A recent Supreme Court decision on directors´ liability

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Spanish law, like other European laws, does not provide a legal framework for groups of companies, except for tax and accounting purposes.

This situation gives rise to difficult practical problems, especially in the context of insolvencies.

The Supreme Court decision that we comment in this note is of particular interest because it lays down criteria which can be applied generally. The facts were the following:

- The claimant was a minority shareholder of a Spanish company integrated in a French group of companies. Most of the Spanish company's business was in France.

- The group decided to incorporate a French subsidiary and to assign to it all of the Spanish company's French clients. The reason for the decision was the risk that the French tax authorities considered that the Spanish company had a permanent establishment in France, subject to taxation in that country.

- Once the clientele was assigned to the French subsidiary, the Spanish company moved directly from profits to losses. However, the French subsidiary had profits since the beginning.

- The minority shareholder was offered the possibility to participate in the incorporation of the French subsidiary, but declined the offer because he preferred to join a competitor.

  He also declined to sell his stake because the purchase offer was made at nominal value.

- The minority shareholder brought a claim against the Spanish company's director.

The Supreme Court found that the director was liable for breaching his duty of loyalty vis-à-vis the Spanish company.

Several criteria laid down by the Supreme Court should be pointed out:

1. The duty of loyalty only refers to the company in which the director serves, and not to the group of companies to which the company belongs. Being part of a group of companies does not imply that a subsidiary loses its identity and autonomy, nor its specific purpose as a company.

2. The group may also have an interest of its own, but it is not absolute nor can it justify any harm to the subsidiary and, indirectly, to its external shareholders and creditors.

3. Directors of a subsidiary cannot hide themselves behind an alleged "due obedience" to the group´s instructions.

4. Should a conflict arise between the group´s interest and that of one of its companies, as the Supreme Court put it,

> *"a reasonable balance between them must be sought […] so as to make possible the efficient and flexible functioning of the group of companies as a unity, but also to prevent the despoilment of the subsidiaries and the unnecessary subordination of its company purpose, and to protect the external shareholders and creditors of any kind, public, commercial or labor."*

5. This balance can be reached through "countervailing benefits", which must be verifiable, real, with economic value, and proportional to the damage suffered by the subsidiary. However, these benefits do not need to be simultaneous to the damage, but can be previous or subsequent.

6. As the Supreme Court said,

> *"the survival of the subsidiary is in any event an ultimate limit to the group´s interest, as a conduct that benefits the group could never be justifiable, if it puts at risk the viability and solvency of the subsidiary, which could damage the external partners and the creditors."*

7. A director may be held liable even when he has not acted covertly or maliciously, and it is irrelevant whether or not he has obtained a personal benefit.

The defendant alleged that the claimant's conduct was abusive, but the Supreme Court rejected this argument, in our opinion, quite arguably, in particular from an equitable point of view, given that:

- The incorporation of the French company was due to legitimate -and apparently compelling- tax reasons.
- The minority shareholder was offered the possibility to participate in the incorporation of the French company, but preferred to join a competitor instead.