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The “perverse loop” of former company shareholders or directors

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The new company shareholders, who have accessed ownership of the securities by ordinary purchase or by enforcement of a pledge of securities, must beware above all of the hitherto dormant claims of former shareholders and directors.

The case of surety shareholders and sellers. The Judgment of the Supreme Court of 20 July 2018 is an exemplary wake-up call for those who do not take appropriate contractual precautions in guarantee agreements or company acquisition agreements. The joint and several sureties of an unpaid mortgage loan judicially claim that they be relieved of the surety bond or that the debtor offer a guarantee that shields the sureties from the danger of debtor insolvency in accordance with art. 1843 of the Civil Code (‘CC’). The loan debtor is a commercial company of which both sureties were shareholders and directors, although at the time of the claim for payment filed by the creditor against the debtor and the sureties, these had already transferred their shares to third parties. The sureties’ claim fails in both instances insofar as constituting an abuse of rights, given that the sureties had been successively directors of the company before selling it to third parties and because the loan instalments ceased to be paid a few months before the transfer. In addition, the company had already triggered a winding up event due to losses without the directors applying for the winding up of the company, an aspect that according to the *Audiencia Provincial’s* ruling could have been concealed from the buyers.

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The Supreme Court sets aside the ruling and points out the exceptional and restrictive nature of the doctrine of abuse of rights. It does not find immorality or asociality in the sureties' conduct since the requirement that the creditor be paid and that the surety's right to contribution be guaranteed is the direct effect of the obligation assumed at the time by the debtor company. Even if the hidden liabilities had been concealed in the transfer of the company, this fact would give rise to an action by the acquirers against the transferors, which has nothing to do with what is being dealt with in this case. The requirements of art. 1843 CC are deemed proven and the debtor company is ordered to provide a sufficient guarantee to cover the possible liability of the claimants as joint and several sureties of the loan in question.

The judgment warns in this way that situations as apparently shocking as the present one cannot be neutralized by simply applying the rule of abuse of rights and that operators will do well to look for protection in appropriate contractual clauses. In our case, such had not been done either in the acquisition agreement or, it seems, in the guarantee agreement.

The perverse loop. It would be a great pity for the creditor, who has ended up with equity securities that guarantee him control of the target company, to find that the former shareholders, former debtors of his, who were in the position of having to guarantee the creditor quiet enjoyment of the company, are the first to assert against this company shares and claims that were dormant or not revealed at the time in which they controlled the asset. A subsequent dissociation or alterity of the company and the shareholders generates a perverse loop in the face of which the creditor must be on guard. The same occurs when the transfer takes place through a division instead of through a sale of assets or the enforcement of a pledge.

Surety bonds and share pledges. The creditor of the operating company has had such company's shareholders pledge the shares representing ownership of the company or become sureties. Faced with the company's default, the creditor enforces the pledge and the entire share capital is allotted to him or to a third party, or claims payment from the sureties, who then intend to obtain repayment from the company. As the shareholders have been company guarantors, and have ended up paying on behalf of the company, they now want to assert an action for contribution against the company. It is essential that the creditor has had the prudence of agreeing in the pledge that the guarantor shareholders will not have any right before or after payment that would allow them to make monetary claims against the debtor company as third-party debt guarantors. Equally, the guarantor shareholders would waive raising any objection against the creditor by reason of harm from taking on the obligation (cf. art. 1852 CC) or bringing any hedging action against the company under art. 1843 CC.

Acquisitions of companies. Having the buyer acquired the equity securities of the transferred company, the former owners and shareholders file against the target or its directors (who have been kept in their position by the buyer) claims that laid dormant whilst said former shareholders owned the company. The buyer cannot defend himself by relying on the rules on remedies for breach of warranty of title (i.e. that the person who is required to warrant the title cannot instigate the remedies),

because what has been sold are the shares and because it is against the company or its directors that the claim is filed; the subject matter of the sale continues to be quietly enjoyed by the buyers. Consequently, in the agreement for the acquisition of the corporate assets, the sellers must acknowledge that they have no action against the company or its directors and waive any future actions they might have occasion to assert against them because of having had to settle, post-closing, obligations that were company debts.

The contribution sought by the former director. This involves the situation where, once the sale has been perfected, the former directors (the sellers themselves or the sellers' insiders) have been ordered, insofar as found criminally responsible for a corporate crime or liable for an administrative infringement, to pay a fine or compensation for a crime or infringement the company 'benefited' from (e.g., tax crime), and now seek contribution, or at least pro parte contribution, since in fact the debt 'belonged' to the company. The buyer has no alternative if he has not taken care to include the relevant clause in the agreement. By virtue of the same, the sellers would waive the bringing of repayment actions, and would hold harmless the buyer and the company, as well as the new directors of the same, from fines for administrative infringements, minor crimes or serious crimes for which the company, its directors prior to this sale, de facto or de jure, and senior managers, should have been liable, whether they have been convicted as principals or found jointly and severally liable or vicariously, and provided that the order to pay is based on acts committed by the company or the sellers or the de facto or de jure directors of the company prior to the date of this sale and purchase agreement. The repayment shares that may lie with the buyers, the company or the new directors of the company shall be subject to the general statute of limitations.

Subordinated loan made by the shareholder. Consider the dangers and options of the creditor with security interest in the equity securities of the debtor company, which in turn is the debtor of a subordinated or participating loan, granted by an insider. If the creditor acquires the equity securities by award, the company, already its own, will continue to be the debtor of the subordinated lender. The senior creditor may not have been able to collect the full amount of his claim with enforcement, and was obliged to give a receipt for payment of the full amount of the debt in accordance with art. 1872 CC.
Again, as in the previous cases, the perverse effects of a loop. In the subordinated loan agreement, senior creditors must include a clause under which the lender will not exercise against the borrower any right of collection, repayment, contribution or subrogation for any reason until the senior creditors have had their claims made good. It would also be agreed that if the senior shareholders have enforced guarantees enabling the award or disposal of the borrower company's equity securities, the lender will in no case have any action for repayment or contribution against the borrower company as long as any amounts owed to the enforcing creditors remain outstanding. The preferential claim shall not be considered to have been fully satisfied if, as a consequence of the award of the securities (cf. art. 1872 in fine CC), the executors had to issue receipts for payment of the entirety of the debt without the claim having been fully redeemed.