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MODIFYING THE CAPITAL COMPANIES ACT FOR THE IMPROVEMENT OF CORPORATE GOVERNMENT – ACT 31/2014 OF 3 DECEMBER

Following the Cabinet agreement of 10 May 2013, which set up an expert committee on corporate government, on 4 December 2014, Act 31/2014 of 3 December was published in the Official State Gazette. This Act modified the Rewritten Text of the Capital Companies Act (the Act). It introduces a series of measures in order to improve capital company corporate government, and establishes the correct operation for certain government bodies and the administration of companies. The legislation aims to increase confidence and transparency for shareholders and investors, and improve internal control and corporate responsibility of Spanish companies.

The measures principally affect the general assembly and the board of administration, and are briefly outlined below.

The role in a company of the **general assembly of shareholders** is strengthened and is given greater powers in company decision-making and management, opening up routes to encourage shareholder participation. Shareholders are now enabled to give instructions to the board of administration in the area of management (previously only provided for limited liability companies) and their powers are extended to include the requirement of approval of reserve company operations whose importance gives them similar effects to structural modifications. Specifically, all purchases, sell-offs or contributions to another company of essential assets must be authorised by the general assembly.

In relation to the legal treatment of **conflicts of interest**, the Act contemplates (i) a clause prohibiting the right to vote for all shareholders benefiting in the most serious and clear cases of conflict, and (ii) a presumed breach of company interest in cases in which the company agreement is taken with the deciding vote of shareholders involved in a conflict of interests.

The **right to information** is also one of the targets of the reform. The new regulation goes further and specifies that, where shareholders in a general assembly ask for certain information or clarifications and this right is breached, those harmed may require the fulfilment of the right to information and all damages caused, even where this breach is not a reason for challenging the assembly.

In relation to the **making of agreements** in the general assembly, the new text establishes that shareholders must take separate decisions on the appointment, ratification, re-election or separation of administrators and any modifications to bylaws. Shareholders must vote separately on all matters which are substantially independent to ensure impartial and undistorted voting.

With respect to the legal system for **challenging company agreements**, the distinction between null and annullable agreements disappears, and all cases of challenging are brought together under a general system of annulment. Under this rule, there is a planned expiry period of one year (three months in the case of companies quoted on the stock market), with the sole exception of the agreements contrary to public order, on which no prescriptions may yet be made. The legitimacy of a challenge has certain imposed conditioned in order to avoid situations of abuse of rights, and will require shareholders to have a minority participation of 1% for unquoted companies and 0.1% for quoted. There are also limitations on the challenging of formal or procedural defects, and the challenging of company agreements due to breach of formalities or procedural requirements is eliminated.

With particular respect to **quoted companies**, the modifications affecting the general assembly of shareholders include the following:

- The minority right is strengthened by reducing the threshold for minority shareholders to exercise the right to attend the general assembly from 5% of the share capital to 3% (and the maximum number of shares to 1,000).
- The right to information is strengthened by reducing the maximum time in which the shareholders can ask for pertinent information.
- The list of subjects reserved for the assembly is extended.
- The express acceptance of the diverging vote is contemplated for intermediary bodies.
- A new regulation of associations and forums of shareholders is established.

The **board of administration** has also had changes in its faculties and operation.

The regulations are intended to guarantee greater commitment and diligence on the part of the company board of administration. Depending on the type of company, it establishes the duties and responsibilities of the administration body, and gives a more precise description of the duties of diligence and loyalty, as well as the procedures to be followed in the event of conflict of interests.

The duty of loyalty is strengthened by the imperative definition of disloyal conduct and the extension of the responsibility of the board members who, in addition to restoring the damage caused, must return any unfair enrichment.

The duty regarding diligence is redesigned to include the "*business judgement rule*" and the assessment of the actions according to the functions of each board member.

The necessary participation for imposing **company action of responsibility** is reduced. Its direct application (without requiring a previous assembly) is allowed if the board of administration should breach its duty to loyalty.

The system of responsibility is extended to additional subjects, such as the principal director of the company (in the absence of the managing director) and the physical person representing any administrating legal entity. Likewise, the legislator once more defines the figure of the actual administrator to include the one "*under whose instructions the company administrators might be accustomed to acting*".

The list of responsibilities that cannot be delegated by the board is extended to include, amongst others, the supervision of the correct action of the committees established, or of other delegated bodies.

Of particular importance is the measure relative to the regulation of administrator **remunerations**, which has been highly discussed up to now. The new Act provides for company bylaws to include the system of payment of the administrators for their management and decision-making functions, and clarifies the system for remuneration of board members exercising executive functions, who must sign a contract including the different payment items with the company, which will be included in the minutes of the session. Board members may not receive amounts or payments for items not expressly provided in the contract, which must also conform to the payments policy approved by the general assembly.

With respect to **quoted companies**, the new points of the regulation are as follows:

- Board members in the operation of the company are obliged to attend board meetings in person. These meetings will be held at least once a quarter, and the right of representation will be limited in accordance with the type of board member involved (i.e. a non-executive board member may only delegate to another non-executive board member).
- With respect to the composition of the board of administration, members are now defined by the law in different categories (executive, dominical and independent board members). The chairman's functions are expressly provided for (and can be extended by the bylaws and the board regulation) and it is established that when the chairman is an executive board member, the board of administration must appoint a coordinating board member from among the independent board members to achieve a balance. The functions of the secretary of the board are also regulated, and the maximum mandate is limited to a period of four years, as opposed to the six established before the reform.
- The appointments of board members are established at four years instead of six and the system for the co-opting and non-admission of replacements is modified.
- The possibility of the board of administration constituting specialised committees formed exclusively by non-executive board members, the existence of an auditing committee and one or two separate committees for appointments and retributions being obligatory.
- The introduction of board of administration obligations (i) to make an annual assessment of its operation and that of the committees, and (ii) to publish the average supplier payment time in the report on the annual accounts. Based on the results, the board will provide a plan of action to correct all encountered deficiencies.
- The submission of the payments policy and any change which might affect this policy to the approval of the general assembly of shareholders, a subject which will be multi-year in nature, as a separate point on the agenda. The components, the overall amount of the fixed annual payment and all of the terms and conditions of the contracts will be described in the payments policy. The board will decide on the individual distribution, always in accordance with said payments policy.
- The control of tax risks in the area of the responsibility of the board of administration. A series of non-delegable faculties of the board will be set out, and will particularly include decisions related to the essential core of the management and supervision, such as the determination of the risk control and management policy and the supervision of the internal information systems.

The Stock Market Act has also been changed to provide the National Stock Market Commission with the necessary powers to supervise some questions brought in or modified with the Act and which are applicable to quoted companies.

Finally, the Act establishes a transitory system for more important changes which might require changes to the bylaws of the organisation, such as modifications in the payment of the administrators and, with respect to quoted companies, those which affect the auditing committee or the appointments and payment committee, which must be agreed in the first general assembly held after 1 January 2015.