

## Considerations for Directors When a Company Is in Financial Difficulty

This quick guide summarises the duties that directors of companies incorporated in Spain are subject to, and how those duties change when the company is insolvent or at risk of being insolvent.

It also gives an overview of the personal risk to directors when the company is in financial difficulty.

This note is intended as an overview and should not be relied on as legal advice. Should you require legal advice in relation to your specific circumstances, please contact the Restructuring & Insolvency team member whose contact details are at the end of this note.

### Directors' Duties When Solvent

- Directors have a general duty of diligence for the good management and control of the company.
- They have a duty to demand and the right to collect adequate and necessary information from the company so that they can fulfill their obligations.
- Directors are required to act in good faith, without personal interest in the matter that is under decision, with sufficient information, and in accordance with an appropriate decision process.
- Directors also have a duty to keep the company's information and affairs confidential and to avoid conflicts of interest.

### Financial Distress

### Directors' Duties When Insolvent, or at Risk of Being Insolvent

- When the company is insolvent, the directors must prioritise the interest of the creditors over the interests of the shareholders.
- Directors are required to:
  - Call a General Shareholders Meeting to dissolve the company within two months from the existence of losses that reduce the equity (being the book value of the assets of the company, as evaluated every year by the auditors of the company or, if the company does not need to be audited, by the board) to an amount that is less than 50% of the share capital, unless the equity is increased or the losses are reduced to remedy that situation
  - Request a judicial declaration of insolvency within a period of two months from when they knew or should have known that the company is insolvent



It is important for directors to understand their directors' duties, as well as how their actions and the decisions the board makes when the company is in financial distress could expose them to personal liability, criminal sanction and risk.

Below is an overview of the potential claims and potential exposure for directors if the company is insolvent or at risk of insolvency.

## Liability for Company Debts

In the event directors breach their obligations, the directors can be made jointly and severally liable for the company's debts.

However, directors are currently exempt from liability for company's debts incurred during the state of emergency in Spain but only in cases where the "legal or statutory cause of insolvency had occurred during the period of the state of emergency".

Therefore, if the cause of the company's insolvency occurred before 14 March 2020, directors will continue to be liable, although they will not have the duty to call the General Shareholders' Meeting until the end of the state of emergency.



## Personal Liability

Directors are at risk of personal liability for their actions, including if they:

- Enter into agreements, new obligations or debts while the company is already in dissolution or an insolvency processes
- Pay monies in advance to certain creditors where it is apparent that the company is insolvent and cannot avoid an insolvency process
- Pay dividends to the detriment or fraud of creditors
- Conceal assets to the detriment of creditors
- Prevent the *de facto* dissolution of the company, without resorting to the legal means of dissolution or liquidation

They could also be personally liable to the company, partners or the company's creditors for any damage caused by their acts or omissions, which are contrary to the law or the bylaws.

Directors may also face personal liability for acts or omissions carried out in breach of duties that are inherent to the performance of their posts, if those acts or omissions are based on intent or gross negligence. Where the act is contrary to the laws or bylaws, intention is presumed, unless proven otherwise.

Directors will not be exonerated even if the act or board decision is adopted, authorised or ratified by the general meeting of shareholders.

The government has announced that during the COVID-19 state of emergency, the following corporate and insolvency obligations have been suspended until the state of emergency ends:

- The obligation to call a General Shareholders Meeting to dissolve the company
- The obligation to request a judicial declaration of insolvency
- For two months after the end of the state of emergency, the Courts will not accept involuntary declarations of insolvency applications
- Directors will not be liable for the company's debts contracted during the duration of the state of emergency

## Practical Tips to Mitigate Liability

- Analysis of the company's existing liquidity, as well as short-term forecasts, to determine if the company will be able to meet payment obligations.
- Increase the equity value in the business if the equity in the company is reducing and could reach a level that is less than 50% of its share capital; however, directors should seek legal advice at the earliest opportunity about this.
- For companies where the legal or statutory cause of insolvency had occurred before the commencement of the state of emergency, directors must be especially cautious before committing the company to additional liabilities or obligations because there is a risk that they could be jointly and severally liable for those new liabilities.
- Directors must avoid authorising new agreements, new obligations or debts if they believe that the company is in a situation where it is at risk of becoming insolvent.
- If directors fear that the company might become insolvent, they must avoid paying certain creditors instead of others of the same rank.
- Directors must recommend stopping paying dividends if they consider that the company is at risk of becoming insolvent.
- When the state of emergency ends, the timeframe for calling the General Shareholders Meeting or requesting a judicial declaration of insolvency resets. Therefore, if the company had been insolvent for one month prior to the declaration of the state of emergency, the directors would be required to call the General Shareholders Meeting within a month of the state of emergency ending.

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## Contact



**Fernando Gonzalez**

Partner, Madrid

T +34 91 426 4843

E [fernando.gonzales@squirepb.com](mailto:fernando.gonzales@squirepb.com)

