Senior management, membership of the board of directors and insolvency proceedings: single association theory yes, but also employer-employee relationship

Despite classifying the association between a legal person and a natural person as a commercial (company/director) relationship and not an employment (employer/employee) relationship, compensation amounts for termination of contract are allowed if they match those accepted by the legal person's insolvency practitioners, just as remuneration amounts are allowed if said practitioners had decided to accept remuneration in some months but not in others.

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1. An interesting question with employment--related elements arises in the context of insolvency proceedings. A company concludes a senior manager employment contract, a contract that provides for compensation for breach of the notice period as well as financial compensation for non-competition. Subsequently, the senior manager is appointed to the office of director of the company, with the company then going on to enter insolvency proceedings and the insolvency practitioners giving notice of termination of contract. The director files a claim for unfair termination within the insolvency proceedings, which is dismissed by the Companies Court in application of the 'association theory' due to the commercial

and non-employment nature of the relationship at issue. This judgment was clarified to specify that the Companies Court was not examining or discussing the possible effects of the termination, but the judgment was not appealed. The insolvency practitioners requested that the rights to compensation for termination of contract, notice and non-competition be rendered void on the grounds that the relationship was that of a company/director, not of an employer/employee, and that, in the alternative, the rights to compensation for termination of contract, notice and non-competition be adjusted so as to release the company from paying any amount under these headings.

In this context, the Supreme Court (Civil Division) recalls, in Judgment no. 1819/2025 of 11 December, the construction of the association theory by the employment branch of the judiciary in, among others, Supreme Court Judgment no. 206/2022 of 9 March, stating that "in cases of simultaneous performance of activities specific to the company's board of directors and to senior management of the company, what determines the classification of the relationship as a commercial or employment one is not the content of the functions but the nature of the association, so that if there is integration in the governing body, in the field of corporate directorship, the powers whereof are exercised directly or through internal delegation, the relationship is not an employment relationship, but a commercial one, which means that, as a general rule, only in cases of employment relationships, in a regime of dependency, which cannot be classified as senior management, but as ordinary employment, would the simultaneous holding of the office of director and discharge of the duties of an employee be admissible" (3rd point of law).

This case law is based on the consideration that there is simultaneous performance of senior management and board of directors functions, but it is possible that one may follow the other. In the Supreme Court (Employment Division) ruling of 24 May 2011 (rec. no. 427/2010), it is concluded that "... the creation of the corporate association has meant the termination of the previous employer/employee relationship, with the consequent lack of jurisdiction of this employment branch of the judiciary to resolve disputes arising between the parties to the litigation. And there is no collective provision or individual agreement in this case on the possible resumption of the senior management relationship after loss of office or on the maintenance, after such loss, of the right to compensation agreed in the senior manager employment contract, the content and scope of which must be interpreted by this Court" (4th point of law).

Consequently, for the Supreme Court, the commencement of the corporate relationship entails the termination of the previous special senior manager employment relationship if there is no collective provision or individual agreement on the possible resumption of the special employment after loss of office or on receiving compensation for the termination of the aforementioned employer/employee relationship.

2. The problem arises, however, with the office of director being held by someone who has previously held a senior management position with the company.

The Supreme Court takes the view that, in the case of a managing director or a director performing executive functions, in accordance with Article 249(3) of the Companies Act (LSC), the company should have signed a director's service contract, the content of which is referred to in Article 249(4) of that law, which states that said contract must detail all the component elements (items) of the remuneration to be earned by the director for the performance of executive functions, including, where applicable, any compensation for removal before expiry of the term of office and the amounts to be paid by the company in respect of insurance premiums or contributions to savings schemes. The director may not earn any remuneration for the performance of executive functions whose amounts or items are not provided for in that contract. The contract must comply with the remuneration policy approved, where applicable, by the shareholders in general meeting. For its part, Article 217 LSC states that the remuneration of directors must in all cases be reasonably proportionate to the importance of the company, its financial position at any given time and comparable companies' market standards.

The issue is complicated if the contract referred to in Article 249(3) LSC has not been signed, above all in cases where the only contract with the company is that of senior manager employment, especially if prior to appointment as managing director or director performing executive functions, since, according to employment case law, the senior manager employment contract is terminated. In the case analysed in the aforementioned Supreme Court judgment no. 1819/2025, as in other similar cases, there is no record of remuneration in the articles of association (it is stated that the position is unpaid) nor has the contract referred to in Article 249(3) been signed. The Companies Court upheld the insolvency practitioners' claim and did not uphold the senior manager's counterclaim because it considered that the latter's remuneration system as a director had been approved by the governing body but did not comply with the provisions of Article 217 LSC, as it was not recorded in the articles of association nor had it been approved by the shareholders in general meeting. However, the Provincial Court would reverse this decision on the grounds that Articles 217 and 249 of that law are not applicable to the case because the action brought is strictly insolvency-related, not corporate-related.

3. And, in the field of insolvency, only the restructuring plan contains uniform rules for directors and senior managers; according to Article 621 of the Insolvency Act (LC), "when necessary for the successful completion of the restructuring, the restructuring plan may provide for the suspension or termination of contracts with managing directors and senior managers". In the event of termination, in the absence of an agreement, the judge may adjust the compensation owed to the managing director and senior manager, rendering the compensation agreed in the contract void, with the compensation limit established in employment legislation for collective redundancies, which will also be applicable to managing directors. Disputes shall be decided on as an incidental issue raised in insolvency proceedings by the judge competent for homologation, and the judgment shall be open to review.

However, the Supreme Court interprets that, as this regulation does not exist as such in the field of insolvency, the rules specific to insolvency proceedings must be applied, the cases of directors and senior managers not being comparable, as they are in the field of restructuring. Thus, Article 130 LC provides that "if the office of director of the legal person is remunerated, the insolvency judge may order the remuneration to cease or a reduction of the amount of remuneration in view of the content and complexity of directorial functions and the importance of the assets available for distribution". And, in the previous version of the law - applicable to the case in question - the former Article 48(4) LC provided in similar terms that "if the office of director of the legal person is remunerated, the insolvency judge may order the remuneration to cease or a reduction of the amount of remuneration in view of the content and complexity of directorial functions and the insolvent debtor's estate".

For its part, Article 61 of the original Insolvency Act — in force at the time of the termination of the contract by the insolvency practitioners —, relating to the validity of contracts with reciprocal obligations pending fulfilment, provided that "the insolvency practitioners, in the event of suspension, or the insolvent debtor, in the event of receivership, may request the termination of the contract if deemed to be in the interests of the insolvency proceedings. The court clerk shall summon the insolvent debtor, the insolvency practitioners and the other party to the contract to appear before the judge and, if there is agreement on the termination and its effects, the judge shall issue a decision declaring the contract terminated in accordance with the agreement. Otherwise, disagreements shall be settled through the insolvency proceedings and the judge shall decide on the termination, ordering, where appropriate, the restitutions to be made and the compensation to be paid from the estate". Now, Article 165(3) LC states that "the claim for termination shall be decided on as an incidental issue raised in the insolvency proceedings. The judge shall decide on the requested termination, ordering, where appropriate, the appropriate restitutions. Any claim corresponding to the counterparty as compensatory damages shall be considered an insolvency claim payable upon distribution".

Similarly, Article 133(1) LC allows the insolvency judge, either *sua sponte* or at the reasoned request of the insolvency practitioners, to order, as interim relief as of the opening of insolvency proceedings for a legal person, the freezing of the property and property rights of the directors or liquidators, de jure and de facto, and general managers of the insolvent debtor, as well as of those who had held this office or position in the two years prior to the date of said opening, when the proceedings establish that there is a possibility that, in the characterisation decision, the persons affected by the freezing order will be ordered to meet all or part of the shortfall under the terms provided for by law.

Therefore, even admitting that there is specific regulation for senior managers in the insolvency proceedings (Articles 186 et seq. LC), the Supreme Court considers that, in this case, only the withdrawal or reduction of remuneration (Art. 130 LC) and the freezing of property and property

rights (Art. 133 LC) are applicable to the director. However, it says nothing about the termination of the contract under Article 249(3) LSC, if any, or the payment of compensation for loss of office or the deferral of satisfaction of the claim relating to the compensation that, where applicable, corresponds to the managing director, as provided for in Article 188 of the Insolvency Act with regard to senior managers.

The director performing executive functions must sign a contract specifying his or her remuneration, including compensation for loss of office

4. Despite this, and with regard to the specific case, the appealed judgment upholds part of the claims made by the senior manager and does not agree to void the compensation, which was the first request of the insolvency practitioners, abandoned thereafter. This is precisely because the claim allowed by the Provincial Court matches the claim accepted by the insolvency practitioners. With regard to the items of remuneration claimed, the Supreme Court considers that, given the commercial nature of the relationship, the claim is not admissible. However, the Supreme Court interprets that the reasons why the insolvency practitioners decided not to pay the remuneration claimed or to accept the claim are not justified when those corresponding to a subsequent month were allowed. It is not enough to say that this is due to the insolvency situation because, if it decided to reduce the remuneration in a given month, it should have followed suit in the following month or, at least, expressly justified a departure in order not to be arbitrary. Therefore, these remuneration amounts should be allowed.

It does not do the same with the non-compete and notice clauses contained in the senior manage employment contract signed. The Provincial Court dismisses them because, in insolvency proceedings, the financial position of the company takes precedence. However, the Supreme Court makes it clear that it is the circumstances of the insolvency proceedings that justify the refusal. Firstly, because after the opening of insolvency proceedings, the notice period loses its meaning. If the insolvency practitioners decide to terminate the contract, they will have taken that decision at the time they consider it to be in the best interests of the insolvency proceedings. This decision cannot be subject to a specific notice period, especially when we consider that a director's remuneration during the insolvency proceedings may even be suspended, meaning that failure to give notice cannot give rise to compensation.

Nor is it appropriate to allow compensation for non-competition because, following the commencement of the liquidation of the insolvent debtor, which presupposes its winding up, its raison d'être has ceased to exist. This compensation is linked to the prohibition of competition for a certain period of time, which is intended to prevent the senior manager or managing director, as the case may be, from taking advantage

of the knowledge acquired in the management of the company for his or her own benefit or that of a competitor after his or her contractual relationship with the company has been terminated. Consequently, the Supreme Court decides that it was the order to commence the company's liquidation that caused the director's removal by operation of law, regardless of whether the insolvency practitioners considered that, as the director had signed a senior manager employment contract, this relationship should be terminated.

5. Leaving aside the complex procedural course of the case analysed, it is extraordinary that the association theory is taken as a basis, but that compensation and remuneration amounts derived from the senior manager employment contract are allowed procedurally. Of course, the regulation that standardises the effects of both relationships in terms of restructuring makes more sense, and its lack of application does not seem to make much sense when, in the insolvency proceedings, the regime for termination and suspension of the senior manager employment contract is included. This is because, in this case, it is not clear whether the board of directors ratified the senior manager employment contract and "converted" it into the contract referred to in Article 249 LSC, as is often done, although, in this case, due to formal defects, its existence was not accepted. This is an increasingly common practice for the purpose of "shielding" the managing director's employer/employee relationship. What makes no sense is to be "selecting" what is accepted and what is not; when someone is a senior manager and when a director; which legislation applies, whether company or insolvency law; and whether, ultimately, with the relevant amounts that have been the subject of the real dispute, employment concepts, whether in terms of salary or compensation, are relied on.