Informative Note

Liability of the directors during the state of alert due to insolvency or cause for dissolution

20th March 2020

As it is already known, as a consequence of the situation generated by the COVID-19, on March 17th, the Royal Decree law 8/2020 (RD-L 8/2020), which adopted a series of urgent measures to respond to the economic and social impact of this situation, including several (contained in particular in Articles 40 and 43 of the aforementioned Royal Decree-Law) which introduced a series of modifications in relation to the obligation of company directors to carry out certain actions when the company was in the legal or statutory cause of dissolution or in a situation of insolvency.

In relation to such actions, it should be remembered that, in accordance with our current legislation (and specifically Article 365 of the Law on Corporations), when such situations come to their attention, the corporate directors have the duty to *"call the general meeting within a period of two months to adopt the resolution of dissolution or if the company is insolvent, the company shall file for bankruptcy"*, and in the event of failure to comply with this obligation, Article 367 of the same legal text imposes personal and joint and several liability on the company's directors for the obligations of the company after the cause for dissolution has arisen. This liability is also reproduced in an analogous manner, although with some nuances, in the Bankruptcy Law, with regard to those directors who fail to comply with the obligation to file for voluntary bankruptcy of the company when it is in a situation of insolvency.

In relation to the above, and in view of the corporate and judicial standstill arising from COVID-19 and the state of alarm decreed, our legislator has introduced, among others, the following measures:

- On the one hand (article 40.11 of RD-L 8/2020), it suspends, until the end of the state of alarm, the legal period of two months for the administrators to call a general meeting in case there is a legal or statutory cause for dissolution.

- On the other hand (art. 43 of RD-L 8/2020), the legal obligation to request the insolvency proceeding during the state of alert is suspended (including those cases of debtors who have already presented the communication provided for in article 5.bis of the Insolvency Law).

At the same time, the processing of the necessary applications for bankruptcy proceedings filed by potential creditors of the debtor in insolvency is suspended until two months after the end of this state of alert, and it is also established that, if during this period the voluntary bankruptcy proceedings are filed by the latter, the voluntary proceedings will be processed in preference to the necessary ones, even if they are filed at a later date.

These measures seem entirely logical, given the impossibility that the directors will have to face during the state of alarm both to hold general meetings and to prepare and initiate legal proceedings for dissolution or insolvency.

The problem, however, arises when one starts to analyse the situation from the specific point of view of the liability of the company administrators for the obligations of the company arising during that "transitional" period and which are not fulfilled.

It should be remembered that, precisely, what our legislation seeks to protect, through the provision of article 365 of the Law on Corporations regulating the joint and several liability of the directors, is, in addition to providing incentives for compliance by the directors with their legal obligations, to protect the third parties with whom, during these situations of dissolution or insolvency of the company, the latter may continue to contract and assume new obligations that are subsequently not met.

Thus, in relation to this issue, and as a direct consequence of the extension of time periods provided for in section 11 of Article 40, Royal Decree law 8/2020, in the following section of the same article, also introduces an exoneration of the directors from their joint and several liability for company debts incurred by the company as a result of dissolution during that period.

This is where, in our opinion, a clear problem arises with this legal provision.

Thus, attention should be drawn to the fact that Article 40(11) provides for the suspension of the obligation of the directors to call a meeting within a maximum period of two months, when there is cause for dissolution *"before the declaration of the state of alert and during the validity of that state"*. However, the following paragraph 12 of the same article, by regulating the exoneration of the joint and several liability of the company's administrators for the company's debts incurred during the state of alarm, only limits it to the cases in which the *"legal or statutory cause for dissolution had occurred during the validity of the state of alarm"*, Consequently, in practice, the directors of companies where the cause for dissolution occurred before 14th March are not protected and therefore have little use for the provision in paragraph 11 which only relieves them of the obligation to call a meeting.

The above could be considered justified in the desire of our legislator to try to avoid situations of abuse, by virtue of which the directors of companies in a situation of cause for dissolution that were already in competition prior to the declaration of the state of alert could take advantage of their temporary exemption from possible joint and several liability to continue contracting with third parties on behalf of the company, with these obligations subsequently being unfulfilled and without the option of the creditors deriving liability from the director(s) of the debtor company.

However, in our opinion, this approach hardly justifies the differentiation introduced by Article 40(12), both from a "positive" analysis and from a "negative" one.

Thus, in the first place, it is difficult to understand the differentiation when the aforementioned possible situation of abuse mentioned above may also occur in the area of companies in which the cause of dissolution occurs during the state of alarm, as well as in the area of companies in a situation of insolvency (subsequent to or immediately prior to the state of alarm) but in which the directors, as a

result of the extension of time provided for in Article 43 of the Royal Decree law, will have a further period of up to two months from the end of the state of alarm to file for voluntary bankruptcy without incurring any breach.

It is clear that in both situations the company will be able to enter into new contracts with third parties, although its directors will be protected from possible personal and joint liability under Article 365 of the Law on Corporations, by virtue of the measures introduced by Royal Decree law 8/2020, unlike the case of directors of companies that have been dissolved prior to the declaration of the state of alarm.

In this sense, and from another point of view, it should be noted that the difference in treatment proposed by Royal Decree law 8/2020 cannot be properly understood either, since the directors of the latter companies (i.e. those who are in the process of dissolution due to the state of alert) will often be deprived of the possibility of taking the necessary actions during this period, such as calling and holding general meetings, given the situation of general confinement decreed.

In relation to this issue, it should be noted that, although the Royal Decree law has introduced specific measures to allow board meetings to be held telematically, and even with direct voting in writing and remotely, without the need for a meeting, nothing similar has been foreseen (except for listed companies) with respect to the holding of general meetings, continuing to require the physical attendance of shareholders or their representatives, with the impossibility of holding them during the state of alert.

Therefore, and since it is precisely this temporary impossibility of holding general meetings that theoretically would have led to the introduction of the extensions of time described above in Article 40 of the Royal Decree law, it is difficult to understand the difference in treatment introduced in paragraph 12 of that same article for companies in dissolution where the cause has arisen before or after the declaration of the state of alarm, since, if appropriate, it would have made more sense to apply this distinction only to those companies in which it had already occurred, on the date of the declaration of the state of alarm, the legally established period of two months (a distinction which, in any case, is missing in the literal wording of paragraph 11, which speaks generically of situations which occurred "before the declaration of the state of alarm", so that in this field of application any case would theoretically come into play, even if it was a year or two after the cause for dissolution had arisen, with its administrators now having a new period of two months from the date on which the state of alarm ended, if the literal wording of that paragraph were followed).

Thus, in view of the above, it must be concluded that those directors of companies that have been wound up (for example, due to accumulated losses that would have reduced their net worth to less than half of their share capital) prior to the date on which the state of alert was declared, and that during the period of validity of the state of alert they will be unable to adopt the measures that the legal system requires of them (and, in particular In the event that the company is dissolved, the shareholders must be particularly careful about assuming any new obligations by the company, as there is a risk that any measures to restore the company's assets will not be approved by the shareholders and, if the cause for dissolution is definitive, the company may be held personally liable for any obligations that are not fulfilled and that arise during the state of alert.

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