareholder may bring a direct action instead of a derivative action under two circumstances. A shareholder may be permitted to bring a direct action if he or she alleges an injury ‘separate and distinct’ to himself or herself and different from the injury that the corporation generally suffered. This situation often occurs when a majority shareholder breaches a shareholder's agreement or commits fraud by misleading a shareholder to buy or sell stock. Direct actions are also allowed when the injuries arise

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172 See, e.g., In re Nuveen Fund Litig., 855 F.Supp. 950, 954 (N.D. Ill. 1994) (denying a direct suit by shareholders where new shares were offered to existing shareholders, diluting the value of all shares, because "the injury to each shareholder [was] of the same character"); Appeal of Richards, 590 A.2d 586, 590 (N.H. 1991) (stating that shareholders could not bring a direct suit because of a diminution in stock value, due to an inadequate rate increase for customers, because such an injury is not distinguishable from that suffered by all shareholders); Loewen v. Galligan, 882 P.2d 104, 112 (Or. Ct. App. 1994) denying direct suit by shareholders after merger diminished value of their stock because they had suffered no “special” injury.

out of a special duty running from the alleged wrongdoer to the plaintiff.\(^{174}\) The fiduciary duty that a majority shareholder owes to a minority shareholder is considered a “special duty” that satisfies the second of the above two exceptions.\(^{175}\)

Although the courts generally require derivative suits, it is comprehensible why shareholders would rather bring direct suits. As noted above, unlike a direct suit, a derivative suit requires that the shareholder comply with pleading requirements, such as written demands and waiting periods, which can ultimately defeat a derivative action. Direct suits also allow the injured shareholder to recover personally, rather than have the proceeds go back into the corporate treasury.\(^{176}\)

Although there is a theoretical conflict of interest, direct and derivative suits may be brought simultaneously.\(^{177}\) For example, a shareholder may bring a derivative action and an individual claim at the same time if he or she has suffered a different injury than the other shareholders.\(^{178}\) Additionally, if a shareholder's complaint states a cause of action that is both direct and derivative, the shareholder may choose to proceed with only the direct action.\(^{179}\)

\(^{174}\) \textit{Gaskin}, 675 S.E.2d at 117. See \textit{Eisenberg v. Flying Tiger Line, Inc.}, 451 F.2d 267, 268 (2d Cir. 1971) (allowing a direct suit where minority shareholder claimed that his ability to control the corporation through voting rights was diluted).

\(^{175}\) See \textit{Eisenberg v. Flying Tiger Line, Inc.}, 451 F.2d 267, 268 (2d Cir. 1971) (allowing a direct suit where minority shareholder claimed that his ability to control the corporation through voting rights was diluted).


3.1.2 Procedural Rules – Class Actions

In appropriate circumstances, a shareholder may also sue as a representative of a class of shareholders to seek relief for direct injuries that are independent of any injury to the corporation.\(^{180}\)

State civil procedure statutes used vastly different language than the Federal Rule. State courts tend nonetheless to rely on the language of the Federal Rule of Civil Procedure 23 and the federal cases interpreting it. This section will then mainly focus on Federal Rule 23 and the Federal cases.

A representative action arises if the parties are too numerous to be joined, in which case one shareholder or a few shareholders are permitted to sue on behalf of all the shareholders.\(^{181}\) An action is representative if it is based on a primary or personal right belonging to the plaintiff shareholder and those of his or her class.\(^{182}\)

\(^{180}\) See \textit{Parnes v. Bally Entertainment Corp.}, 722 A.2d 1243 (Del. 1999). See also \textit{Kahn v. Lynch Communication Sys., Inc.}, 638 A.2d 1110, 1111 (Del. 1994) (noting that the plaintiff brought a class action on behalf of all shareholders of the acquired company whose stock had been procured through the merger).


As to class actions in federal courts, generally, see Am. Jur. 2d, Federal Courts §§ 1782 to 2221.

As to class actions, generally, see Am. Jur. 2d, Parties §§ 53 to 123.

\(^{182}\) \textit{Schreiber v. Butte Copper & Zinc Co.}, 98 F. Supp. 106 (S.D. N.Y. 1951): A class action would be certified in an action commenced by two shareholders arising out of an alleged breach of fiduciary duty by the individual defendants, who allegedly failed to fully disclose the terms of a tender offer and misappropriated a part of the price of the corporation. Brandon v. Chefetz, 106 A.D.2d 162, 485 N.Y.S.2d 55 (1st Dep't 1985).
Further, under Federal Rule 23, a class action is proper if one of the following three situations is present: either (1) separate actions would create a risk of inconsistent results or impair the interests of unnamed parties, (2) the defendants has acted or refused to act on grounds applicable to the class and injunctive or declaratory relief is appropriate for the class as a whole, or (3) common questions of law or fact predominate over individual issues and a class action is superior to alternate methods of adjudication. In case of a minority shareholder plaintiff suing to enforce controlling shareholders’ duties, those three situations can be encountered.

As derivative actions, class actions have restricting legal requirements that reduce the extent to which minority shareholders can use this procedure. Nonetheless, class actions, whenever certified by a court, allow minority shareholders to be adequately and fairly represented by one of them. It reduces costs and helps to enforce controlling shareholders’ fiduciary duties efficiently.

This is especially important in comparison to the French legal system where class actions do not exist.

3.2 French Procedural Rules

Whereas minority shareholders may bring a claim both under civil and criminal law, how those rules can be enforced limit their effectiveness.
3.2.1 Right to Sue on Behalf of the Corporation under Civil Law

In France, individual shareholders have traditionally been able to sue directors on behalf of the corporation (*action sociale ut singuli*).\(^{183}\) Liability suits can be brought not only against directors formally elected,\(^{184}\) but also toward anyone de facto managing the company by exercising powers that are typical of a director, like presiding over board meetings, individually making the main company’s decisions, and so on. Typically, this can be the case of a controlling shareholder.\(^{185}\)

Also, French law provides that shareholders representing at least 5% of the capital may petition the court for the appointment of a business expert (*expert de gestion*) in order to gather information about business decisions.\(^{186}\) Since these business decisions can sometimes be motivated by controlling shareholders’ self-interest, appointment of a business expert can help uncover such self dealing. According to Professors Conac, Enriques and Gelter, “using this procedure is convenient for the minority shareholder since the judge can oblige the company to pay for the expert’s compensation, which is

\(^{183}\) Article L. 225-252, French Commercial Code.

\(^{184}\) In French law, de facto directors and managers of solvent companies are subject to liability not by application of the specific provisions of the commercial code regarding liability, since they do not include de facto managers, but rather under the general civil principle of liability (Article 1382 French civil code). See. Cass. com., March 21, 2005, Rev. sociétés 1995, p. 501, n. B. Saintourens. In case the company is insolvent, de facto directors and managers are subject to liability by application of specific provisions of the French commercial code.


\(^{186}\) Article L. 225-231 French Commercial Code.
not the case for the generally applicable procedure providing for the appointment of a pre-trial court expert (so-called *expertise in futurum*).187

### 3.2.2 More Specifically with regards to the Abuse of Majority

Shareholders have the right to challenge in court the validity of shareholder resolutions, if they violate the company’s bylaws or the law.188 Voting behavior violating either rules or standards of conduct for shareholders (such as the “abuse of majority”) is considered a violation of the law and may result in nullification.189

For a minority shareholder to sue, he or she has to prove that the controlling shareholder had a conflict of interest that had an impact on the interest of the corporation (*l’intérêt social*).190 It seems that there is no other restriction to standing to sue: a shareholder may be able to bring a request for nullification of a shareholder meeting resolution even if he or she was not a shareholder at the time of the vote on the resolution, and even if he or she voted in its favor.191

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188 Shareholders also have standing to sue in order to obtain nullification of a company’s board resolutions. This is the case with respect to self-dealing transactions for which the ex ante authorization of the board of directors was not obtained (CA Amiens, December 1st, 1966, Recueil Dalloz 1967, p. 234, n. Dalsace).


One of the main criminal law tools against self-dealing in France is the provision against abuse of corporate assets (abus de biens sociaux).\textsuperscript{192} It punishes the ones who “use the company’s property or credit, in bad faith, in a way which they know is contrary to the interests of the company, for personal purposes or to favor another company or undertaking in which they have a direct or indirect interest.”\textsuperscript{193} The minority shareholder, acting derivatively in the name of the company (action sociale ut singuli), can initiate a criminal prosecution by filing a criminal complaint (plainte avec constitution de partie civile) with the Dean of the Examining magistrates of the Criminal first degree court (Tribunal correctionnel). In order for the complaint to be admissible, it is enough that the circumstances that gave rise to the complaint allow the examining magistrate to consider ”possible” the existence of the damage to the company and the link with the alleged abuse of corporate assets.\textsuperscript{194} Therefore, the examining magistrate is not free to choose to investigate or not, as long as he or she considers satisfied this standard, which is not very demanding. Case law makes actually clear that the examining magistrate has a “duty” to investigate. This rule was created by case law as soon as 1906 and did not change since.\textsuperscript{195} This remedy is very attractive for minority shareholder since the examining

\textsuperscript{192} Article L. 242-6 French Commercial Code.
\textsuperscript{193} Article L. 242-6 French Commercial Code.
judge holds the ability to access documents, and at no or very little cost for the minority shareholder.\footnote{Pierre-Henri Conac, Luca Enriques and Martin Gelter,\textit{ Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany, and Italy}, ECFR, 491–528, 2007.}

As a consequence, criminal prosecutions for abuse of corporate assets (\textit{abus de biens sociaux}) are relatively frequent in France.\footnote{Some statistics as to the effectiveness of the abuse of corporate assets (\textit{abus de biens sociaux}) are available. According to the French Department of Justice, there have been between 416 and 558 convictions for abuse of corporate assets (\textit{abus de biens sociaux}) in France every year from 2000 to 2008: see\textit{ Annuaire Statistique de la Justice}, Edition 2006, p. 189, and \textit{Annuaire Statistique de la Justice}, Edition 2009-2010, p. 191, available at http://www.justice.gouv.fr/. Most criminal convictions relating to company law are for abuse of corporate assets (\textit{abus de biens sociaux}) and criminal bankruptcy (\textit{banqueroute}). The French Department of Justice does not provide the number of cases litigated involving an allegation of abuse of corporate assets (\textit{abus de biens sociaux}). Nonetheless, the number of convictions for abuse of corporate assets remains relatively scarce compared to the number of companies in France: from 2003 to 2998, there have been between 2,579,672 and 3,022,176 companies in France. See INSEE,\textit{ Répertoire des Entreprises et des Établissements – Sirene} (REE), 2010.}

\subsection{3.2.4 Enforcement of French Rules in Practice}

Although French rules regarding the enforcement of minority shareholders’ rights seem quite protective of minority shareholders, French courts tend to always confirm majority shareholders’ voting, even in conflict-of-interest, unless it falls under one of the instances in which the law expressly prohibits it.\footnote{Pierre-Henri Conac, Luca Enriques and Martin Gelter,\textit{ Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany, and Italy}, ECFR, 491–528, 2007}

Further, there are very few cases before the French courts relating to ‘potential self-dealing transactions’ (\textit{Conventions Réglementées}).\footnote{Article L. 225-38 of the French Commercial code, which imposes the approval of the board of directors before entering in certain types of self-dealing transactions.
Gelter argue that there are two possible explanations for the scarcity of such cases, which are possibly cumulative. According to them, “the first, optimistic explanation is that majority shareholders are deterred from entering into such contracts by fear of a refusal of the board of directors or disclosure to the shareholders. The second, more skeptical explanation is that those provisions are, in practice, strictly construed, so that a number of related-party transactions are entered into without complying with them and hence not even properly disclosed to shareholders.\textsuperscript{200}”\textsuperscript{,} 201

Other differences between the US and French laws may worse be noted here. One is that a lawyer in France cannot under any circumstance solicit clients, nor introduce a cause of action without being mandated by a client to do so. A second, relating to the potential benefits of a claim, is that punitive damages are not allowed under French law. The only damages that are awarded are damages to compensate the plaintiff, i.e. to put the plaintiff in the position he or she would have been had the controlling shareholder not breached his or her fiduciary duties.\textsuperscript{202} A third major issue that comes as a limit to the enforcement of controlling shareholders’ fiduciary duties is that class actions are not allowed in France. Hence, every shareholder who wants to bring a claim has to be represented for herself and takes the strategic decisions by herself, meaning a certain regular involvement. It also means a lower global amount of recovery compared to the potential amount of recovery in US class actions, and, as such, less appealing cases for lawyers.


See also Dominique Schmidt, \textit{Les Conflits d'intérêts Dans La Société Anonyme}, 120-21 (2d ed. 2004).

\textsuperscript{201} Pierre-Henri Conac, Luca Enriques and Martin Gelter, \textit{Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany, and Italy}, ECFR, 491–528, 2007

\textsuperscript{202} \textit{Le contentieux de la responsabilité civile ayant pour finalité la réparation intégrale du seul préjudice réellement subi}. 
Further, those litigations may also be costly for minority shareholders, as it discussed in the following section.

3.3 Who Has to Pay for the Attorney fees and When?

Depending on who has to pay for the attorney fees and when, it may change the economics of the litigation and also the effectiveness of the controlling shareholder’s fiduciary duty rules.

3.3.1 In the US

According to the MBCA, upon termination of a derivative action, the court may order the corporation to pay the plaintiff’s reasonable expenses (including attorney’s fees) incurred in the proceeding if it finds that the action has resulted in as substantial benefit to the corporation. If the court finds that action was commenced or maintained without reasonable cause or for an improper purpose, it may order the plaintiff to pay reasonable expenses of the defendant. More specifically, in McLaughlin v. Beeghly, involving a breach of the fiduciary duty owed by a controlling shareholder to a minority shareholder in a shareholder's derivative action, the court explained that attorney's fees are recoverable, at the discretion of the trial court. The court added that holding otherwise would have diluted minority shareholders’ rights.

203 MBCA, § 7.46.
In determining whether to grant attorney's fees, the primary consideration is whether or not a benefit was conferred upon the corporation as a result of the work undertaken by the attorneys.\(^\text{206}\) Success, therefore, is a condition precedent to the allowance of attorney's fees.\(^\text{207}\) An unsuccessful plaintiff is not entitled to attorney's fees or other expenses.\(^\text{208}\) However, a party seeking attorney's fees need not necessarily be the prevailing party, nor must the derivative claim have proceeded to a final judgment or order.\(^\text{209}\) Attorney's fees or other expenses of a shareholder incurred in maintaining a suit which results in a benefit to him or her or to other shareholders, but not to the corporation itself, are not chargeable against the corporation.\(^\text{210}\) It follows that if the benefit from the defense of a suit inures to the shareholders individually,\(^\text{211}\) or to the shareholders' attorney,\(^\text{212}\) rather than to the corporation, the attorney's fees incurred in the defense are not properly chargeable to the corporation. Also, courts do not award attorney's fees where the judgment in a derivative action only confers a benefit on an individual shareholder's personal interests, and not on the other shareholders or the corporation.\(^\text{213}\)


\(^{210}\) Aiple v. Twin City Barge & Towing Co., 279 Minn. 22, 154 N.W.2d 898 (1967); Leppaluoto v. Eggleston, 57 Wash. 2d 393, 357 P.2d 725 (1960).


Hence, it is practically impossible to determine ex-ante with certitude that minority shareholder attorney’s fees will be chargeable against the corporation. This may dissuade minority shareholders from enforcing controlling shareholders’ fiduciary duties.

3.3.2 In France

In France, not only class actions do not exist but also full contingent fee cases are not allowed, i.e. attorney fees cannot be dependent on the sole successful resolution of a client’s case and payable from the judgment proceeds (*pacte de quota litis pure*).\(^{214}\) Nonetheless, attorney fees may include additionally to an initial compensation for legal services an extra payment dependent on the resolution achieved or the service done (*pacte de quota litis mixte*).\(^{215}\) According to case law, the extra payment may be superior to the principal payment, without any proportionality between the two.\(^{216}\) But the extra payment must not be exaggerated, i.e. be above the common measure.\(^{217}\) Partial contingent fees remains uncommon in France, maybe due to this incertitude on what is allowed and what is not.


According to the *Conseil National des Barreaux (CNB)* and the *Barreau de Paris*, this mechanism is sufficient to protect lawyers’ independence while facilitating access to justice by clients with limited means to pay for legal services (see European Commission’s Competition Directorate General, invitation to comment, Regulation in Liberal Professions and its effects, Summary of Responses, October 2003).

See also CA Paris, Ord. 1er president, March 7 2000, n# 99/45205; Cass. 1ere civ., December 7 1999, n# 97-16.971, n# 1937 P, n# 97-20.427.


Further, when plaintiff is granted the reimbursement of attorney’s fees, the reimbursement is not based on the real amount paid by the minority shareholder but instead on a fixed rate basis, which is usually very low.\textsuperscript{218}

The rules regulating attorney’s fees is one of the major limitations to controlling shareholders’ duties in France. It also explains why the filing of criminal complaints for abuse of corporate assets (\textit{abus de biens sociaux}) is so successful, since the examining judge holds the ability to access documents, and the minority shareholder bears only no or very little cost for this kind of proceedings. But although minority shareholders bear few costs in criminal proceedings, the potential benefits are so limited compared to the potential damages in the US, as it is detailed above (see section 3.2).

3.4 Conclusion – At the level of practice, how does the US and French principles compare?

There are some major differences between the enforcement of the US and French rules. The three main differences are certainly first the absence of class actions under French law, second the effectiveness of civil law suits under US law versus the effectiveness of criminal law suits under French law and third the limits on contingent fees under French law.

First, with regards to class actions, under US law, in appropriate circumstances, a shareholder may sue as a representative of a class of shareholders, whereas class actions

\textsuperscript{218} Usually between 700 and 5000 euros.
do not exist in France. A higher involvement in the litigation is then required for minority shareholders in France, while diminishing what is at stake in a single litigation for the controlling shareholder. Thus, the absence of class actions in France not only renders litigation by minority shareholders less likely but also diminishes the potential economic risk of each litigation for the controlling shareholders.

Second, the US legal system is structured around civil law suits whereas the French system includes both civil and legal lawsuits. Criminal law suits could be considered as more effective in France because they are less costly for minority shareholders, but are also less beneficial than US civil law suits with regards to the amount of potential awarded damages. Although the cost / benefit analysis is in favor of controlling shareholders in France, having a criminal record is generally enough for motivating controlling shareholders to comply with the law. Further, US courts develop extensive analysis of the business situations whenever self-dealing is proven. On the opposite, French courts tend to agree with plaintiffs only when transactions are directly forbidden by the law. Even though fiduciary duties of controlling shareholders are more extensive in France, they are applied more restrictively.

Third, the economics of the litigation for minority shareholders differs substantially in the US and in France. Not only punitive damages are never awarded under French law,\(^\text{219}\) but also minority shareholders are not granted the reimbursement of the totality of their attorney’s fees, and full contingent fees do not exist. With regards to this last issue, there is a controversy in France as well as in Continental Europe that the contingent fee system

\(^{219}\) Only compensatory damages are awarded.
is an inducement for lawyers to bring suits that otherwise would not have been brought.\textsuperscript{220} This may be true, but it is also true that many cases that may be meritorious are not brought except on the basis of a contingent fee. Whether and to what extent non-meritorious cases would be given undue encouragement is an irresolvable issue.\textsuperscript{221} The contingent fee system results in cases being prosecuted that would not have been brought if the claimant had to bear the risk of paying a lawyer’s fee at the beginning of the proceedings. As Professors Hazard and Dondi pointed out, “the contingent fee gives the “average person” who has a valuable but risky claim an opportunity to obtain representation by highly competent counsel”.\textsuperscript{222}

Hence, although France law has a larger set of rules to limit shareholders’ powers and to increase their duties both toward the corporation and their fellow shareholders, courts interpret those rules restrictively, and lawsuits tend be more costly and less potentially beneficial for minority shareholders. As a result, although minority shareholders should be in theory better protected in France than in the US, they are in practice better off in the US than in France.

\textsuperscript{220} See e.g. European Commission’s Competition Directorate General, invitation to comment, Regulation in Liberal Professions and its effects, Summary of Responses, October 2003.


4. Conclusion

Duties should come as a balance to powers. In accordance with this principle, shareholders have more powers in France but also more fiduciary duties: whereas shareholders have more control on the board of directors in France, they may also be sued both under civil and criminal laws for breach of concepts closed to fiduciary duties (majority's abuse of control, minority’s abuse of control, abuse of corporate assets).  

This conclusion may be quite surprising as it is usually considered that minority shareholders are less protected in France than in the US. For instance, according to Professors La Porta, Lopez-De-Silanes, and Shleifer, minority shareholders are more exposed to a risk of expropriation by controlling shareholders in France and ownership structures tend to be more concentrated in France than in the US. This idea that minority shareholders are less protected in France than in the US finds all its meaning when the enforcement of the rules on fiduciary duties are analyzed. Whereas the rules regulating controlling shareholders’ fiduciary duties are more extensive in France, minority shareholders have fewer incentives to bring a claim than in the US. First, the economics of litigation are not as beneficial for minority shareholders in France than they

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223 Abus de majorite, abus de minorite, abus de biens sociaux.


La Porta, R., Lopez-De-Silanes, F., Shleifer, A., Vishny, R., Investor protection and corporate governance. Journal of Financial Economics 58, 3–27, 2000: The rights of minority shareholders and creditors are less protected in civil law system (such as France, Germany and Italy) than in common law system (such as the US and the UK).


are in the US, mainly because of the general rules of French procedures (see Section 3). Second, courts tend to read the statutory rules restrictively: whereas French courts will stop outright fraud through the application of statutes, they will find it more difficult to stop self-dealing transactions with a plausible business purpose. In fact, although no concept closed to the “business judgment rule” exists under French law, French courts tend to confirm majority shareholders’ voting, even in conflict-of-interest, unless it falls under one of the instances in which the law expressly prohibits it. According to Professors Johnson, La Porta, Lopez-de-Silanes and Shleifer, “regulating self-dealing behavior involves a basic trade-off between legal predictability and fairness. Civil law countries emphasize the predictability of the law and rely on statutory rules to govern self-dealing behavior. (...) In contrast, (...) the common law notion of fiduciary duty is associated with a high level of judicial discretion to assess the terms of transactions and to make rules.” Whereas it is not clear whether the primary goal of French law is legal predictability, it is true that French courts rely primarily on the letter of the law and do not engage in detailed analysis of the business transactions, even when there is a conflict-of-interest, so long as it does not fall under one of the situations expressly prohibited by law. Thus, a better protection of minority shareholders in France would not only require changes in the civil procedure rules (with regards to allowing class actions), in the ethical rules (for attorney fees), but it would also require courts to be willing to assess business decisions, in particular in presence of conflicts of interests. The problematic of minority


shareholders under US law is quite different. Although the continuous evolution of controlling shareholders’ fiduciary duty rules is often necessary, legal predictability of whether a business transaction meets the intrinsic fairness standard is also essential. A more global conception of the rules regulating controlling shareholders’ fiduciary duties would achieve this goal.