Invalidity of agreements concluded by director in breach of duty of loyalty

In Judgment no. 142/2025 of 11 April, the Madrid Provincial Court (Twenty-Eighth Chamber) addressed a series of issues related to a declaration of invalidity of two share purchase agreements concluded by a company director in breach of his duty of loyalty.

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1. Background

§1. In June 2019, a member (specifically, the chairman) of the board of directors of a public limited company, acting on his own behalf, purchased from the company he chaired two bundles of shares representing part of the share capital of two (industrial) companies in which the selling company held a stake (the three companies formed part of the same group and were comprised by the same shareholders). In the share purchase agreements, a daughter of the purchasing director acted as authorised signatory of the selling public limited company.

§2. It is important to note that this purchase, which gave the director control of the two industrial companies, did not comply with what had been previously agreed at the general meetings of the investee companies (held in March 2019). At those meetings, the shareholders (common to the above-mentioned three companies) decided that the subsidiaries would acquire the shares representing their own share capital that were owned by the parent company for subsequent cancellation after a capital reduction. None of this happened.

§3. The price of the shares purchased - which was set in accordance with the report prepared by an auditor in relation to the planned transaction and not the one actually carried out - was paid by the purchasing director on the same day that the sale and purchase agreements were signed.

§4. The selling company sued the director and his daughter via a corporate liability claim and specific actions for breach of duty of loyalty (an action for declaration of invalidity of the sale and purchase agreements and an action for unjust enrichment). It should be noted that, as was proven in the proceedings, the claimant company did not pass any resolution regarding the filing of a corporate liability claim, although this matter was on the agenda of a meeting held prior to the filing of said claim.

§5. The Companies Court partially upheld the claim. It declared the two sale and purchase agreements invalid and ordered the purchasing director to return the purchased shares to the selling company. The remaining claims were dismissed, the defendant signatory thus not being found liable.

§6. The director lodged a statutory appeal in which he argued, on the one hand, that, in any case, it would be the dissenting shareholders who would be in a position to sue, but not the company, as no resolution had been passed at the General Meeting regarding the bringing of actions against the director. On the other hand, he argued that, in reality, the disputed sales did not harm the corporate interests of the selling company, but rather were convenient and beneficial to it insofar as they allowed it to reduce the risk it was exposed to due to its excessive attachment to the group companies, which were facing financial difficulties.

§7. For its part, the defendant signatory also lodged an appeal relating exclusively to the ruling on costs. The content of this appeal, which was upheld, is beyond the scope of this paper.

§8. The director's appeal was dismissed by the Madrid Provincial Court (Twenty-Eighth Chamber) in Judgment no. 142/2025 of 11 April (ECLI:ES:APM:2025:5147).

2. The company as claimant

§9. In the words of the Provincial Court, the problem in this case was that of determining "which person has the authorisation to bring the action, whether it is the company or the minority shareholders". It should be noted that, formally, the action was brought by the selling company. However, the General Meeting never passed the resolution to take action against the director. Therefore, the appellant argued, the minority shareholders (who owned much more than 5% of the share capital of the claimant company) could have filed a claim on their own behalf (even if they were litigating in the interest of the company), but the selling company itself could not do so.

§ 10. The Provincial Court agreed to a certain extent with the defendant›s argument on this point (although, as we shall see below (*infra,* § 12), it dismissed the appeal on this point for other reasons). In fact, the judgment in question recalled, with regard to the corporate liability claim - which, it should be remembered, had been dismissed at first instance without the claimant having appealed - that, in order for a company to file such a claim, a prior company resolution to that effect is required. If such a resolution is not passed (see Article 239(1) of the Companies Act (LSC)), the shareholders proposing such resolution may themselves file the claim, acting on their own behalf (taking the position of claimants) and in defence of the company's interests (in fact, Article 239(2) of the Companies Act provides that the claimant shareholders shall be reimbursed for the necessary expenses incurred in carrying on the proceedings if the claim is ultimately upheld in whole or in part). Furthermore, when the corporate liability claim is based, in particular, on a breach of the duty of loyalty, minority shareholders may file the corporate liability claim *directly,* but always in the interests of the company (Art. 239(1)(2) LSC).

§ 11. With regard to what it called *specific actions for breach of the duty of loyalty* (*cf.* Art. 232 LSC) —which were the only ones on which, strictly speaking, it had to rule, given the development of the proceedings—, the Provincial Court pointed out that they lack a locus standi regime similar to that provided for corporate liability claims. Therefore, the general rules on a company's representation and intention formation must be followed. In this regard, the analysed judgment indicated that, for this reason, "if the company brings such actions, it must either act through the company's board, under its power of legal representation [...], or a company resolution is required expressing the intention of the company, as a legal person, to bring such an action". In the latter case, should a conflict of interest preventing the governing body from representing the company arise, the Provincial Court was of the opinion that a rule inspired by a logic similar to that underlying Article 206(3) of the Companies Act (referring to a hypothetical event where the challenger of a company resolution is at the same time the company's sole director) could be applied. Consequently, the judgment in question proposed allowing, in such cases, the shareholders whose votes had passed the resolution to act in the proceedings on behalf of the company. If, on the other hand, there were no company resolution and the directors had not decided to act on behalf of the company, there would be no way for the company to formally appear as the claimant. However, nothing would prevent, the Provincial Court pointed out, "the shareholder or shareholders with an interest from bringing an action on their own behalf, *directly* and without further procedural requirements, acting as the claimant and doing so in defence of the company's interests, assuming the procedural risks inherent in the litigation".

§ 12. As we have already pointed at, in this case, no company resolution (either at a general meeting or at a board meeting) was ever passed on the filing of a liability claim or the bringing of an action for declaration of invalidity of the share purchase agreements. However, it was established in the proceedings that, after the removal of the company directors decided at the general meeting in September 2019 (including the chairman of the board, who was subsequently sued), the new managing director of the company granted power of attorney to a procurator to act on behalf of the company. Therefore, the decision to sue was taken by the governing body of the selling company which, in the exercise of its representative powers, granted power of attorney to sue on behalf of the company. As explained by the Provincial Court, in view of the above, there was no problem whatsoever with regard to standing in the action for declaration of invalidity of the agreements entered into by the company and the director in breach of the latter's duty of loyalty. The company was therefore in a position to act formally as the claimant.

3. Invalidity of the sales due to breach of the duty of loyalty

§ 13. The first instance judgment had declared the two share sales invalid because they were transactions between the defendant director and the company and, therefore, there was a clear conflict of interest for which there was no record of any dispensation by either the General Meeting or the governing body of the selling company. The first instance court also took the view that the possible convenience for the selling company of a sale that would reduce its links with two other companies in the group that were experiencing financial difficulties could not justify the transaction and prevent it from being declared invalid. It added that, at the time, the shareholders had agreed to a different transaction, with the cancellation of the acquired shares, and had not expressed their agreement with the acquisition of the shares by a director who, with that transaction, acquired a majority stake in the industrial companies (*supra*, § 2).

§ 14. In his appeal, the defendant director insisted on the necessity and appropriateness of the sale and purchase transaction and, in any case, on the existence of a tacit dispensation granted by the shareholders.

§ 15. The Provincial Court rejected the appellant's arguments. It began by recalling that the duty of loyalty, together with that of care, is one of the fiduciary duties governing the directorship of companies limited by shares. This duty of loyalty implies the existence of a model of conduct (a standard of behaviour) to which the director must adhere in the discharge of his duties, which means that the company director must, in all his actions as such, put the interests of the company before his own or those of third parties. This is the test that must guide directors' actions: "to discharge their duties with the loyalty of a faithful representative, acting in good faith and in the best interests of the company" (Art. 227(1) LSC).

§ 16. This general rule is supplemented by the (non-exhaustive) list of basic obligations arising from the duty of loyalty contained in Article 228 LSC. The judgment in question explained, in this regard, that despite the illustrative nature of the list, "when the allegation of breach of the duty of loyalty refers to facts that can be subsumed under any of the cases set out in the aforementioned provision, the examination of that behaviour must be based on the characteristics and criteria indicated therein for the type of behaviour in question".

§ 17. In the case in question, the claim accused the defendant director (purchaser) of breaching the duty of loyalty by failing to take "the necessary measures to avoid situations in which his interests, whether on his own account or on account of another, may conflict with the interests of the company and his duties to the company' (Art. 228(e) LSC). More specifically, for having carried out "transactions with the company", which are only admissible when "they are ordinary transactions, carried out under standard conditions for customers and of scarce importance..." (Art. 229(a) LSC). As explained by the Provincial Court, "the existence of a conflict of interest is presumed when the director carries out a transaction with the managed company". And, if such a conflict does indeed exist, the breach of the duty of loyalty opens the door to an action for declaration of invalidity of the transactions (in our case, the share sale and purchase) carried out (Art. 232 LSC).

§18. In view of the above, the Provincial Court deemed irrelevant whether or not the sale of the shares was convenient or necessary for the claimant company (i.e., whether or not it was to the advantage of the company). The problem was, in fact, the manner in which the matter was handled: the director decided to purchase the shares himself, excluding any other possible purchasers (third parties, persons related to the director, the companies issuing the shares, etc.). The judgment in question concluded that neither the financial situation of the companies issuing the shares nor the possible interest of the selling company in reducing its exposure to that risk were justifiable causes for the director's breach of his duty of loyalty and, specifically, his obligation to refrain from carrying out transactions with the company itself, legally classed as an action involving a conflict of interest.

§19. Nor did the Provincial Court find that the company had granted the director an implicit dispensation to carry out the sales and purchases (a dispensation that, according to the appellant, was implicit in the agreement of all the shareholders with the idea that it was necessary for the claimant company to divest itself of its stake in the industrial companies).

§20. As explained by the Provincial Court, in light of the current regime, "the concept of tacit dispensation" (not to be confused with "presumed" dispensation) is "very difficult to accept". Indeed, according to Article 230(2) LSC, the company may, *in specific cases*, dispense with the prohibition on a director (or a person related to him) of carrying out a particular transaction with the company. Therefore, the authorisation, if any, cannot be generic, but must refer precisely to a specific operation or transaction, which is not easily compatible with a "tacit" authorisation or dispensation. In addition, the law requires that the authorisation be agreed by the shareholders in general meeting if it affects a transaction whose value exceeds 10% of the company's assets and by the governing body in other cases (in the latter case, provided that certain circumstances also apply: the independence of the members granting the dispensation and the harmlessness of the authorised transaction for the company's estate or, where applicable, its execution under market conditions and the transparency of the process). Nor is this easily reconcilable with the possibility of tacit authorisations.

§ 21. A different problem, which was also raised by the Provincial Court, would be that the action for declaration of invalidity had been brought in breach of good faith because it had been possible to establish prior tolerance by the shareholders of the transaction that was subsequently challenged. However, the possibility that the shareholders were estopped by their own conduct was ruled out because the fact that they had agreed to the transfer of the shares to the issuing industrial companies could not be equated with their consent to their purchase by a director.

§ 22. In short, the Provincial Court upheld the declaration of invalidity of the sales made by the Companies Court and specified that the issue under debate did not revolve around the unenforceability of the agreements for reasons intrinsic to the transactions (e.g., because the purpose thereof was illegal). On the contrary, what had been brought was a specific action for declaration of invalidity, "for reasons external to the typical contractual elements, consent, subject matter and purpose, based on a breach of the duties of loyalty of company directors, which recognises the existence of a conflict of interest in the conclusion of the agreement and establishes, as an effect, its invalidity".