

**Financial assistance provided by a company for the acquisition of its own shares**

Madrid, March 2019

The Spanish Supreme Court (SC) has ruled<sup>1</sup> on the consequences resulting from the infringement of the *prohibition of financial assistance* set out in the Spanish Companies Act (CA), according to which a company is prevented from advancing funds, granting loans or guarantees or providing any kind of financial assistance for the acquisition of its own shares or the shares in any company belonging to its group by a third party<sup>2</sup>.

The SC's judgment was issued in a case where a limited liability company (Almonte) had sold and transferred some treasury shares to certain shareholders and agreed upon the deferment of the payment of part of the purchase price for several years, free of interest and without any payment guarantee.

The claimant, who was another shareholder, requested the share purchase agreement to be declared null and void, amongst other reasons, because Almonte had provided financial assistance to the acquiring shareholders by accepting such a deferred payment.

The court of first instance ruled that the prohibition of financial assistance had been breached by Almonte and the acquiring shareholders; however, it considered that the infringement should not result in the annulment of the transfer of the shares, but only of the financial assistance itself. Consequently, the court annulled the deferment of the payment and declared that the entire price was immediately due and payable. The court of appeals confirmed that decision.

The judgment of the court of appeals was challenged by the claimant before the SC, which started by pointing out that the prohibition of financial assistance is aimed at preserving the company's solvency and the integrity of its equity and share capital<sup>3</sup>.

On that basis, the SC stated that the administrative sanction foreseen by the CA for the breach of such a prohibition (i.e. a fine of up to the par value of the shares acquired thanks to the financial assistance provided by the company) does not repair the harmful effects that the prohibition intends to prevent. It therefore found that the annulment of the financial assistance provided by Almonte was justified.

The SC considered that the controversial matter was whether, in addition to the financial assistance itself, the share purchase agreement must be annulled because of the infringement of the prohibition laid down in the SC.

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<sup>1</sup> SC judgment n° 541/2018, dated 1 October 2018.

<sup>2</sup> The most relevant SC judgments on the prohibition of financial assistance are n° 413/2012, dated 2 July 2012, n° 472/2010, dated 20 July 2010, and n° 511/2001, dated 28 May 2001.

<sup>3</sup> SC judgment n° 413/2012, dated 2 July 2012.

The judgment concludes that the answer is negative, for the purpose of the legal provisions on financial assistance (preserving the company's solvency and the integrity of its equity and share capital) is fully safeguarded through the annulment of the financing granted to the purchaser, and thus the transfer of the shares does not have to be annulled. In the case at hand, the detrimental effects caused to the company and to its shareholders and creditors were removed, according to the SC, by declaring Almonte's right to demand immediate payment of the entire price from the acquiring shareholders.

According to this SC judgement purchasers of shares through a typical LBO structure (and their financiers) should be wary of the potential consequences of a partial annulment of the LBO transaction, i.e. the annulment of only the financing and its security package, leaving both the purchasers and their financiers in an economically disastrous situation.