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MANDATORY DIVIDEND? YES OR NO?

The Supreme Court, by means of a ruling handed down on January 11, 2023, has ruled for the second time in favor of the possibility of the courts of justice condemning commercial companies to apply the profit for the year in a different way to that agreed at the general meeting, forcing them to distribute among the shareholders amounts that, in principle, had been set aside for reserves. This is a judicial decision of great interest, since it supplements a previous Supreme Court decision in the same sense, issued on May 26, 2005. Thus, as there are two Supreme Court decisions, the jurisprudential doctrine on the matter is strenghtened.

The typical case we are dealing with would be that of a company (SA or SL alike) in which the holders of the majority of the social capital, and therefore of the control of the company, who usually also occupy management positions, subject to sometimes significant remuneration, have no special interest in distributing dividends, which may lead them to repeatedly adopt resolutions whereby the profit for the year is systematically allocated to reserves. Independently of the decision that occupies them, there is a reiterated court case doctrine in Spain that establishes that these corporate resolutions can be annulled in case they are abusive, as they unjustifiably benefit the holders of the majority of the social capital to the detriment of the minority. The essential question lies in the fact that this abuse must be duly proven, and this has not always been the case.

On many occasions the resolution of the litigation depends on the court's view of the nature of the distribution of profits in a capital company. Some consider that in profit-driven corporations, the declaration of dividends should be the rule, and therefore the corporation must adequately justify the reasons for departing from that principle and not distributing the profits. Other judges, however, will make a different reading and will be especially strict with respect to the demonstration of abuse or unjustified prejudice to the minority, based on the premise that the general meeting is sovereign and can adopt the decisions it may consider fit.
Article 348Bis of the Capital Companies Law, which is at the center of this controversy, reads as follows.

> ***Article 348 bis. Right of separation in the event of non-distribution of dividends.***
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> *Without prejudice to the provisions of the eleventh additional provision, unless otherwise provided in the bylaws, after the fifth fiscal year from the date of registration of the company in the Mercantile Registry, the shareholder who has recorded in the minutes his or her protest against the insufficiency of the dividends recognized shall have the right of withdrawal if the general meeting does not resolve to distribute as a dividend at least twenty-five percent of the profits obtained during the previous fiscal year that are legally distributable, provided that profits have been obtained during the three preceding fiscal years. However, even if the aforementioned circumstance occurs, the right of separation will not arise if the total of the dividends distributed during the last five years is equivalent to at least twenty-five percent of the legally distributable profits recorded in said period.*
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> *The provisions of the preceding paragraph shall be understood without prejudice to the exercise of any actions to challenge corporate resolutions and liability actions that may be applicable.*

2. For the elimination or modification of the cause for separation referred to in the preceding paragraph, the consent of all the partners shall be necessary, unless the right to separate from the partnership is recognized to the partner who did not vote in favor of such resolution.

3. The period for exercising the right of separation shall be one month from the date on which the ordinary general meeting of shareholders was held.

4. When the company is obliged to prepare consolidated accounts, the same right of separation shall be recognized, unless otherwise provided in the bylaws, to the shareholder of the controlling company, even if the requirement set forth in the first paragraph is not met, if the general meeting of said company does not resolve to distribute as a dividend at least twenty-five percent of the consolidated profits attributed to the controlling company for the previous year, provided that they are legally distributable and, in addition, consolidated profits attributed to the controlling company have been obtained during the three previous years.

5. The provisions of this article shall not apply in the following cases:

a) In the case of listed companies or companies whose shares are admitted to trading in a multilateral trading system.
b) When the company is in bankruptcy.
c) When, under the insolvency legislation, the company has notified the court having jurisdiction to declare its insolvency of the commencement of negotiations to reach a refinancing agreement or to obtain adherence to an early proposal for a composition agreement, or when the court has been notified of the commencement of negotiations to reach an out-of-court payment agreement.
d) When the company has reached a refinancing agreement that satisfies the conditions of non-cancellability set forth in the insolvency legislation.
e) In the case of Sports Corporations.

There is no doubt that article 348 bis of the LSC is a precept directly related to the problems of oppression of the minority in closed companies, which has undergone several modifications throughout its existence to reduce its requirements; and that in times of crisis its application has even been suspended. And all this is very possibly as a result of the criticisms that from the beginning were projected on this article, whose application can endanger, on certain occasions, the survival of the company, as the company has to face an important payment to the separating partner.

As can be seen, the aforementioned article links the right to the dividend basically to the shareholder or partner right of separation, although the judgment we are commenting on is also important because it goes beyond this limited scope by establishing that

"...this right of separation regulated in art. 348 bis LSC, in addition to being optional, is compatible with the exercise of other actions, whether those of challenging the resolutions that applied the result of profits to reserves, or the possible liability actions against the administrators for the breach of legal duties that constitute an unavoidable prerequisite for the adoption of the resolution for the distribution of profits. In such a way that the power to request the separation, once the conditions and requirements of art. 348 bis LSC have been met, is not the only remedy available to the minority shareholder. He also has the possibility of challenging the resolution, if it is proven that it was adopted with abuse of the majority, as in this case. And with this variety of actions, each of which responds to its own purpose and is subject to its own requirements, it is up to the shareholder entitled to those legitimate interests to opt for the legal action that best satisfies its claim".

Obviously, the problem does not arise when the partners or shareholders of a closed corporation do not represent a minority that may feel affected by the decisions that the Supreme Court's ruling puts under the spotlight. However, there are countless small and medium-sized companies in which the problem has arisen quite often and which, with the present ruling, are somehow clarified and smoothed out.

We wish to end this report by pointing out that the ruling we are discussing obliged the company, after analyzing its situation, to declare a dividend of 75% of the profits, so it is advisable to seek expert advice in each case to assess the situation of the specific dividend and company. ///////