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A step forward in the transparency and professionalism of the management of Spanish companies

Law 31/2014, modifying the Law on Share Capital Companies in order to improve corporate governance enters into force

The final text of this Law was published in the Official Journal last 4 December. In its Preamble, the legislator stresses the importance of good corporate governance as an essential factor for the creation of value, the improvement of economic efficacy and also to strengthen investor confidence, and also refers to the progress made in Spain in this field during recent years.

As explained in the Preamble, the purpose of this Law is twofold: on the one hand the measures introduced are aimed at strengthening the role of the Shareholders Meeting, and at encouraging the shareholders' participation in the company. On the other hand, the legislator recognizes the importance of having a well-managed Board of Directors. In view of this, specific regulation is introduced that addresses certain increasingly important aspects of the functioning of such governing body.

In this special edition of our CAPSULAS newsletter we will highlight the most relevant modifications that Law 31/2014 concentrating on those measures that affect unlisted companies.

Matters reserved to the Shareholders Meeting

Law 31/2014 expands the list of matters which require approval by the Shareholders Meeting. This now includes the purchase, sale or transfer of essential assets. An asset is presumed to be essential when the amount of the transaction exceeds twenty five percent of the aggregate value of all the assets of the company recorded in its last approved balance sheet.

As to the possibility that the Shareholders Meeting gives instructions on matters of management, that already existed for Limited Liability Companies ("Sociedades de Responsabilidad Limitada"), this faculty is now extended to the Shareholders Meeting of Joint Stock Companies ("Sociedades Anónimas"). For both types of Companies, the By-Laws may limit such faculty.

Conflicts of interest at Shareholders Meetings

The regime on conflicts of interest is modified, and the general clause that prohibits a shareholder to vote in the most serious cases of conflict of interest, listed in the Law, is extended to Joint Stock Companies. Furthermore, it is from now on presumed that the company's interests have been violated in case a corporate resolution has been adopted with the determining vote of the shareholder(s) affected by a conflict of interest. If any such resolution is challenged, then the Company or the affected shareholder (s) shall have the burden of proving that the resolution does not harm the interests of the Company.

Adoption and challenging of corporate resolutions

A new article is introduced, making it mandatory to submit matters that are substantially independent to the Shareholders' approval in a separate way, even though such issues may be included in the same point of the Shareholders Meeting's agenda. Examples of matters that must be voted on separately are the appoint-

ment, the reelection or the dismissal of any director, the modification of any article of the by-laws that has its own autonomy, or those matters for which the by-laws have established such obligation.

As regards the adoption of resolutions by the Shareholders Meeting of Joint Stock Companies, it is clarified that such resolutions are validly adopted when approved by simple majority of the votes of the shareholders present or represented at the meeting, that is, when there are more votes in favor of a resolution than votes against. This was not quite clear in the previous wording of the Law on Share Capital Companies.

The regulation on the challenging of corporate resolutions has also been revised, on the basis of a balance between reasons of business efficiency, the protection of minority shareholders and the security of legal transactions. As a result, resolutions may no longer be challenged because of the infringement of certain minor procedural requirements.

Furthermore, the new law introduces a general regime for the annulment of corporate resolutions that simplifies the existing procedure. Actions for annulment expire after one year, except for actions against resolutions that are contrary to public order, which have no statute of limitations.

Finally, in relation to the challenging of resolutions that are detrimental to the corporate interest, it should be noted that such concept of corporate interest has been widened. From now, corporate interest will considered to have been violated when the corporate resolution is imposed in an abusive way by the majority of shareholders.

Duties of the Board of Directors

The current wording of the Law on Share Capital Companies already included specific provisions on the duty of care, the duty of loyalty, and on the conflicts of interest of the directors of the company, but Law 31/2014 reinforces all these provisions.

As to the duty of care, the new wording of the Law contains a more precise description of what this duty entails, having regard to the nature of the position held by each director and to the functions attributed to each of them. In this sense, we may highlight that directors must apply an appropriate degree of dedication and must adopt those measures that are necessary for the good governance and control of the company.

In the sphere of strategic business decisions to be adopted by the directors, the business judgment rule is introduced. This means that the director's duty of care is considered to be fulfilled when he or she has acted in good faith, without the inference of personal interests, on the basis of sufficient information and in accordance with an appropriate decision making procedure. This business judgment rule does not apply to decisions that affect other directors or affiliated persons personally.

Board Meetings must be held at least quarterly

The new law places special emphasis on the importance of the direct implication of the directors in the daily management of the Company and on the continuous involvement of the directors in the company's affairs. A result of these enforced requirements of implication is the newly introduced obligation that the Board of Directors must meet at least once every quarter. Even though the Law does not expressly state this, such meetings may be held by

means of remote communication procedures, such as telephone or videoconferences, provided that each member of the Board of Directors who participates in the meeting is able to hear and address all of the other participating members simultaneously.

Duty of Loyalty

As regards the duty of loyalty, its contents is described with more detail and a specific procedure that must be followed in case of a conflict of interest is established. The fulfilment of the duty of loyalty is made imperative, and the company's by-laws may not limit or exclude such duty. In case a director breaches his or her duty of loyalty, such director will be obliged to indemnify the damages caused to the company, and also to return to the company any unjust enrichment obtained that he or she might have obtained.

Liability of directors

As regards the regime for liability of directors, it is established that directors shall be liable towards the company, its shareholders and creditors for any damage caused by their acts or omissions that are contrary to the law or the By-Laws or by acts performed in breach of the duties that are inherent to the exercise of their positions. In order for liability to exist, the director must have incurred in willful misconduct or negligence, but this will be presumed to exist, unless proven otherwise, when the act is contrary to the Law or to the company's by-laws.

In the event that no permanent delegation of the faculties of the Board of Directors has been made, all provisions on the duties and responsibilities of the directors will apply to the person who, in whichever capacity, has been entrusted with high management functions within the company, without prejudice to the legal remedies that the company may bring against such person on the basis of the legal relationship that binds the company with such person.

Remuneration of directors

As to the remuneration of the directors, the general rule continues to be that directors do not get paid in consideration for their holding such position unless the by-laws of the company state otherwise. In the event that the by-laws of the company determine that the position of Director is remunerated, Law 31/2014 introduces a specific regulation on the way in which the by-laws must establish the retributions that the directors may receive by virtue of their position.

The maximum amount of the yearly remuneration of all of the directors, in their capacity as such, must be approved by the Shareholders Meeting and will remain in force until expressly modified. Unless the Shareholders Meeting decides otherwise, the distribution of the amount between the separate directors will be decided upon by the directors themselves. If the directors operate as a Board, then the Board shall be the one taking such decision. This distribution must be made on the basis of the functions and responsibilities attributed to each member of the Board.

In any case, the law states that the remuneration of the directors must be proportionate to the magnitude of the company, to its economic situation and to the market standards of comparable companies. The remuneration system must be oriented towards promoting the long-term profitability and sustainability of the company, and incorporate those measures that may be necessary to avoid that the directors may be incentivized for taking excessive risks, or that they may be rewarded for unfavorable results.

Permanent delegation of faculties of the Board of Directors

As regards the faculties that the Board of Directors may delegate to one or more managing directors ("Consejeros Delegados") or executive committees, Law 31/2014 lists a series of matters that may not be subject to delegation because they are considered to be at the core of the management and supervisory functions of the Board of Director.

As an example we may cite the supervision of the effective functioning of the committees that may have been created or of the delegated bodies, the determination of the company's general policies and strategies, the appointment or termination of managers who directly depend from the Board of Directors or from one of its members, and the establishment of the terms of the contracts of such managers, including their remuneration.

Furthermore, it has been established that when a member of the Board of Directors is appointed as managing director, or is otherwise given executive powers, the company and the appointee must enter into a written agreement that shall be attached as an annex to the minutes of the meeting in which the appointment is formalized.

This contract shall lay down all concepts for which the director may receive compensation related to the exercise of the executive functions, including, if applicable, the possible indemnity for the early termination of such functions, and the amounts payable by the company in concept of insurance premiums or payments to savings plans.

No payments may be made to the director for the exercise of executive powers in case the amounts or concepts are not contemplated in the contract, which must be in line with the remuneration policy that may be in force in the company.

The contract must have been previously approved by the Board of Directors, with the favorable vote of two thirds of its members. The member of the Board affected by the appointment shall refrain from assisting and voting at the meeting in which such contract is discussed.

Public information

Finally, the Second Final Provision of Law 31/2014 introduces the obligation for unlisted companies that formulate their annual accounts in unabbreviated form to include their average period for payment to suppliers on their website. Such companies were already under the obligation to include this information in their annual accounts; the novelty here is the publication on the website.

Entry into force

Law 31/2014 enters into force on 24 December 2014. The modifications that affect unlisted companies and that deal with the remuneration of Directors will enter into force on 1 January 2015, and the corresponding decisions by the Shareholders Meeting must be adopted in the first Shareholders Meeting that may be held after such date.