

Shareholder dispute: court cancels capital increase due to breach of preferential subscription right

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Introduction

On 26 June 2019 the Luxembourg District Court cancelled a company's capital increase on the grounds of a breach of the preferential subscription right of one of its shareholders.

The dispute arose among two joint-venture partners with regard to the validity of a capital increase that was fully subscribed by one partner, in the absence of the other, and fully paid up by a contribution consisting of a claim held by the subscriber towards the company.

The court decision gives interesting insight into:

- the convening process for shareholders' meetings;
- the legal qualification of a debt contribution and its consequences;
- the outcome of a breach of a preferential subscription right; and
- the prescription period applicable to the cancellation of shareholder decisions.

Starting date of eight-day notice period to convene shareholders' meetings

The court ruled that a shareholders' meeting convening notice, sent per registered letter, need be sent to the shareholders only eight days before the meeting.

The court confirmed that the date of receipt of a convening notice is irrelevant; thus, only the mailing date counts.

Under such circumstances, a shareholder might not be informed of and consequently miss a shareholders' meeting simply because the registered letter was not promptly delivered. This position may have important practical implications.

Therefore, rather than using a registered letter, it is highly recommended that a company's articles of association expressly provide for another means of communication (eg, express delivery), as provided in the Companies Law, to ensure that the shareholders receive a convening notice in a timely fashion before a shareholders' meeting.

Legal analysis and qualification of debt contributions

The court confirmed that the settlement of the subscription price for newly issued shares by way of setting off a claim held by the subscriber towards the company is assimilated to a contribution in cash if specific conditions are met. Specifically, the claim must be:

- 'certain' (ie, not subject to a serious dispute). The court explained that an artificial contestation cannot prevent a set-off; the contestation must be serious. The courts have full discretion to decide whether a dispute is serious. In the case at hand, the court considered that the dispute regarding the claim was not sufficiently serious to make it uncertain;

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- 'liquid' (ie, for a specific amount); and
- 'due' (ie, payment can be requested immediately, without terms or conditions). The court specified that unless otherwise agreed, a shareholder's account is repayable at any time.

The court decided that the claim held by the subscriber and contributed to the company to settle the new shares' subscription price was certain, liquid and due.

As such, this contribution was assimilated to a contribution in cash (as opposed to a contribution in kind). Therefore, the capital increase and issuance of new shares were subject to the preferential subscription rights of all of the existing company shareholders.

Violation of preferential subscription right

Shareholders of a public limited liability company benefit from a preferential subscription right. Accordingly, shareholders have a priority right to subscribe to new shares to be issued by the company. This right is proportional to their existing shareholding in the company and can be waived or adapted only under specific conditions foreseen by the Companies Law.

This right is part of the Luxembourg public protection order. It means that protected persons may invoke a breach of this right without any consideration of the interests of the company or its shareholders or the existence of a prejudice on their behalf.

In practice, if a capital increase is decided in breach of the preferential subscription right of one shareholder, the decision will automatically be cancelled if the shareholder so requests.

Starting date of six-month prescription period to challenge validity of shareholders' resolutions

The court ruled that the six-month prescription period to challenge the validity of a shareholders' resolution will start on the date of publication of the minutes of the shareholders' meeting in the *Official Gazette*.

Receipt of the convening notice or knowledge of the shareholders' meeting date are insufficient to constitute effective knowledge of the decision by a shareholder wishing to challenge the decision. The company or any interested shareholder could demonstrate that this shareholder had effective knowledge of the decision via other means.

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