

The differences in meaning and scope of conflicts of interest between shareholders and directors

The recent Judgment of the Spanish Supreme Court of 2 February 2017 (the "**Judgment**") regarding the shareholder's duty to abstain from voting at general meetings when a conflict of interest exists has shed some light on the scope of Article 190 of the Spanish Companies Act (*Ley de Sociedades de Capital*, "**LSC**"), by clarifying that such duty only applies to *direct* conflicts affecting the shareholder him/herself, but not *indirect* conflicts in which the interest affected is that of a person related to the shareholder.

Apart from confirming the settled interpretative criteria in Spanish case law regarding the need to restrictively construe the shareholders' duty to refrain from voting, the Judgment also stresses the very divergent meaning of the rules on conflicts of interest in the case of shareholders, as opposed to the rules applicable to directors.

Facts of the Judgment

The facts of the Judgment refer to the approval, by the general meeting of a family-run limited liability company, of a resolution which included a dispensation from the director's prohibition against competing, authorisation for an agreement for the provision of services involving the director himself, and the granting of several loans to companies in which such director is a majority shareholder.

The resolution was approved with the favourable vote of the director himself, but above all with the deciding vote of a company in which the director himself held a majority stake in the share capital and the rest belonged to his wife and children.

Key issues

Relevant Judgment of the Supreme Court regarding conflicts of interest of shareholders
Shareholders' duty to abstain from voting in general meetings does not apply to related persons
The Judgment confirms the differences in meaning and scope of conflict of interest between shareholders and directors

The resolution was challenged by two minority shareholders, who essentially alleged that both the director and the company should have abstained from voting. The legal action was upheld in the first instance but dismissed by the Barcelona Court of Appeal.

Legal opinion of the Supreme Court

In the Judgment, the Supreme Court dismissed the appeal brought by the shareholders and ultimately confirmed the validity of the resolution challenged.

Although it can be understood that the director himself should have abstained by application of Article 190.1.e LSC, the issue arises solely –with regard to what is referred to as the "resistance test" (Art. 204.3.d LSC)- in relation to the vote issued by the company controlled by the director, which in itself was decisive for reaching the majority.

Since the company in question was controlled by the director and it could therefore be considered a "person related to the director" (Art. 231.1.d LSC), the underlying problem is whether the shareholders' duty to abstain (in this case the duty of the shareholder/director) at the general meeting applies not only to the shareholders, but also to the persons related to them.

The legal opinion of the Supreme Court states essentially as follows:

- (a) "Article 190 LSC only prohibits the right to vote, as did Article 52 of the Limited Liability Companies Act, in relation to the shareholder in question, but such prohibition does not apply to related persons";
- (b) "neither the Limited Liability Companies Act, nor the Spanish Companies Act in force, have regulated what is known as indirect conflict of interest"; that is to say, a conflict in which the interests of a shareholder are not directly opposed to those of the company, yet a close link exists between such shareholder's interests and those of another shareholder, which in the matter at hand, come into open conflict with those of the company";
- (c) "In order for a conflict of interest to exist, the dispensation of the duty to not compete should affect the group of companies or all shareholders, but if it only affects some of them, then no conflict of interest can be deemed to exist, and therefore the duty to abstain does not apply to another company of its corporate group or to another shareholder".

In short, the Judgment confirms the validity of the resolution challenged, as it construes that the company controlled by the director was not legally obliged to abstain from voting.

Significance of the Judgment

Although from an initial assessment of the decision reached the Judgment may seem surprising, it does indeed serve to highlight the great differences in the meaning and scope of the rules on conflicts of interest as they apply to shareholders compared to how they apply to directors.

Directors, in their capacity as the shareholders' "agents" or "representatives", are obliged to act at all times "with the loyalty of a faithful representative" (Art. 227.1 LSC). They must always put the shareholders' interests before their own, in any situation in which the two are, or could be, in conflict. For this reason, the LSC requires directors to abstain from voting on

those resolutions or decisions in which the director or any person related to him/her "may have a conflict of interest, whether direct or indirect" (Art. 228.c).

However, the cases in which such a conflict is considered to exist are not defined or listed. It is left up to the director him or herself (and, otherwise, to the plenary management body) to decide whether or not a conflict of interest of any sort exists. And to abstain from the vote if so.

By contrast, when shareholders vote at a general meeting, they do not perform a role or duty for or on behalf of other persons, but instead they merely exercise a right. And this right may be exercised according to their own and exclusive interest, with the only restriction being that they not sacrifice or cause detriment to the company's interest (Art. 204.1 LSC).

This is why the LSC does not oblige shareholders to abstain in any potential case of a "conflict of interest, whether direct or indirect", as it does with directors, but instead provides an exhaustive list of the various cases in which the shareholder cannot exercise its right to vote (Art. 190.1). Consequently, in cases not on such list, the shareholder can vote, without prejudice, logically, to the fact that other shareholders authorised to vote and the directors are entitled to challenge any resolutions they consider to be contrary to the corporate interest.

Apart from the cases of conflict expressly indicated, the *ex ante* protection represented by the shareholder's duty to abstain is replaced by the *ex post* protection mechanism consisting of the possibility of challenging the resolution.

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