

# Supreme Court rules on whether dissolved companies can be sued

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## Facts

A Spanish company developed a building in Valencia. In 2005 it sold one of the flats in the building to an individual. In 2009 the developer registered the deed of dissolution with the Companies Registry. After the company was dissolved, the individual found defects in the flat's flooring. She filed a claim requesting that the company repair the floor or pay the price of the repairs.

The defendant filed its statement of defence and appeared in the proceedings by means of its liquidator. The defendant alleged that it lacked legal standing given that it had been dissolved.

The first-instance court upheld the claim on the grounds that the extinguished company could be sued. However, the court of appeals reversed the ruling and held that the defendant lacked legal standing. The court of appeals stated that the claim should have included a request that the company's cancellation be annulled. This ruling established that the claimant was still entitled to sue the company's directors and its liquidator.

The claimant filed an appeal before the Supreme Court.

## Background

While it is quite clear when a company has been incorporated and started operating on the market, it is more difficult to determine the exact point at which a company stops existing.

The typical process for dissolving a company in Spain is as follows:

- The company's corporate bodies decide on its liquidation.
- This is followed by the liquidation phase, in which the company's assets are monetised and used to cover the company's liabilities.
- Next, the company's liquidation balance is drafted (ie, the company combines the liquidation actions and demonstrates that it can pay its existing debts).
- Lastly, the liquidation deed is signed and the company's dissolution is registered with the Companies Registry (this is generally when the company stops existing).

The dissolution of a company is possible only if it can be proven that the company has paid all of its outstanding debts. Otherwise, the appropriate path to follow is insolvency proceedings.

The main problem with the dissolution of companies is the appearance of new debts after a company's dissolution has been registered. Such debts may be covered by the shareholders up to the amount that they received within the liquidation framework.

One way of addressing this issue is to consider that a dissolved company has lost its legal capacity and thus its legal standing after the cancellation of its registration with the Companies Registry. The Supreme Court issued a ruling on July 25 2012 (RJ 8372, 2012) which reasoned that the cancellation of a company's registration signifies the end of the company (ie, it no longer has legal capacity). According to this position, when a company debt arises after the cancellation of the company's registration with the registry, the claimant must first request the nullity of the liquidation, after which the company's liquidation will be reopened. Only then will the company again have legal standing.

Another approach is to consider that a dissolved company keeps its legal standing only due to being a defendant of the new creditors, although it lacks legal capacity for any other purpose. Thus, the annulment of a liquidation is not a requirement for the company to have legal standing. According to two former Supreme Court rulings (dated December 27 2011 (RJ 1897, 2012) and March 20 2013 (RJ 2594, 2013)) – as well as certain Directorate General for Registers and Notaries of the Ministry of Justice(1) decisions – the liquidation process finishes (from a material perspective) only when all of the company's debts have been fully paid up, even if they appear at a later stage. In other words, the cancellation of the company's registration with the registry entails only a formal dissolution.

The difference between these two approaches is subtle, as they both recognise a creditor's right to sue the company. The question is whether the creditor must request that the liquidation be reopened before or at the same time as it files its claim. After years of uncertainty, the Supreme Court seems to have ended this discussion by opting for the second approach in its May 24 2017 ruling (RJ 2217, 2017).

### **Supreme Court decision**

Article 6 of the Civil Procedure Act states which kind of person can be sued, which includes legal persons. The main issue to be resolved in the case at hand was whether the cancellation of a company with the Companies Registry:

- removes its legal capacity; or
- only limits it for the purposes of covering the debts that appear after such cancellation, in which case the company could be sued.

The ruling states that a company's legal capacity no longer exists following the cancellation of its registration in the registry. An exception occurs only when new company debts arise after such closing. For this purpose, the company keeps its capacity, mainly because such debts should have been considered in the liquidation (ie, if the liquidation had taken place when the new debt had appeared). Thus, the ruling recognises that a liquidation in such cases, as carried out, would have been defective.

The Supreme Court's ruling states that, in some cases, a dissolved company does not need to be sued and thus this analysis will not apply. This is because a remainder can exist once the company's assets have been monetised and its debts have been fully paid up. Such a remainder is distributed among the company's shareholders and such shareholders remain joint and severally liable with the company of the new debts up to the amount that they received after the liquidation process (the so-called '*cuota de liquidacion*').

However, in the case at hand, the claimant requested that the court:

- declare that there had been a breach of contract; and
- order the defendant to carry out the repairs or pay damages.

Thus, it was necessary to sue the company. Even so, it would have been advisable to sue the shareholders as well, provided that the claimant could confirm that the shareholders had received a *cuota de liquidacion* after the completion of the liquidation process.

Another issue that this ruling clarifies is who should represent such a company in court. According to the ruling, the company's former liquidator should do so.

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## Endnotes

(1) The Directorate General for Registers and Notaries of the Ministry of Justice is an administrative body that, among other things, is in charge of ruling on challenges filed against registrar decisions.

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