

Abuse of right and shareholders' disputes

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In our March 2018 note we discussed about two recent Supreme Court judgments on abuse of right as a basis to challenge GSM decisions¹. This note refers to another recent court decision dealing with the annulment of an arbitral award, rendered in equity, that had ordered the winding up a company on the grounds of abuse of right by the shareholder holding the majority of the voting rights². This judgment contains interesting considerations about the arbitration in equity and the annulment of arbitral awards in general, but we will focus on abuse of right.

The background and facts of the arbitration are not totally spelled out in the HCJ decision, but for the purposes of this note it is sufficient to say the following.

- A dispute arose between several shareholders of a company that held the majority (in terms of percentage of the share capital, but not in terms of voting rights) and the other shareholder (that held the majority of the voting rights); for the sake of clarity, though, we will call the first shareholders the minority shareholders and the latter the majority shareholder.
- According to the company's by-laws, disputes had to be resolved through arbitration in equity (*ex aequo et bono*).
- A number of judicial actions had been brought between the two groups of shareholders prior to the arbitration mentioned below, showing the existence of an apparently long-lasting confrontation between them.
- After having unsuccessfully tried through a GSM decision, the minority shareholders initiated an arbitration in equity seeking the winding up and liquidation of the company; they submitted that the majority shareholder had been consistently abusing his voting rights (in relation to a certain conflict of interest, directors' compensation, denial of information and amendment of by-laws, as well as, apparently, the majority shareholder's unwillingness to buy out the minority shareholders while, at the same time, requesting the latter to pay certain debts).
- The arbitral award found that the majority shareholder had in fact abused his rights for a number of reasons and ordered the winding up and liquidation of the

¹ One of the judgments referred to in that note pointed out that abuse of right is defined by the Civil Code as the situation whereby an act or omission exceeds the normal limits to the exercise of a right, as a result of its purpose or the circumstances, and causes a damage to a third party. As we said in that note, the two Supreme Court decisions are very relevant to minority, direct and indirect, shareholders and, generally, to holders of an economic interest in a company because they clarify that a corporate GSM decision may be annulled (i) even when the claimant is not a shareholder of the company, (ii) no detriment has been caused to the company's interest, provided that (iii) the claimant has suffered an unjust damage (iv) due to an abuse of right by the shareholders that have adopted the decision.

² Judgment of the Madrid High Court of Justice (HCJ) nº 1/2018, dated 8 January 2018.

company, as that was the only way to put an end to his abusive behavior; the award appointed a certain services company as liquidator and designated the ICC as appointing authority in case the former did not carry out its engagement.

- The majority shareholder brought a vacatur action against the award on the basis that it violated the public policy, including in particular public policy principles essential to the corporations' legal regime or Corporations Act (CA); he claimed *inter alia* that a company cannot be wound up except for the reasons contemplated in the CA or the by-laws, none of which included the abuse of right.

The HCJ found that an (arbitral or judicial) decision ordering the winding up of a company may entail a violation of the public policy when *ius cogens* rules affecting the essence of the "corporations' system" are breached.

However, the HCJ also found that a decision ordering the winding up of a company on the basis of abuse of right and loss of the *affectio societatis* is not *per se* a violation of the corporations' public policy; according to the HCJ, case law accepts that a court may order the winding up of a corporation in similar circumstances, above all when the dispute is between two groups of shareholders.

The HCJ vacated the award, but for a reason that had nothing to do with abuse of right as a basis to order the winding up of the company, namely that the arbitrator had not considered all the evidence submitted (including the judgments rendered in other disputes among the same parties) and had not sufficiently motivated his decision, all of which amounted to arbitrariness, according to the HCJ.

This judgment is, thus, another reminder that abuse of right in general may play an important role in shareholders' disputes when no specific CA's provision may be invoked.