

Corporate abuse of formality

Madrid, January 2019

The Spanish Supreme Court (SC) has applied again¹ the *abuse of formality* doctrine according to which a company cannot refuse to pay the remuneration contractually laid down for its directors on the basis that it is not contemplated in the company's by-laws, as the Spanish Companies Act (CA) requires, provided that said remuneration has been agreed by all shareholders.

The background of this recent case is similar to that of previous judgments², including the well-known Hispasat case³, and may be summarised as follows:

- (i) According to the company's by-laws, directors' remuneration consisted of an annual fixed amount, to be determined by the general shareholders' meeting.
- (ii) The company had a sole director who was also appointed as general manager. He entered into a labour agreement with the company that was unanimously approved by the shareholders, pursuant to which he would receive a remuneration for the services provided, not in his capacity as a director, but as general manager; the agreement also included a severance compensation.
- (iii) After several years, the general shareholders' meeting resolved to dismiss the company's sole director and general manager without any compensation.
- (iv) He claimed for the severance pay before the labour courts, which declared themselves incompetent since the relation between the company and the sole director was not labour but mercantile.
- (v) He then brought a lawsuit before the commercial courts and obtained a favourable judgment that was challenged by the company before the court of appeals. The latter concluded that the claimant was not entitled to the severance compensation because the functions he had performed were those of a director, and the general shareholders' meeting had not in fact set any remuneration payable to him in his capacity as a director.

¹ Judgment of the Supreme Court nº 646/2018, dated 20 November 2018.

² For instance, judgments of the Supreme Court nº 708/2015, dated 17 December 2015 and nº 893/2012, dated 19 December 2011.

³ Judgment of the Supreme Court nº 411/2013, dated 25 June 2013.

However, the SC found that the sole director was entitled to the severance pay and revoked the judgment of the court of appeals on the following grounds:

- (i) Directors' remuneration system -including every remuneration item- must be provided for in the company's by-laws⁴; this legal requirement is aimed at protecting not only directors, but mainly shareholders.
- (ii) This purpose is also achieved where a certain remuneration item (in this case, the severance pay) has been unanimously approved by the shareholders, even when it is not contemplated in the by-laws⁵.
- (iii) A company that refuses to pay a director the remuneration agreed upon by all the shareholders by arguing that such a remuneration is not provided for in the by-laws is *abusing a formality*, and this cannot be accepted.

According to SC's judgments on this matter, it seems that an express approval of the remuneration by the shareholders is not an essential requirement for this legal doctrine to apply, for their tacit acquiescence should be sufficient.

⁴ Article 217 CA:

1. *The role of director is unpaid, unless the company's by-laws provide otherwise and establish a remuneration system.*
2. *The established remuneration system shall determine the directors' remuneration items [...].*

⁵ Note that the by-laws only contemplated the payment of an annual amount to the directors, not any severance compensation.