



corporate governance

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THE COMMITTEE OF EXPERTS ON CORPORATE GOVERNANCE UNVEILS ITS STUDY ON PROPOSED LEGISLATIVE AMENDMENTS

1. INTRODUCTION

On October 14, 2013, the Spanish National Securities Market Commission published a study on proposed legislative amendments produced by the Committee of Experts on Corporate Governance set up under a decision by the Spanish Cabinet on May 10, 2013.

The study is the result of the initial phase of the work entrusted to the Committee of Experts under the above-mentioned decision, which required the Committee, within four months of being set up, to submit a study to the Ministries of Economy and Competitiveness and of Justice, for referral to the Cabinet, so that based on the report, the Government could approve the necessary legislative reforms or proposals within the following two months.

To conduct the study, the Committee of Experts analyzed the degree of compliance with and the relevance of the recommendations contained in the Unified Code, the international standards on good governance and, in particular, the European Commission's recommendations, as well as various documents and proposals from international organizations and associations, contributions by corporate governance experts, and the laws of comparable countries. In the case of Spain, apart from an analysis of corporate legislation and of the recommendations contained in the Unified Code, the Committee of Experts particularly took into consideration the recently published Proposal for the Commercial Code.

The Committee of Experts structured its analysis and the proposals for enhancement of the current framework under two main heads:

- Shareholders' meetings: the proposed measures are geared towards expanding the powers of the shareholders' meeting, strengthening minority shareholders' rights and ensuring transparency in the information received by shareholders.
- Boards of directors: among other goals, the proposed measures are aimed at tightening the legal rules on directors' duties and liability, promoting diversity on boards in terms of gender, experience and expertise, introducing the role of 'coordinating director'—where one person holds office as chairman and as chief executive officer—, shortening

the term of office of directors to 4 years, clarifying the rules on compensation and its approval by the shareholders' meeting, or making the appointments and compensation committee legally mandatory, like the audit committee, for listed companies.

To facilitate its task and specify the scope of its proposals, the Committee of Experts included a schedule with the wording of the proposed amendments to the revised Corporate Enterprises Law ("LSC").

2. PROPOSED LEGISLATIVE AMENDMENTS RELATING TO THE SHAREHOLDERS' MEETING AND SHAREHOLDER RIGHTS

2.1 Powers of the shareholders' meeting

- To widen the power of the shareholders' meeting to scrutinize management matters to include all corporate enterprises (*sociedades de capital*), as the current wording of article 161 LSC only seems to reserve such power in the case of limited liability companies (*sociedades de responsabilidad limitada*).
- To extend the powers of shareholders' meetings of listed companies in line with the current wording of recommendation 3 of the Unified Code to cover the following matters: inclusion in subsidiaries of essential activities, acquisition or disposal of essential operating assets, transactions the effect of which is equivalent to the company's liquidation and, moreover, in line with other proposals, approval of the policy on directors' compensation.

2.2 Minority shareholder rights. Powers relating to the shareholders' meeting

- To lower the 5% threshold currently stipulated by the LSC to able to exercise certain minority shareholder rights to 3% in the case of listed companies.

2.3 Calling shareholders' meetings

- To strengthen the right to information before shareholders' meetings of listed companies are held, particularly as regards the appointment of directors.

2.4 Right to attend shareholders' meetings

- Set the maximum threshold requirable by the bylaws of listed companies to attend shareholders' meetings at 1,000 shares, as opposed to 0.1% of the capital stock, which is currently the general rule.

2.5 Voting at shareholders' meetings

- At all corporate enterprises, to require mandatory separate voting at shareholders' meetings on essentially independent matters, namely, the appointment, ratification, reelection or removal of each director, and amendment of bylaws by article or group of non-interdependent articles.
- To tackle the problem of conflicts of interest in decisions adopted by shareholders' meetings, the Committee of Experts proposes three measures:
 - In the most serious cases, the current rules applying to limited liability companies (prohibition against the right to vote) in article 190.1 LSC should be adapted with slight modifications;
 - In other cases, there should be a presumption that the corporate interest is contravened where the resolution is adopted with the decisive vote of shareholders subject to the conflict of interest; and
 - Separate voting by the various groups of shareholders should be required for bylaw amendments that have an asymmetrical impact from a substantive standpoint, resulting in discriminatory treatment.
- To amend article 524 LSC to achieve a more appropriate treatment of the delegation of the power of representation and of voting by intermediary entities (vote splitting and different voting).

2.6 Adoption of resolutions at shareholders' meetings

- In the case of all corporations (*sociedades anónimas*), the Committee of Experts proposes clarifying interpretational doubts over the calculation of majorities according to the following rules:
 - Ordinary resolutions: relative majority (more votes for than against).
 - Special resolutions (as referred to in article 194 LSC): absolute majority (more than one half of the shareholders present in person or by proxy at the meeting), unless, on second call, there are shareholders representing at least 25% but less than 50% of the subscribed voting capital, in which case two thirds of the capital present in person or by proxy at the meeting must vote for the resolution.

2.7 Shareholders' right to information

- The Committee of Experts proposes in the case of all corporations:
 - Distinguishing between the legal consequences of the different forms of exercising the right to information;

- Introducing safeguards for the exercise of the right in good faith and to prevent its abuse.
- In particular, in the case of listed companies, the Committee of Experts proposes extending the time period which shareholders have to exercise their right to information before the shareholders' meeting until five days before it is held, and posting on the company's website answers to valid questions from the shareholders from the date they are given.

2.8 Challenging corporate resolutions

- Measures aimed at maximizing the material protection of the corporate interest and of the minority shareholders (in the case of all corporate enterprises):
 - Unifying all cases for challenging resolutions under one general system for annulment of resolutions with a one-year time limit for doing so (three months in the case of listed companies), except for resolutions contrary to public policy (no time limit).
 - Clarifying that resolutions adopted in breach of the shareholders' meeting or board regulations are voidable.
 - Expressly providing that the corporate interest is also damaged even though the resolution does not cause damage to the company's assets if it imposed in an abusive manner by the majority. It is deemed that a resolution is imposed in an abusive manner where it does not meet a reasonable need of the company and is adopted by the majority for its own benefit and to the unjustified detriment of the other shareholders.
- Measures focusing on prevention of the opportunistic use of the right of challenge (also applicable to all types of corporate enterprise):
 - Restricting the legal standing to bring an action to challenge resolutions, so that 1% of the capital stock of unlisted companies and 0.1% in the case of listed companies is needed; with recognition, below those thresholds, solely of the right to claim the appropriate damages.
 - Establishing a series of cases in which a challenge would be inapplicable.
 - Preventing challenges that are unjustified because the resolution challenged no longer has any effect or has been validly superseded by another; in a new development, the Committee of Experts proposes express recognition that a resolution can also be revoked or rectified after an action challenging it has been filed.

2.9 Shareholder associations and forums

- To develop the rules on associations of shareholders of listed companies, completing the current rules by establishing the requirements for their formation (*inter alia*, they must have at least 100 members and none must own more than 0.5% of the company's capital), and the prohibition against receiving, directly or indirectly, any amount or financial advantage from the listed company, and including the obligation to have their accounts audited so as to ensure greater transparency in their activities.

2.10 Knowledge of the identity of shareholders

- To reserve the right of the shareholders of listed companies to know the identity of fellow shareholders, shareholders having an individual or joint holding of at least 3% of the capital stock and any associations of shareholders formed at the issuer, solely for the purposes of facilitating communication with the shareholders for the exercise of their rights and to better defend their common interests.

3. PROPOSED LEGISLATIVE AMENDMENTS IN RELATION TO THE LEGAL STATUS OF DIRECTORS, THE COMPOSITION AND FUNCTIONING OF THE BOARD OF DIRECTORS, THE RULES ON DIRECTORS' COMPENSATION AND BOARD COMMITTEES

3.1 Status of directors: duties and rules on liability (applying to all types of corporate enterprises)

- Duty of diligence: to complete the rules by establishing different regimes having regard to the functions entrusted to each director, and to enshrine in legislation the so-called 'business judgment rule', the aim of which is to protect the entrepreneur's discretion in matters of strategy and in making business decisions. The Committee of Experts also proposes to make explicit the right and the duty of directors to request the necessary information to make informed decisions.
- Duty of loyalty: to improve the order and description of the obligations flowing from such duty, completing the current list—above all, in the area of conflicts of interest—, and extending it to *de facto* directors in a wide sense. To also extend the scope of penalties beyond indemnification for the damage caused, so as to also include returning the ill-gotten gains.
- Rules on liability: to extend the rules on directors' liability to similar persons and to facilitate company actions for liability against directors, reducing the ownership interest needed to qualify for standing and permitting, in cases of breach of the duty of loyalty, such an action to be filed directly without having to wait for a resolution by the shareholders' meeting.

3.2 Board of directors: composition, powers and functioning

- To introduce a provision that expressly and directly establishes an obligation on the managing body of a list company to take the form of a board of directors.
- To introduce a programmatic provision for listed companies to recognize the relevance of diversity in the composition of their boards in terms of gender, experience and expertise (notwithstanding any analysis of the advisability of having more specific recommendations in the proposed reform of the Unified Code).
- To reserve certain powers to the board, establishing for such purpose a list of nondelegable powers applicable to listed and unlisted companies alike, and another specific additional list for listed companies.
- To establish at least four board meetings a year for all corporations (regardless of any special treatment given to listed companies in the area of good governance recommendations).
- In the case of listed companies, to also introduce an obligation on directors to attend meetings, a ban on nonexecutive directors delegating to executive directors, and the right of board members to receive sufficiently in advance the agenda for the meeting and the necessary information to debate and adopt resolutions on the business to be transacted.

3.3 Board chairman

- Also in the case of listed companies (although the Committee of Experts sees it as applying to all corporate enterprises), to develop rules on the functions of the chairman of the board and to establish the need for a prior report from the appointments and compensation committee for his or her appointment.
- To legislate for the role of ‘coordinating director’ where the same person holds office as chairman and as chief executive officer, together with his or her functions and the procedure for his or her appointment.

3.4 Board secretary

- As in the case of the chairman, it is proposed that listed companies (although the Committee of Experts sees it as applying to all corporate enterprises) develop rules on the functions of the board secretary and establish the need for a prior report from the appointments and compensation committee for his or her appointment.

3.5 Appraisal of the board of directors and of board committees

- To introduce a mandatory annual appraisal for the boards of listed companies and their committees.

3.6 Appointment of directors

- To establish that proposed appointments of directors be accompanied by a supporting report, assessing their résumé and considering the competence, experience and merits of candidates; and that the proposed appointment or reelection come necessarily from the appointments and compensation committee in the case of an independent director, or be backed up by a report in the case of a different category of director.
- To modify the cooptation system at listed companies, doing away with the need to be a shareholder, and to provide a solution in the case of a vacancy arising after a shareholders' meeting has been called but before it is held.
- To remove the possibility at listed companies of designating deputies.
- At listed companies, to shorten the maximum term of office of directors (from 6 to 4 years).

3.7 Definition of the different classes of director

- To establish by legislation the definitions of the different classes of director provided for in Order ECC/461/2013, of March 20, 2013, while maintaining that of other nonexecutive directors.

3.8 Directors' compensation. Special consideration for board members' compensation

- Proposals applicable to all corporate enterprises:
 - To include programmatic references which must serve as inspiration for decisions on director's compensation, and which include the reasonableness of the compensation, in keeping with the company's economic situation and with the functions and responsibilities attributed to the directors, so that the compensation system is geared to promoting the company's long-term profitability and sustainability, while building in the necessary safeguards to avoid excessive risk-taking.
 - To provide that the bylaws must set out the system for directors' compensation according to their functions as such, and that the annual compensation for the directors as a whole must be approved by the shareholders' meeting.
 - To generally clarify the rules on compensation for directors who perform executive functions, and to establish adequate safeguards for their establishment by the board.

- Proposals applicable to listed companies:
 - To establish the necessarily compensated nature of the office of director.
 - To establish the minimum terms of the policy on directors' compensation which must be approved by the board, at the proposal of the appointments and compensation committee, and submitted to the shareholders' meeting for approval. It will fall to the board, in the context of the compensation policy resolved by the shareholders' meeting, to determine the compensation for each director, according to his or her management and executive functions.
 - To submit to the shareholders' meeting for approval, at least once every three years, the company policy on directors' compensation as a separate item on the agenda (without it being possible to make any modification or payment for the discharge of, or termination from, the office of director unless envisaged by and consistent with such policy, or specifically approved by the shareholders' meeting).
 - To maintain consultative voting on the compensation report. Notwithstanding the consultative nature of voting, if the report is rejected, it will become necessary to review the compensation policy, which must be submitted to the next shareholders' meeting for approval (even if the three-year period mentioned above has not yet passed).

It is envisaged that a transitional regime will be introduced in relation to approval of compensation policies and the report on compensation at listed companies.

3.9 Board committees

- Apart from the audit committee, to establish a mandatory appointments and compensation committee (or two separate committees), which will be composed of nonexecutive directors, two of whom must be independent, and the chairman of which must be elected from among the independent directors.
- To modify the composition of the audit committee: composed of nonexecutive directors; there must be at least two independent members, the appointment of one of whom must take into account his or her expertise in and experience of accounting and/or audit matters. The chairman must be an independent director.

4. OTHER LEGISLATIVE AMENDMENTS

Lastly, the study mentions other legislative amendments relating to the supervisory powers of the Spanish National Securities Market Commission, infringements, repeals, and the due systematization of the information that issuers are required to undertake.

5. NEXT PHASE IN THE WORK TO BE DONE BY THE COMMITTEE OF EXPERTS

In the next four months, the Commission of Experts must tackle the next phase of its work, namely, a review of the recommendations of the Unified Good Governance Code.

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