

CORPORATE UPDATE

***Liability of shareholders for corporate debt:
Separating the owners from the business***

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Given the current economic climate we have seen an increase in the concerns of shareholders, in particular parent companies or majority shareholders, to limit their liability for the debts of their subsidiaries and ensure they are not exposed unnecessarily particularly in insolvency situations.

In the two types of companies in Portugal, namely: *Sociedade por quotas* (Lda.), i.e. private limited quota company and *Sociedade Anónima* (S.A.), i.e. public company, there is a common liability rule for both types of companies: Shareholders are liable up to the value of the quota/share held in the Portuguese Company subject to the following specific exceptions:

- i. Where a SA type company has only a sole shareholder that shareholder is liable for the duties/debts of the incorporated SA.
- ii. In relation to *Sociedades por quotas* (“SQ’s”) Article 84 of the Companies Code provides that the sole shareholder may be liable for the companies liabilities which have arisen during the period when there was only a sole shareholder provided that during this time it the legal provisions governing the allocation of the Company’s assets in performance of its obligations were not satisfied. It should be noted, however, that this provision has limited impact, since legal commentators take the view that the liability of the sole shareholder only arises if there is a connection between the insolvency and the fact of the sole shareholder managed the Company in a way that the assets of the Company were mixed with its own assets and for its interests and not for the purposes of the Company.

- iii. Article 501 of the Portuguese Commercial Companies Code and following provides that companies which are in a “group” relationship or “controlled”¹ may be liable generally (i.e. regardless of insolvency) for the debts of the subsidiary / controlled company. There is, however, an extensive debate over this point in Portugal in particular, strong arguments to say that it does not apply to shareholders who are based outside of Portugal.
- iv. Finally, Article 334 of the Portuguese Labour Code (recently introduced since this only came into force in 2009) provides for the liability of the shareholders (again only where in a group relationship or the insolvent company is controlled) for the payment outstanding employment debts that are overdue for more than 3 months.

Liability under article 334 and 501 only kicks in where it can be established that the shareholder exercised a dominant control over the Portuguese company. In practice we are talking about either clear control via voting rights / power to appoint directors which might be construed as dominant and having power to control the day to day management of the company, e.g. a de facto shadow director of some form.

The following shareholder liability aspects should also be taken into account in insolvency situations: the share capital and cash contributions (*“prestações suplementares”*), both considered as equity (*“capital próprio”*) cannot be reimbursed if insolvency proceedings are commenced.

A Shareholder which has power to appoint a director without the remaining shareholders passing a resolution in connection with this appointment, is jointly liable with this person, whenever the latter is held legally liable to the company and fault can be attributed in the selection of the person appointed.

Furthermore, a shareholder which is able to elect a director or member of the supervisory board will be held jointly liable with the person elected, where fault can be attributed in the appointment made, whenever the latter is held legally liable to the company or its shareholders as long as the resolution passed includes the vote of that partner and those referred above and less than half of the remaining shareholders present or represented at the general assembly.

¹ “**Group**” and “**Control**” means that a dominant influence can be exercised on a company by means of (a) the possession of the majority of the issued capital of the company, or (b) the power to cast the majority of the votes attached to shares issued by the company, or (c) the actual power to appoint more than half of the members of the directorial, executive or supervisory body of the company as defined under Article 21(1) and 21(2) of the Portuguese Securities Code (CVM);

A shareholder which has the power to remove a director, or member of the supervisory board and by using its influence makes that person to act or omit to act in a particular manner shall be jointly liable in the circumstances where this person incurs legal liability towards the company or its partners for the act or omission.

A controlling or parent company can be liable for the obligations of its subsidiary for as long as such a dominant position exists, in the following ways:

- The subsidiary is entitled to demand compensation from the Parent company in respect of any annual losses which the former suffers whenever those losses are not met by the affiliate's reserves.
- This liability of the Parent company becomes compulsory if the affiliate is declared officially insolvent;
- From the undertaking date and during the undertaking period the Parent Company in the event of the affiliate's insolvency is jointly and without limitation liable for the affiliate's debts, provided that it is shown that the legal criteria and duties in relation to managing the subsidiary's assets in good faith and ensuring they are used only to meet its obligations have been breached.

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