SQUIRE PATTON BOGGS

Liability of a Company's Director for Transferring the Company's Client Portfolio to Another Company Belonging to the Same Group

Ruling 695/2015, of Courtroom One of the Supreme Court, dated 11 December 2015.

The Supreme Court has issued a ruling in regard to the appeal filed by the director of a company who had been sentenced by the Barcelona Provincial Court for breaching his duty of loyalty to the company he managed.

The matter at debate was the liability of the director of a Spanish company which, for tax purposes and at the behest of the senior management of the group to which the company belonged, transferred most of its client portfolio to a French company belonging to the same group and with the same corporate purpose. The transfer resulted in sizeable losses for the Spanish company which jeopardised its viability and solvency. Against this backdrop, one of the minority shareholders of the damaged company filed a lawsuit against the company's directors, which was initially dismissed but then partially upheld by the Provincial Court.

The Court examined whether or not the director of a subsidiary could be held liable for following the instructions of the parent company of the same group, to the detriment of the company said director managed (the Spanish company), and whether the director of a company was duty-bound to act as a loyal representative in upholding the corporate interest, putting the interests of the company that director manages before his own or those of third parties.

In its ruling, the Court stated that the duty to act as a loyal representative in upholding the interests of a company implied the need to put the interest of the managed company before one's own or those of third parties. This duty of loyalty is in respect of the managed company, not in respect of others, regardless of whether or not they belong to the same group, and even if certain actions are in "the group's interest". The Supreme Court went on to explain that the group's interest did not justify the damage caused to a subsidiary, which may jeopardise its external shareholders (the Court refers to these as minority shareholders) and its creditors. In the Court's own words, "the group's interest is not in itself a justification for the damage caused to a subsidiary", and therefore did not exonerate the directors of the damaged company of their responsibility.

Accordingly, the Supreme Court recalled that a company belonging to a group did not imply the total loss of identity and independence, but that the subsidiary maintained its own identity, goals and specific corporate interests.

A company director must manage the company in a loyal and orderly manner in respect of the corporate interest, regardless of its belonging to a group of companies. The group's interest was not absolute and damage or jeopardy to the subsidiary may not be justified by the simple interest of the group or because instructions from the group's directors were being followed. The Court indicated that this cannot be used as a shield, since the director of the company has his own sphere of independent decision.

The Court acknowledged that when there is a conflict between the group's interest and that of one of its member companies, a balance should be sought between those interests, so as to permit the proper operation of the group. However, it highlighted that said balance may not result in the plundering of the subsidiary, but must be based on offsetting benefits. In that context, these benefits may justify actions by the directors that in other scenarios would be considered prejudicial to the company, or that might trigger disadvantages in exchange for the common good of the group, but always provided the subsidiary also benefits. According to the Court, the benefits for the damaged subsidiary did not necessarily have to be simultaneous or subsequent to the damaging action, but may be previous to them. In any event, the economic value of the benefit must be substantial and in proportion to the damage incurred and the benefit must be verifiable, with mere hypotheses not being sufficient.

Moreover, the Court argued that the survival of the subsidiary ultimately marked the limit of the group's interest, since an action benefiting the group but jeopardising the viability and solvency of the subsidiary, as in this case, shall never be justified.

Finally, the Court confirmed the ruling by the Barcelona Provincial Court, in the understanding that the director failed in his duty of loyalty to the Spanish company, and, although his action was not actus reus, it was a voluntary and conscious action that culminated in effective damage to the company. Similarly, the Supreme Court stated that, although the director did not obtain personal benefit from his action it did not exonerate him of the responsibility for having failed in his duty of loyalty, since what is relevant in connection with liability is the damage effectively caused to the company he managed as a result of transferring the client portfolio to another company within the group.