



ACT 31/2004, AMENDING THE COMPANIES ACT (“LEY DE SOCIEDADES DE CAPITAL”)

Improvement of Corporate Governance



INTRODUCTION

Act 31/2014, of 3 December, amending the Capital Companies Act for the improvement of corporate governance, as published in the Official State Gazette (BOE) of 4 December 2014, has introduced significant changes in Spanish Company Law on corporate governance.

The **background** to this Act is the Cabinet Resolution of 10 May 2013, whereby a committee of experts on corporate governance (“*Committee of Experts*”) was created for the purposes of ensuring the good governance of Spanish companies. This Committee was tasked with safeguarding the proper functioning of corporate bodies, which comprise the Board of Directors and the General Meeting, to promote the highest levels of competitiveness, generating trust and transparency for domestic and foreign investors and shareholders, improving internal control and corporate responsibility and ensuring an adequate separation of functions, duties and responsibilities, with the utmost professionalism and rigour.

Moreover, Act 31/2014, was drafted based on a study of the regulatory amendment proposal on corporate governance (“*Report*”) issued by the abovementioned Committee on 14 October 2013, and has adopted almost all its recommendations.

The amendments to Act 31/2014 can be grouped as follows: amendments affecting all Companies, those exclusively related to Listed Companies, other amendments, transitional regime and effectiveness, and repealing provision.



I. AMENDMENTS AFFECTING ALL COMPANIES

1.1 Amendments relating to the General Shareholders' Meeting

- The faculties of the General Shareholders' Meeting include deliberating and resolving on the acquisition, disposal or contribution of core assets to other companies (assets are taken to be core assets when the amount of the transaction exceeds 25% of the value of the assets included in the latest approved balance sheet).
 - The power of the General Shareholders' Meeting to deal with management issues is expressly extended to stock companies (formerly only applicable to limited liability companies), and the provision that the by-laws may limit such power remains.
 - With regard to the conflict of interest and the prohibition on voting:
 - The shareholders of limited liability companies (SL) may not exercise the voting rights inherent to their shares when adopting any resolution (in addition to the provisions of Article 190 of the Companies Act (LSC)) authorising them to transfer shares subject to a restriction under the Act or by-laws, or exempting them from the obligations arising out of the duty of loyalty, in accordance with Article 230 (non-competition clause).
 - In stock companies (SA), the shareholders shall only be subject to the prohibition on exercising their voting rights in the event of resolutions authorising them to transfer shares subject to a restriction under the Act or by-law, or removing them from the company, where said prohibition is expressly provided for in the relevant clauses of the by-laws governing the restriction on free transfer or removal.
 - Shareholders are not denied their voting rights in other cases of conflict of interest under Article 190 of the LSC.
 - In the event of challenge of company resolutions (where the vote of the shareholder or shareholders involved in the dispute has been decisive in the adoption of the resolution) then the company and, as the case may be, the shareholder or shareholders affected by the dispute will have the burden of proof of the resolution being in accordance with the corporate interest.
- It will be for the challenging shareholder or shareholders to provide evidence on the existence of a conflict of interest, except for resolutions relating to the appointment, removal, revocation and accountability of directors and any other officers of similar significance, in which cases it will be for the challenging parties to provide evidence of the damages caused to the corporate interest.
- **Right to information in an S.A.**
 - Failure by the directors to respond to the verbal request for information by the shareholders in a General Shareholders' Meeting shall not amount to grounds to challenge the general shareholders' meeting, the shareholder only being entitled to demand the fulfilment of the reporting obligation, and claim for any damages it may have suffered in relation thereto.
 - The shareholder shall be liable for any damages caused in the event of an abusive or harmful use of the information requested (this provision must be seen in conjunction with Article 204.3 which also excludes the right to challenge due to the shareholder incorrectly or insufficiently exercising its right to information prior to the General Shareholders' Meeting being held).
- **Voting on resolutions**
 - A new provision on separate voting per issue, Article 197 *bis*, is added. The following issues must be voted on separately, even if included under the same item of the agenda: (i) the appointment, ratification, re-election or removal of each director; (ii) the amendment of stand-alone articles of the by-laws; and (iii) any other matters as determined by the company by-laws.
 - Calculation of majorities: (i) in an SA, resolutions shall be adopted by simple majority, noting that such majority shall be obtained when the votes

in favour exceed the votes against; (ii) in the case of resolutions that require a reinforced voting quorum, in addition to the attendance, in person or represented, of more than 50% of the share capital, an absolute majority shall be required at first call, and a majority of two thirds of the share capital and, at least, 25% of the share capital attending in person or represented, shall be required at second call.

■ Challenges to corporate resolutions

- Any corporate resolutions contravening the company general shareholders' meeting regulations may be challenged.
 - The distinction between void and voidable resolutions disappears.
 - A new concept of “harm to the corporate interest” is introduced: such harm occurs where a resolution, while not causing damage to the company's assets, is imposed abusively by the majority, pursuing their own interest to the unjustified detriment of that of the remaining shareholders.
 - A corporate resolution may not be challenged: (i) where it has been annulled or validly replaced by another resolution adopted prior to the challenge being filed, or (ii) where the challenge is based on the following reasons (unless they are deemed to be essential): infringement of merely procedural requirements for the call or the setting up of the general shareholders' meeting or the board of directors, or for the adoption of the resolution, incorrect or insufficient information provided by the company in response to the exercise of the right to information prior to the shareholders' meeting, participation in the meeting of persons not entitled to do so, one or several votes being invalid, or erroneous calculation of the votes cast.
 - Distinction is only made, for the purposes of the time limit for challenge, between challengeable resolutions and resolutions contrary to public policy (not resolutions that are null and void).
 - The right to challenge corporate resolutions shall not expire or terminate for those resolutions that, because of their cause or content, are contrary to public policy (the one-year term is maintained for the remaining resolutions).
- The time limit shall be calculated as follows: (i) from the date of adoption of the resolution, if the resolution is adopted in a shareholders' meeting or in a meeting of the board of directors; (ii) from the date of receipt of the copy of the minutes, if the resolution is adopted in writing, and (iii) from the date of enforceability (or registration date), if the resolution is registered.
 - The persons entitled to challenge are: (i) any of the directors; (ii) third parties proving that they have a legitimate interest and (iii) any shareholders who acquire this status prior to the adoption of the resolution, provided that they represent, individually or jointly, at least, 1% of the share capital (this percentage may be reduced in the company by-laws).
 - Shareholders who do not meet these percentages and, therefore, are not entitled to challenge, shall be entitled to compensation for any damages suffered due to the challengeable resolution.
 - Anyone who has not denounced a particular formal defect in the resolution-making process despite having the opportunity to do so may not rely on any such defect at a later stage.

1.2 Changes relating to Directors

■ Remuneration of directors

- The by-laws shall establish the remuneration of directors (including, as specified by the Act, without limitation, the following): (i) fixed salary; (ii) allowance for attendance; (iii) profit sharing; (iv) variable remuneration; (v) remuneration by shares; (vi) compensation for removal; and (vi) any savings or pension/insurance schemes as deemed appropriate.
- The maximum amount of the annual remuneration of all directors shall be approved at a general shareholders' meeting.
- The distribution of remuneration among the directors falls within their competence (unless otherwise agreed by the shareholders' meeting).
- Reasonable and proportional remuneration criteria are established, designed to promote long-term profitability and sustainability of the company, incorporating the necessary measures to avoid excessive risk-taking and the rewarding of poor performance.

- The general shareholders’ meeting shall determine the percentage applicable, not exceeding the remuneration limit, by means of profit sharing as established in the by-laws (in an SL, a legal limit of 10% is established, and in the SA, the limits in force prior to the reform of the law are maintained).

■ **Directors duties**

- The scope of the director’s duty of care is extended and clarified: directors shall employ the required dedication and take any necessary measures for the proper management and control of the company, and shall have the duty to request and the right to obtain from the company the adequate and necessary information for the fulfilment of their duties.
- The *business judgment* rule is introduced, which reflects the standard of care of a prudent businessperson in decisions subject to the directors’ discretion. A reference is made to good faith, without personal interest, with sufficient information, in accordance with an appropriate decision-making procedure (excluding those decisions that personally affect other directors and related persons and, in particular, those seeking to authorize projected transactions in the event of absence).
- The scope of the directors’ compulsory duty of loyalty and the liabilities incurred for the infringement thereof is more widely regulated, and any provisions in the by-laws limiting or contravening such regulations shall have no effect:
 - Concepts such as the loyalty of a faithful representative, good faith, and performance of the role of director in the best interest of the company, are included.
 - Also included is the principle of personal responsibility with freedom of judgment in the performance of the directors’ duties.
 - In particular, the duty to avoid entering into any situations conflicting with the corporate interests is provided for. The director (and any persons related thereto who are the beneficiaries of the actions detailed below) shall refrain from (in addition to those actions already regulated):
 - (i) carrying out transactions with the company (except for regular and non-relevant standard transactions performed for clients, the details of which are not necessary to fairly reflect the equity, the financial situation and the results of

the company); (ii) using corporate assets and confidential information for private purposes; (iii) taking advantage of business opportunities of the company; (iv) obtaining benefits or remuneration from third parties other than the company or its group, related to the performance of his/her office (excluding acts of mere courtesy).

- Breaching the duty of loyalty shall lead not only to the obligation to compensate for any damages caused to the corporate assets, but also to the reimbursement to the company of the unjust enrichment obtained by the director.
- Civil liability claims may be brought separately from claims related to actions performed in breach of the duty of loyalty.
- Certain actions conflicting with the company’s interests may be permitted, provided that the shareholder’s meeting or the board of directors consents thereto.

■ **Liability of directors**

- Clarification is made that liability arises “where *wilful misconduct or negligence is involved*”, and that guilt will be presumed, unless otherwise proven, where the relevant action is contrary to the law or to the by-laws.
- *De facto* directors are defined (for the purposes of liability claims) as any person who, in the course of trade, performs, without a title, or with a non-valid or expired title, or any other title, the duties inherent to a director, and that person on whose instructions the directors of the company act.
- Should there be no permanent delegation of the board powers to one or more chief executive officers, the provisions regarding the duties and responsibilities of the directors shall apply to the person holding the powers of the company’s senior management.
- It is established that any natural person representing a director with legal personality, is subject to the same requirements and has the same duties as those of the latter, and both the natural and the legal persons are jointly and severally liable.
- Minority shareholders are entitled to call upon a liability claim, if the directors do not call the shareholders’ meeting, or to directly exercise a corporate liability action when the duty of loyalty is infringed.

- The right to exercise liability actions against directors, whether corporate or individual, will expire on the fourth anniversary of the date upon which the relevant action may have been exercised.

1.3 Amendments relating to the Board

- The board shall meet, at least, quarterly.
- An agreement shall be entered into by and between the chief executive officer (or any other directors performing executive duties) and the company, to be approved in advance by the board of directors, with the vote in favour of 2/3 of its members.
- The agreement shall contain, at least, details on remuneration for the performance of executive duties and potential compensation for early termination thereof, and any amounts payable by the company with regard to insurance premiums or contributions to savings schemes. No additional remuneration can be received for performing executive duties, the amount or description of which are not provided for in such agreement, all of which in accordance with the remuneration policy as approved in the general shareholders' meeting.
- The powers of the board of directors that cannot be delegated are expressly described: supervising the effective operation of any committees created, and the performance of any delegated bodies and executives that may be appointed; determining the general policies and strategies of the company; authorising or waiving any obligations arising from the duty of loyalty; its own management and operation; preparing the annual accounts and presenting them to the general shareholders' meeting; formulating any type of report required under law from the board of directors; appointing and dismissing chief executive officers of the company and executives directly reporting to the board or to any of its members, and setting forth the conditions of their agreements; the remuneration of directors within the scope of the by-laws and the remuneration policy as adopted in the general shareholders' meeting; calling of the general shareholders' meeting and drafting of the agenda and proposed resolutions; elaborating the policy in relation to own shares; and any powers that the general shareholders' meeting delegates to the board of directors.
- The percentage stake necessary to challenge any resolutions by the board is lowered to 1%.
- Breaches of the board of directors' regulations are included as grounds for challenging company resolutions.

1.4 Other amendments

- The management report of companies that cannot produce abridged profit and loss accounts shall include the average time taken to pay suppliers. If this exceeds the maximum limit established in the legislation on late payments, an indication shall also be given as to the measures to be applied in the following year in order to reduce the payment periods to such limit.
- For the purposes of non-discrimination between classes of shares in the S.A., any amendment substantially entailing a clearly asymmetrical effect on the economic or voting rights inherent to the various share classes, or to the holders thereof, shall be deemed to be discriminatory.

II. AMENDMENTS AFFECTING EXCLUSIVELY LISTED COMPANIES

2.1 General regime

- In addition to the provisions already applicable to the SA, the following specifications are expressly added:
 - 3% of share capital, as compared with the general 5%, for the exercising of certain shareholder rights.
 - 0.1% of share capital for the challenging of corporate resolutions.
 - Three-month expiry term for the action of challenging of corporate resolutions (except for resolutions contrary to public policy, which do not expire).
- The right to know the identity of the shareholders is extended to any shareholders' associations created within the issuing company representing, at least, 1% of share capital, as well as to any shareholders holding, individually or jointly, at least, a 3% stake in share capital.
- The shareholders' association or, as the case may be, the shareholder shall be liable for any abusive or detrimental use of the information requested.

2.2 General shareholders' meeting

- Powers reserved to the general shareholders' meeting shall comprise the transfer of core business to subsidiaries, any transactions equivalent to the liquidation of the company, and the directors' remuneration policy. The core nature of business and operating assets is assumed where the size of the transaction exceeds 25% of the total assets on the balance sheet.

- The general information prior to the shareholders' meeting is extended to cover, in relation to the appointment, ratification or re-election of members of the board of directors, the identity, curriculum vitae and category thereof. Such information may also be requested on any individual representing a legal person.
- The share capital necessary to submit proposals or to complete the agenda is lowered from 5% to 3%.
- Directors are exempt from the obligation to provide such information, if this is stated on the company's website.
- Shareholders' requests and directors' responses shall be included on the company's website.
- The by-laws may not require the holding of more than one thousand shares in order to attend the general shareholders' meeting.
- Different categories of executive and non-executive directors are established and regulated: directors representing substantial shareholders and independent and other external directors.
- The power of co-optation is extended since directors do not need to be shareholders, although substitution of directors is not allowed.
- The term of office of directors shall be determined in the by-laws, and in no event shall exceed 4 years.
- Directors may be re-elected, one or more times, for periods not exceeding 4 years.
- Certain board committees are more specifically regulated: board committee, audit committee and appointment and remuneration committee.
- Directors shall be remunerated, unless otherwise stated in the by-laws.

2.3 Board of directors

- A board of directors is mandatory, and gender diversity when appointing the members thereof must be ensured, facilitating the incorporation of women into the selection process.
- A larger number of non-delegable powers of the board are set forth (including such powers generally non-delegable by the boards of all stock companies).
- Attendance at the meetings by the directors shall be in person, although directors may delegate their representation to another director, with the particularity that non-executive directors may only delegate to non-executive directors.
- The powers and duties of the chairman and the secretary of the board are established.
- A coordinating director shall be appointed for independent directors, if the chairperson is an executive director.
- The performance of the board of directors shall be assessed annually.
- Directors' remuneration policy is fully regulated.
- A corporate governance report and a report on the directors' remuneration shall be submitted annually to the Spanish Stock Exchange Commission (CNMV), the contents of which are regulated.

III. OTHER AMENDMENTS

- The Securities Market Act 24/1988, of 28 July, is amended to bring it into line with the new provisions of the LSC, and it is stated that a number of the provisions applying to listed companies are now incorporated into the stock exchange organization and conduct rules, under the supervision of the CNMV.
- Additional Provision Three of the 15/2010 Act, of 5 July, amending Act 3/2004, of 29 December, whereby measures on combating late payment are implemented for commercial transactions, is modified to bring it into line with the amendments of the LSC, in particular, by adding that listed companies, and unlisted companies which do not file abridged annual accounts, shall publish on their websites the average time it takes for them to pay their suppliers.

IV. TRANSITIONAL REGIME AND EFFECTIVENESS

- Act 31/2014 of 3 December **entered into force** almost in its entirety **on 24 December 2014**.
- The provisions listed below became effective on **1 January 2015** and shall be resolved upon at the first general shareholders' meeting to be held thereafter:
 - **Any amendments introduced by this Act with regard to the remuneration of directors in stock companies.** For a listed SA, any amendments regarding the non-delegable powers of the board of directors, the board of directors' performance review, board committees, audit committee, appointment and remuneration committee, and remuneration of directors based on their roles or on the performance of their executive duties.
 - Any amendments relating to the approval of the **directors' remuneration policy in a listed SA**, as follows:
 - In the event that the first general shareholders' meeting, to be held from 1 January 2015 onwards, were to approve on a consultative basis the report

on the directors' remuneration, the company's remuneration policy contained therein shall also be deemed to have been approved.

- In the event that the annual shareholders' meeting above was not to approve on a consultative basis the report on the directors' remuneration, the directors' remuneration policy must be submitted to the general shareholders' meeting for binding approval, no later than the closing of the following year, with effects from the subsequent year.
- Directors appointed prior to 1 January 2014 may complete their mandates even if they exceed the maximum term of 4 years.

V. REPEALING PROVISION

- Any equal or lower rank provisions are contrary to this Act and, in particular, to Articles 61 *bis*, 61 *ter*, 100.b) *ter* and b) *quáter*, and Additional Provision Eighteen of the Securities Market Act 24/1988, of 28 July, are repealed.



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