

Challenge of GSM resolutions by third parties with a legitimate interest

Madrid, March 2018

Two recent judgments of the Spanish Supreme Court (SC) have thrown more light on case law concerning (i) the possibility that a GSM resolution correctly adopted from a formal view point be annulled when it entails an abuse of right, even when it has not caused any harm to the company itself, and (ii) the legal standing of third parties with a legitimate interest (even merely economic) to challenge said resolution.

In the first of these judgments¹, the three shareholders of a company had granted a third party a call option over the majority of the share capital of the latter. Eventually, the option holder exercised the option and, immediately after, the grantors held a GSM and called a capital increase. As a result, the exercise of the call option could not any longer grant the option holder control of the company.

The option holder challenged the corporate resolution claiming it entailed an abuse of right. The commercial court dismissed the claim; however, the court of appeals annulled the resolution, and the SC confirmed the court of appeals judgment on the grounds below:

- (i) The option holder was entitled to challenge the resolution, as he had a *legitimate interest* because the GSM decision affected its rights pursuant to the call option, in that it deprived it, *de facto*, of the possibility to acquire the majority of the share capital and, thus, obtaining control of the company.
- (ii) The GSM resolution did not respond to any reasonable corporate interest and caused an *unjust detriment* to the option holder: although it had been taken in a correct way from a formal point of view, it entailed an abuse of right, given that (a) it had been adopted as a reaction to the decision of the option holder to call the option, and (b) it had not been taken in the interest of the company, but in that of the individual shareholder; the SC went on saying that it was not necessary that the resolution damaged the corporate interest for it to be challengeable.
- (iii) Abuse of right is considered unlawful in general, pursuant to article 7.2 of the Civil Code; despite the fact that the Corporates Act (CA) does not expressly contemplate the abuse of right in general as a cause to annul a GSM resolution, any resolution contrary to the law is voidable and, hence, a GSM resolution adopted with abuse of right may be annulled to the extent it violates article 7.2 of the Civil Code.

In the second judgment², the claimants were shareholders of Enebro, S.A. (Enebro), a company that held 99.99 percent of the share capital of the well-known Spanish winery Bodegas Vega Sicilia, S.A (Vega Sicilia).

¹ Judgment nº 73/2018, 14 February 2018.

² Judgment nº 87/2018, 15 February 2018.

One of the claimants in the case at hand had previously brought an action against several shareholders of Enebro, seeking, on certain legal or contractual grounds, political rights over 50.69 percent of Enebro's share capital (which would thus give him control of Enebro and, indirectly, of Vega Sicilia). This claim was upheld by the first instance and the appeals courts, and ultimately, by the SC.

But while the appeal was pending, Enebro granted a pledge over 58.42 percent of Vega Sicilia share capital in favour of the respondents (the other Enebro's shareholders); such pledge was meant to guarantee the purchase price payable by Enebro to the respondents as a result of a sale and purchase agreement over a shareholding in another related company.

Immediately after, Vega Sicilia passed several GSM decisions, including an amendment of the by-laws whereby the political rights over pledged shares would vest on the pledgee.

The claimants -that, as we have said, were not shareholders of Vega Sicilia but of its parent company Enebro- challenged the GSM resolutions on the grounds of abuse of right.

Both the first instance commercial and the appeals courts considered that the claimants had legal standing as third parties with a legitimate interest; however, they dismissed the action on the grounds that it had become time barred³.

A challenge of the court of appeals judgment was filed before the SC, that ruled that GSM resolutions entailing an abuse of right, even when not detrimental to the corporate interest, are contrary to the law (namely to article 7.2 of the Civil Code) and, hence, only become time barred after one year. As the SC put it, the GSM resolutions at hand were in fact aimed at preventing that the claimants obtained control of Enebro and, indirectly, of Vega Sicilia. As a result, the SC remanded the dispute to the court of appeals.

Finally, we note that the SC has clarified in these judgements that the abuse of right contemplated in general in article 7.2 of the Civil Code may be a ground to challenge a GSM resolution, and one different from the so-called abuse of majority (which is specifically contemplated in the CA and requires damage to the corporate interest).

These two SC decisions are very relevant to minority, direct and indirect, shareholders and, generally, to holders of an economic interest in a company, because they clarify that a GSM decision may be annulled (i) even when the claimant is not a shareholder of the company, (ii) no detriment has been caused to the company's interest, provided, however, that (iii) the claimant has suffered an unjust damage (iv) due to an abuse of right by the shareholders that adopted the decision.

³ According to the wording of the CA prior to its 2014 reform, corporate resolutions merely detrimental to the corporate interest became time barred after 40 days, as opposed to resolutions contrary to the law, that became time barred after one year.