

**A paradoxical judgment about a situation of indirect conflict of interests**

Madrid, March 2017

The Spanish Supreme Court recently ruled on the shareholders' prohibition to vote in relation to matters which entail a conflict of interests<sup>1</sup>.

A shareholder in a Sociedad Anónima or SA (and a partner in a Sociedad de Responsabilidad Limitada or SL) cannot vote in relation to certain matters listed by the Spanish Corporates' Act (SCA)<sup>2</sup>. The list includes what the lawmaker has considered to be the more serious situations of conflict of interests, including the exemption to the non-compete obligation of directors who are also shareholders. Where a conflict of interests different from those listed in the SCA exists, the conflicted shareholder is entitled to vote; however, in case of challenge, the burden of proof that the relevant decision is in the interest of the company lies with him or the company.

In the case at hand, a number of minority shareholders challenged certain resolutions passed by the GSM of a company controlled by an individual (directly and through a company). The resolutions were approved with the votes of the individual shareholder -who was also the company's director- and those of the company controlled by him. Amongst the resolutions passed, the GSM exempted the individual shareholder-director from his non-compete obligation.

The minority shareholders claimed that both shareholders (i.e., the individual shareholder-director and the company related to him) were conflicted and therefore should have not voted.

The Supreme Court rejected the minority shareholders' challenge because:

- (i) Directors have a non-compete obligation *vis-à-vis* the company, but the GSM may exempt them from such obligation; and
- (ii) The affected shareholder-director cannot vote the motion to exempt him from the non-compete obligation, but the prohibition to vote does not extend to parties related to him.

However paradoxical the above may seem, it is clear that the Supreme Court has followed a restrictive interpretation of the law. This is probably because, although an indirect conflict (i.e., a conflict that arises through related entities) does not entail a prohibition to vote at the GSM, the relevant resolution can still be challenged in certain circumstances. Indeed, as already said, in such cases, the burden to proof that the decision was consistent with the company's interests shifts towards the company or the shareholder indirectly conflicted.

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<sup>1</sup> Judgment of the Supreme Court nº 68/2017, of 2 February 2017.

<sup>2</sup> See section 190 SCA.