

A decision of the Barcelona Court of Appeals on the *business judgment rule*

Madrid, January 2021

The Barcelona Court of Appeals (BCA) has issued a judgment¹ regarding, *inter alia*, the *business judgment rule* (article 226 of the Spanish Companies Act²).

The case refers to Mr. Gabino, the CEO of Montefibre, a textile manufacturing company, who was dismissed by the board of directors with cause because of an allegedly serious breach of his duty of diligence.

In April 2013 Montefibre stopped the activity of its manufacturing plant and filed for pre-insolvency proceedings (the so-called *article 5 bis application*) and in May 2013 Mr. Gabino was appointed CEO. Although Mr. Gabino was an experienced manager, he did not have specific experience in the textile business. In June 2013 Montefibre filed for insolvency proceedings.

In April 2014 Praedium offered to acquire 90 per cent of the shares in Montefibre based on a viability plan prepared in February 2014 by the company with the assistance of Deloitte. In December 2014 Montefibre reached an arrangement with its creditors and in May 2015 Praedium took Montefibre over.

Praedium then replaced several board members but confirmed Mr. Gabino as the CEO and Montefibre and Mr Gabino signed a contract regulating the terms of the latter's position of CEO.

Praedium made certain contributions to cover the company's funding needs as forecasted in the successive business plans drawn up by Mr. Gabino until July 2017, when he warned the board of directors that, due to several problems, the company would have to cease its activity and be wound up unless it received a further contribution of € 5 million to meet the required working capital.

At that same meeting the board of directors dismissed Mr. Gabino with cause, namely on the grounds of a serious and negligent breach of his duties as CEO, as, according to the company, (i) the business projections he had submitted had not been met (forcing the majority shareholder to make contributions of funds beyond those envisaged in the business plans) and (ii) the urgently required contribution of funds to the working capital was not supported by a new business plan.

Mr. Gabino then filed a claim seeking a severance compensation, but the commercial court dismissed the claim given that he had made strategic and business decisions without sufficient information and not following an appropriate decision-making

¹ Judgment of the Barcelona Court of Appeals nº 2297/2020, dated 26 October 2020.

² Pursuant to article 226.1, "*as regards strategic and business decisions subject to business discretion, the standard of diligence of an orderly entrepreneur will be deemed to be met when the director had acted in good faith, without personal interest in the matter under decision, with sufficient information and according to an appropriate decision-making process*".

process and, thus, beyond the limits and the protection of the *business judgment rule*.

He then filed an appeal and the BCA reversed the first instance judgment and fully upheld the claim, *inter alia*, for the following reasons:

- (i) It was for the company to prove specific violations by the CEO of his duty of diligence, for general allegations of lack of diligence are not sufficient;
- (ii) Neither the company's bylaws nor the CEO's contract laid down specific procedures for the CEO to (a) report the problems encountered and their impact on the business and (b) take strategic decisions;
- (iii) The CEO's business plans and projections of cash requirements and of gross margin had been based on (a) the information provided by the company's technical staff and checked by Deloitte and on (b) a viability plan prepared by the latter;
- (iv) The CEO had reported to his fellow board members and to the majority shareholder on a monthly basis;
- (v) The CFO of a company controlled by the majority shareholder that was in the same business sector than Montefibre had signed one of business plans alongside Mr. Gabino;
- (vi) Mr. Gabino had explored every possibility to find new investors.

In view of those circumstances, the BCA concluded that, even though the business plans' objectives had not been reached, the CEO had taken his decisions with sufficient information and following an appropriate decision-making process.

The *business judgement rule* is relatively new to Spanish corporate law and the above BCA judgment is particularly helpful these days, when corporates face difficult and unclear situations, as it sheds some light on the way it will be applied in practice.