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Corporate Governance

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Contents

Herbert Smith Freehills Spain LLP has a Madrid-based team made up of more than 100 professionals led by 12 partners and ten of counsel. The office's lawyers have a long-standing reputation of acting for both national and foreign corporations and have developed a strong reputation for handling complex and innovative transactions and disputes as well as complex cross-border advice. The firm has a high level of activity in corporate governance matters, covering a wide range of topics such as the preparation and drafting of regulations for boards of directors, board committees and shareholders' meetings, the negotiation and execution of shareholders' agreements as well as corporate governance reports required by the current legislation. Recent work includes advising Redexis Gas on its corporate defence programme and compliance, Fotowatio Renewable Ventures Services in relation to D&Os' legal duties and responsibilities and BNP Paribas on the analysis and implementation of a corporate governance structure.

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1. Introduction

1.1 Forms of Corporate/Business Organisations

The most common forms of companies in Spain are Public Limited Company (*Sociedad Anónima*) and Private Limited Company (*Sociedad de Responsabilidad Limitada*). Both are limited liability companies incorporated with a share capital contributed by the shareholders/partners.

The Spanish legal framework also foresees other types of entities, such as the General Partnership (*Sociedad Colectiva*), the Simple Limited Partnership (*Sociedad Comanditaria Simple*) and the Limited Joint-stock Company (*Sociedad Comanditaria por Acciones*). The main features of each of these types of entities are as follows.

Public Limited Company (Sociedad Anónima)
This type of company has its share capital represented by shares.

The minimum share capital required for the incorporation of a Public Limited Company is EUR60,000, although only 25% must be paid up at the time of incorporation and the remainder may be paid afterwards.

Spanish legislation foresees that companies performing certain business activities (eg, banks, real estate investment funds, insurance, private TV, private equity, securities or listed companies, securities agencies) must have the form of a Public Limited Company and a specific amount of share capital.

The issuance of non-voting shares is allowed. The holders of these non-voting shares are entitled to receive minimum annual dividends, whether fixed or variable, as established in the company's articles of association.

Private Limited Company (Sociedad de Responsabilidad Limitada)
The share capital of these entities is divided into quotas (*participaciones sociales*) that cannot be incorporated into negotiable securities or called shares (*acciones*).

In the case of Private Limited Companies, the share capital may not be less than EUR3,000. The quotas into which the share capital of the Private Limited Company is divided must be fully assumed by the shareholders and the nominal value of each of them fully disbursed at the time of incorporation.

General Partnership (Sociedad Colectiva)
Unlike the previous forms, these companies are partnerships by nature since their shareholders are personally and jointly and severally liable, with all their assets, vis-à-vis third parties, to face the results of the management of the company.

Simple Limited Partnership (Sociedad Comanditaria Simple)
These companies, as in the case of General Partnerships, are partnerships in nature, although there are two types of shareholders:

- general shareholders (*socios colectivos*), who are personally and unlimitedly liable for social debts; and
- limited shareholders (*socios comanditarios*), who are only liable up to the amount of their contribution.

Limited Joint-Stock Company (Sociedad Comanditaria por Acciones)
These companies have similar features to Simple Limited Partnerships, but their main difference is that their share capital is divided into shares (*acciones*) which are held by limited shareholders (*socios comanditarios*).

Given their significance in the Spanish Market, the analysis contained in this chapter focuses on the two types of companies currently most used in the Spanish market:

- Public Limited Companies; and
- Private Limited Companies.

1.2 Sources of Corporate Governance Requirements

The Spanish Civil Code (CC) and the Royal Decree 28 August 1885 on the approval of the Commercial Code (CCo) contain general provisions applicable to civil and commercial companies respectively. However, this regulation is essentially of a supplementary nature, since the CCo establishes that commercial companies shall be governed, in the first place, by the clauses and conditions of their respective contracts and articles of association. On the other hand, the special laws that govern the different types of companies have reduced the application of the CC and the CCo in practice.

As a consequence, we can distinguish two main regulations:

- the CCo; and
- the Royal Legislative Decree 1/2010 of 2 July which approves the consolidated text of the Capital Companies Law, as amended (LSC).

Additionally, Spanish law contains other mandatory regulations affecting corporate entities and their governance, the main ones being:

- the Securities Market Act (recast by Royal Decree-Law 14/2018 of 28 September, amending the revised text of the Securities Market Law, approved by Royal Legislative Decree 4/2015 of 23 October);
- Law 10/2014 of 26 June, for the monitoring, supervision and solvency of credit institutions;

- Law 22/2015 of 20 July, on Auditing Accounts (the 'Auditing Accounts Act');
- Law 3/2009 of 3 April, on the Structural Modification of Companies;
- ECC/461/2013 of 20 March, determining the content and structure of the Annual Report on Corporate Governance, the annual remuneration report and other information instruments for listed companies, savings banks and other entities that issue securities admitted to trading on official securities markets;
- Circular 3/2015 of 23 June, of the Spanish National Securities Market Commission (CNMV), on the technical and legal specifications and information that the websites of listed companies and savings banks that issue securities admitted to trading on official secondary securities markets must contain;
- Order EHA/3050/2004 of 15 September, on related-party transactions;
- Circular 5/2013 of 12 June, of the CNMV, which establishes the Annual Report on Corporate Governance models for listed companies, savings banks and other entities that issue securities admitted to trading on official securities markets;
- Royal Decree 1362/2007 of 19 October, on transparency requirements in relation to information regarding issuers of securities that are listed on an official secondary market; and
- Law 2/2011 of 4 March, on sustainable economy.

In addition, the articles of association of each company establish the terms and conditions for the operation of the companies. These cover the relationships between shareholders and contain corporate rules (eg, General Shareholders' Meetings, powers and duties of directors, etc). In cases of discrepancy, legal provisions prevail over a company's articles of association.

On the other hand, shareholders' agreements are very common to regulate matters not strictly related to the governance and ownership of the companies in a more flexible manner, such as:

- restrictions on the transfer of shares;
- voting rules;
- resolution of deadlock situations;
- financing requirements and capital calls;
- commercial and business matters; or
- the company's management.

1.3 Corporate Governance Requirements for Publicly Traded Companies

Spanish listed companies are legally bound in matters of corporate governance by the aforementioned Spanish Securities Market Act and, for listed financial institutions, the Law 10/2014 of 26 June, for the monitoring, supervision and solvency of credit institutions.

In addition to the above regulations, listed companies in Spain are subject to the 2015 Good Governance Code, which consists of 'soft law' setting out recommendations under the principle of 'comply or explain'; therefore, although it is not mandatory for listed companies to comply with the recommendations, companies must give a reasoned explanation in their Annual Report on Corporate Governance for any deviations from those recommendations. The purpose of this code is to ensure the proper functioning of the management and administrative bodies of Spanish listed companies in order to:

- lead them to the highest levels of competitiveness;
- generate trust and transparency for national and foreign shareholders and investors;
- improve the internal control and corporate liability of Spanish companies; and
- ensure the appropriate segregation of functions, duties and responsibilities in companies, from a perspective of maximum professionalism and thoroughness.

2. Corporate Governance Framework

2.1 Key Rules and Requirements

Listed companies have a duty to disclose information and prepare various documents, as follows.

- An annual financial report within the first four months following the closing of the business year. This financial report should comprise the annual accounts and the management report (including the Annual Corporate Governance Report) revised by auditors as well as its contents liability declarations.
- A biannual interim financial report that should include the resumed annual accounts, an intermediate management report and its contents liability declarations.
- A quarterly interim management report to be issued within the first and second six-month period of the business year that should have the following minimum content:
  - (a) an explanation of the significant events and transactions that took place in the relevant period and their impact on the financial situation of the listed company and its controlled companies; and
  - (b) a general description of the financial situation and the results of the listed company and its controlled companies within the relevant period.
- Any change to the rights of the securities and information about new debt issuances.
- Any project to modify the incorporation documents or the articles of association.
- Information regarding significant holdings and transactions of listed companies with their own shares.

- Information in relation to transactions carried out concerning the company's securities by its directors, officers and their family/arm's-length ties.
- Price-sensitive information, ie, information that could reasonably have an impact on the securities' listing in the market and thus affect investors must be disclosed immediately after the relevant agreement has been reached, a significant event has occurred or an important decision has been made and which may affect the price of the relevant securities in the market.
- The Annual Corporate Governance Report, which should be published as 'price-sensitive information', must contain at least the following information regarding the company:

  (a) ownership structure;
  (b) management and administrative structure;
  (c) related-party transactions between the company and its shareholders and directors and officers as well as intra-group transactions;
  (d) risk control system;
  (e) operation of the General Shareholders' Meeting;
  (f) an account of compliance with the corporate governance recommendations and of the reasons for non-compliance, as the case may be; and
  (g) a description of the main aspects of the risk monitoring and internal management system in relation to the transmission of financial information.

2.2 Current Issues and Developments

The most relevant developments that have taken place in recent years in the Corporate Governance area in the Spanish legal framework are the following.

- The amendment of the LSC introduced by Law 31/2014 of 3 December, which amends the LSC to improve corporate governance provisions. This law introduced modifications in relation to the General Shareholders' Meeting aimed mainly at strengthening its role and encouraging the participation of the shareholders, and in relation to the board of directors.
- The issuance by the CNMV on 24 February 2015 of the new Good Governance Code of Listed Companies.
- Law 22/2015 of 20 July, on Auditing Accounts, which implied significant internal changes in the organisational functions of all companies. Among the main developments introduced were the ten-year external rotation of audit firms in the case of public interest companies and the creation of an inspectorate to oversee the work of auditors.

Likewise, the latest amendments that have taken place following the transposition of Directive 2014/65/EU of 15 May 2014 on markets in financial instruments should also be noted. In relation to this, the modification of the Securities Market Law by Royal Decree-Law 14/2018 of 28 September, amending the revised text of the Securities Market Law, approved by Royal Legislative Decree 4/2015 of 23 October, is particularly noteworthy.

Finally, the recently approved Law 11/2018 of 28 December has introduced new regulations on corporate governance in matters of non-financial information and diversity. In this regard, according to these amendments, companies which meet certain requirements are obliged to disclose the statement of non-financial information, individual or consolidated.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Spanish companies need corporate bodies to enable the process for the adoption and execution of decisions, as well as to develop their corporate purpose. In light of this the LSC sets out, as a mandatory requirement, the existence of two different bodies in companies:

- the General Shareholders' Meeting, which is the body that expresses the will of the company; and
- the management body, which is responsible for the management and representation of the company.

Spanish companies are managed and represented by the management body, which may adopt different forms among the following:

- a sole director (*administrador único*);
- several members acting jointly and severally (*administradores solidarios*), or jointly (*administradores mancomunados*); or
- a board of directors, formed by at least three directors.

In Private Limited Companies, the articles of association may establish different ways of organising the management of the company, such as granting the General Shareholders' Meeting the ability to choose any form between those foreseen without needing to modify the articles of association. If the management body chosen for the Private Limited Companies is a board of directors, it will necessarily have a maximum of 12 members.

In Public Limited Companies, the structure of the management body may be only one of the following forms:

- sole director (*administrador único*);
- two or more joint and several directors (*administradores solidarios*);
- two joint directors (*administradores mancomunados*); or
- a board of directors composed of at least three members.

In the case of listed companies, the existence of a board of directors is compulsory.

3.2 Types of Decisions Made by Governing Bodies

Generally, management is an activity inherent to the management body, whereas the organisation of the company is a responsibility of the General Shareholders' Meeting. The LSC lists, as a frame of reference, a number of matters that fall within the competence of the General Shareholders' Meeting.

Powers of the General Shareholders' Meeting

The General Shareholders' Meeting powers listed in the LSC are articulated around three main axes:

- Determination of the economic and legal structure and organisation of the company – on one hand, all the transactions associated with the legal category of 'structural modifications' (eg, merger, spin-off, global assignment of assets and liabilities, etc) and, on the other hand, those that affect the legal, financial and organisational structure of the company (eg, amendment of articles of association, share capital increases and reductions, suppression and limitation of pre-emptive rights, dissolution of the company, etc).
- Audit of the accounts and control of the management of the directors (for instance, the appointment and removal of the company's directors and the exercise of liability actions against them).
- Intervention in the management matters of the company (for instance, the approval of transactions involving assets with a value that represents more than 25% of the aggregate amount of the company's assets).

Powers of the Management Body

The powers exercised by the management body can be divided into three main categories: governance, management and representation.

- The governance of the company involves functions of a strategic nature and the control of day-to-day management, such as:
  (a) the appointment and dismissal of managers linked to the company by senior management employment agreements;
  (b) the approval of the company's strategic plans and the most relevant transactions (eg, large acquisitions or disposals, mergers, etc); and
  (c) the periodic assessment of the management carried out by the managers, and the accounting and legal control of the management, including the drawing up of the annual accounts.
- The managers, appointed by the management body, exercise executive functions, manage the company's assets and take all the decisions that make up the day-to-day management of the company, in compliance with the strategic plans in force.
- The managers, by virtue of the powers they hold for having been granted by the management body, represent the company in all its acts and agreements with third parties.

3.3 Decision-making Processes

General Shareholders' Meeting

Unless the articles of association of a company foresee qualified majorities, as a general principle the resolutions of the General Shareholders' Meeting must be adopted as follows.

- In Private Limited Companies, any resolution requires votes in favour of at least 50% of the shareholders attending the meeting, provided that they represent at least a third of the total share capital of the company. As an exception to the above:
  (a) a favourable vote by shareholders representing more than 50% of the total share capital of the company is required for share capital increases/reductions or any amendment to the articles of association; and
  (b) a favourable vote by shareholders representing more than two thirds of the total share capital of the company is required for:
    (i) authorising directors to compete in a business that is the same or similar to the business performed by the company;
    (ii) the withdrawal or limitation of a preferential subscription right;
    (iii) transformation, merger, spin-off, global assignment of assets and liabilities;
    (iv) moving the corporate address to another country; and
    (v) the exclusion of shareholders.
- In Public Limited Companies, resolutions are passed by simple majority (ie, more votes in favour than against). However, in the case of the resolutions described below, if at second call the shareholders attending the meeting represent more than 25% but less than 50% of the subscribed voting shares, the resolutions must be passed by at least two thirds of the capital present or represented:
  (a) increase or reduction of share capital;
  (b) any amendment to the articles of association of the company;
  (c) issuance of bonds;
  (d) disapplication or limitation of the preferential subscription right;
  (e) transformation, merger, spin-off, global assignment of assets and liabilities; and
  (f) move of the corporate address to another country.

These majorities can be reinforced in the company's articles of association, although never by requiring unanimity to pass resolutions.

Management Body
Should the management body take the form of a board of directors, decisions must be taken by a majority of its members. However, if the board decides to appoint/delegate all representative powers in favour of a chief executive officer (CEO) or an executive committee, the approval of two thirds of the board members is required.

In addition to the above, the board can also hold a written meeting (voting in writing without a physical meeting) if none of the directors object to this procedure being used.

The company's articles of association can provide for qualified quorums or majority requirements, but not unanimity.

Should the management body take the form of a board of directors, a proxy to hold meetings can be granted only in favour of other members of the board.

4. Directors and Officers

4.1 Board Structure
As a general rule, a board of directors is made up of a chairman, a secretary and ordinary directors (a deputy chairman and deputy secretaries can also be appointed, who shall be entitled to act in the absence of the chairman and secretary, respectively).

The chairman of the board of directors has the power to call the meetings of the board of directors, to chair them and to set out the topics to be dealt with in each of them. In the role of moderator, the chairman is responsible for ensuring that the deliberations and decisions of the board of directors meet the objectives of effectiveness, quality and safety.

The secretary (and when appropriate, the deputy secretary) of the board of directors, among other functions, shall:

- keep the documentation of the board of directors, record in the minutes books the progress of the meetings and certify their content and the resolutions adopted;
- ensure that the actions of the board of directors comply with the applicable regulations and are in compliance with the articles of association and other internal regulations of the company; and
- assist the chairman so that the directors receive the relevant information for the performance of their duties with sufficient notice and in the appropriate format.

4.2 Roles of Board Members
Depending on the degree of relationship with the entity, a distinction can be made between three different types of directors.

- Executive directors, in addition to being part of the board of directors, hold a position in the management team, which makes them a legitimate source of information on the issues related to the area of work they manage.
- Nominee directors (*consejeros dominicales*) form part of the board of directors but do not hold a position in the management team. They are the representatives of shareholders appointed by them to defend their respective interests at the level of the board of directors.
- Independent directors are those who, appointed in accordance with their personal and professional conditions, can carry out their functions without being conditioned by relationships with the company or its group, its significant shareholders or its executives.

4.3 Board Composition Requirements/ Recommendations
Boards of directors must have at least three members, which can be individuals or companies. In the case of Private Limited Companies, unlike that of Public Limited Companies, it is not mandatory that where there are more than three directors acting jointly, the management body must be a board of directors. However, boards of directors of Private Limited Companies must have a minimum of three members and a maximum of 12, a limitation which does not apply to Public Limited Companies, where the maximum number of members of the board of directors is not limited.

The Good Governance Code of Listed Companies recommends, in the interest of maximum efficiency and participation, that the board of directors should be composed of a minimum of five members and a maximum of 15.

Nominee and independent directors should constitute a broad majority of the board of directors and the number of executive directors should be the minimum necessary. As far as possible, the number of independent directors should represent at least half of the board of directors.

Furthermore, it also recommends that the percentage of nominee directors among the total number of non-executive directors should not be higher than the proportion existing between the share capital of the company represented by said directors and the rest of the share capital of the company.

4.4 Appointment and Removal of Directors/ Officers
The directors are appointed by the General Shareholders' Meeting. The appointment must be approved by a resolution of the general meeting passed according to the thresholds outlined in **3.3 Decision-making Processes**, above. Additionally, in the case of Public Limited Companies, directors can also be appointed through the following mechanisms.

Proportional Representation System
Shareholders who voluntarily pool their shares such that the total number of pooled shares is greater than, or equal to, the number of shares obtained by dividing the company's total share capital by the number of members of the board shall have the right to appoint a director. If this power is exercised, those shareholders who have pooled their shares are not able to participate in the voting for the other members of the board.

This right may be exercised only when vacancies exist on the board. Replacements are appointed at a General Shareholders' Meeting.

Appointment by the Board (Co-option Procedure)
If any vacancies arise during the term of appointment of the directors, the board may appoint directors to fill these vacancies up until the next general meeting. Directors appointed by co-option shall hold office up to the date of the first General Shareholders' Meeting held after their appointment, whereupon their position shall be submitted for ratification.

There are two procedures available for a company director to be removed:

- by voluntary resignation of the director pursuant to a resignation letter; or
- by removal of the director pursuant to a resolution passed by a general meeting of the company.

4.5 Independence of Directors and Conflicts of Interest

The independence of directors is a basic obligation that arises from their duty of loyalty. Specifically, according to the Spanish Law, directors must perform their duties under the principle of personal liability, with freedom of judgement or opinion and independence from instructions and third-party links.

In connection with conflict of interest situations, directors have the obligation to abstain from participating in the deliberation and voting of agreements or decisions in which the director or a related person has a direct or indirect conflict of interest.

4.6 Legal Duties of Directors/Officers

Directors have two basic duties: to act diligently and to be loyal to the interests of the company. These two duties can be implemented through certain specific obligations provided by the law, as follows.

Duty of Diligence
The LSC defines the level of diligence a director must observe when performing his/her duties with an abstract and general rule, the 'duty of diligence' according to which a director must act as an 'orderly businessman' (*ordenado empresario*).

The concept of an 'orderly businessman' includes acting in the best interests of the company and with the care that a reasonably prudent person would be expected to exercise in like position and circumstances. While there is no particular definition of the level of diligence, this concept requires at the very least that a director has the duty to acquire the knowledge necessary to carry out his/her office properly.

Business Judgement Rule (Protección de la Discrecionalidad Empresarial)
Directors will comply with the business judgement rule if, in the process of adopting a decision, an agreement or a strategy, they have acted:

- in good faith;
- without having a personal interest in the subject matter of the decision;
- with enough information; and
- in the framework of an appropriate decision-making process.

If these conditions are met, directors shall be deemed to have acted within the framework of their duty of diligence without any need to assess their responsibility to the company, the shareholders or third parties.

However, the following decisions that affect other directors and any person related to them will not be considered to fall within the scope of the business judgement rule:

- waiving the ban on obtaining a benefit or compensation from third parties;
- authorising the use of company assets or a specific business opportunity; and
- authorising a transaction between the director and the company.

Duty of Loyalty
The directors shall act in the best interests of the company, as a 'loyal representative' (*representante leal*).

The concept of a 'loyal representative' includes the obligation not to put the directors' personal interests ahead of the interests of the company and prevents directors, when performing the duties inherent to their office, from pursuing interests that differ from, or are contrary to, the company's interests or the law.

The abovementioned general duty of loyalty embraces other key obligations or prohibitions, as follows.

Conflict of interest
Directors must report any conflicts of interest, whether direct or indirect, that they may have in relation with the company in which they hold their post.

Directors who have conflicts with the interests of the company in relation to a particular transaction shall refrain from being involved in the resolution in respect of the transaction in question. It is unclear under the LSC whether the director needs to leave the meeting during the discussion of the matter (in practice, it may be advisable for the director not only to refrain from voting, but also to leave the meeting while the matter is being discussed, which is in line with the Spanish Corporate Good Governance Code).

Prohibition on using the company name or claiming directorship
Directors must not use the company's name or their office within the company for personal purposes.

Prohibition on taking advantage of business opportunities
Directors must not invest in an asset or project in which the company may be interested (ie, unless that project was refused by the company) if they have gained information on the asset/project as a direct result of their office.

Duty of information
Directors must keep themselves duly informed of the company's business. All directors have this duty and they should keep themselves informed not only of the day-to-day operations of the board, but also of the company.

Duty of secrecy
Directors, even after they cease to be directors, must keep all confidential information and any information, data or reports obtained from holding office strictly confidential.

4.7 Responsibility/Accountability of Directors

Directors are jointly and severally liable to the company, its shareholders and the company's creditors for any damage caused by any actions or omissions they carry out in contravention of the law or of the provisions of the company's articles of association or for actions or omissions which breach the duties inherent to their position as a director.

LSC expressly extends directors' civil liability to de facto or shadow directors (*administradores de hecho*), ie, those entities or individuals which, without having been formally appointed as directors, actually and effectively direct and manage the company, either by substituting the directors formally appointed or by having a decisive influence over them. Therefore, de facto directors include those persons who, without having been formally appointed directors, have the outward appearance to third parties of being directors and controlling the company's management.

4.8 Breach of Directors' Duties

Compensation for any damage caused by directors may be claimed by means of a corporate action (in which the company will be indemnified for the damage suffered) or an individual action (in which the injured individual will be indemnified), as follows.

Corporate Action
A corporate action for liability can be exercised by the company by resolution of the General Shareholders' Meeting, which may be adopted at the request of any shareholder even when not included in the agenda.

In addition, corporate action can also be brought by:

- the company's creditors, when corporate action for liability has not been brought by the company or its shareholders and the company has insufficient assets to repay its debts; or
- by the insolvency administrators of the company who, according to the Spanish Insolvency Act, may file a corporate action aimed at recovering all or part of the damages caused by the directors to the company.

Individual Action
Any third party (including shareholders) may take individual liability action against directors if their interest is affected by the conduct of directors. The purpose of this action is to seek compensation for damages directly suffered by third parties (not for damages caused through the company).

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Only damages resulting from negligent or disloyal management will be claimable against the directors. In this way, the damage is not in itself determinant of liability but, in addition, the fault or negligence of the director and the causality relationship between the negligent actions of the directors and the damage that is claimed must be demonstrated.

Limitations of the Liability of Directors
As an exception to the general liability rule set out above, directors (and de facto directors) may be released from liability if they provide evidence that:

- they did not participate in the adoption or in the execution of a prejudicial resolution and they were unaware of the existence of such a resolution;
- they knew of the adoption of the prejudicial resolution but did everything in their power to prevent any harm (although there is a school of thought that argues that, to be released from liability, the director must have lodged a challenge to the resolution); or
- they knew of the adoption of the prejudicial resolution but expressed their opposition to it.

The approval, ratification or authorisation of a resolution by the general shareholders' meeting shall not preclude directors' liability claims.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The articles of association of companies shall regulate the remuneration system for directors in their capacity as such and determine the activities for which directors may be remunerated.

Additionally, the General Shareholders' Meeting sets the overall maximum annual remuneration for all directors.

On the other hand, the directors, by agreement between them, or the board of directors shall agree on the distribution of remuneration among the different directors, according to the functions and responsibilities attributed to each director. If the company has a board of directors, the agreement to attribute the remuneration to each director must take into account the functions and responsibilities of each director and, therefore, the remuneration of the different directors cannot be the same.

In addition, when a member of the board of directors is appointed as managing director or is assigned executive functions under another title, an agreement must be concluded between him/her and the company which must have been previously approved by the board of directors by a favourable vote of two thirds of its members.

4.11 Disclosure of Payments to Directors/Officers

The Annual Report must contain "[...] the amount of the salaries, expenses and remunerations of any kind accrued in the course of the financial year by the executive managers and the members of the management body, as well as the obligations contracted regarding pensions or payment of life insurance premiums or civil liability with respect to the former and current members of the management body and executive managers. In the event that the members of the management body are companies or firms, the above requirements shall apply to the natural persons representing them."

In addition to the foregoing, in relation to listed companies the CNMV recommends that the information policy on directors' remuneration should be based on the principle of maximum transparency.

For listed companies, the directors' remuneration policy shall comply with the remuneration policy set out in the articles of association and shall be approved by the General Shareholders' Meeting at least every three years.

The board of directors of listed companies must prepare and publish an annual report on the remuneration of directors, including those they receive or should receive in their capacity as such and, where appropriate, for the performance of executive duties.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Being a shareholder of a Public Limited Company or a Private Limited Company entails a number of rights and duties in relation to the company and vis-à-vis other shareholders.

The rights granted to the shareholders include:

- economic rights (concreted in the right to participate in the social profits and to participate in the liquidation quota upon liquidation of the company); and
- political rights (under which the shareholder participates or drives decisions in the company, through the right to attend the General Shareholders' Meeting and the right to vote, complemented by the information right).

The law also recognises other rights which, due to their nature, may fall within both categories, such as the right of preferential subscription of new shares (*acciones o participaciones sociales*) in the company, right to challenge corporate resolutions, right to be represented at the General Shareholders' Meeting, the right of separation in the different cases provided for by law, etc.

5.2 Role of Shareholders in Company Management

The General Shareholders' Meeting has an indirect influence on the management of the company by appointing and dismissing the directors, reviewing the annual accounts and annually assessing the management of the company.

In addition to this, the law provides that the General Shareholders' Meeting may also influence the management body directly, by giving instructions to the management body or requiring prior authorisation for the adoption of decisions on certain matters in accordance with the framework of statutory competence. However, this is not a general empowerment; it can only be occasional on certain management matters.

Specifically, the law stipulates that the General Shareholders' Meeting approval is compulsory in the event of the acquisition, sale or contribution to another company of essential assets (in other words, when the amount of the transaction exceeds 25% of the value of the assets of the last approved balance sheet of the company).

5.3 Shareholder Meetings

Types of General Shareholders' Meetings

The ordinary General Shareholders' Meeting is the meeting that must be held within the first six months of each financial year (or earlier if so established in the articles of association), in order at least to review the management of the company, approve the annual accounts for the previous financial year and decide on the allocation of the result. This

content is exclusive to the ordinary general meeting. The ordinary general shareholders' meeting may also decide on any other matters.

Extraordinary shareholders' meetings will be all those that do not have this annual periodical character and the content reserved to the ordinary General Shareholders' Meeting.

Calling General Shareholders' Meetings
There are two ways of calling the General Shareholders' Meetings in Spanish companies:

- at universal shareholders' meeting where all shareholders are present or represented, and unanimously agree to constitute a universal shareholders' meeting with an agreed agenda; and
- by the directors of the company, either directly or at the request of shareholders holding at least 5% of the company's share capital, complying with certain legal formalities.

In addition, if the ordinary General Shareholders' Meeting or the General Shareholders' Meetings set out in the articles of association are not called within the corresponding legal or statutory established period, they may be called, at the request of any shareholder and following a hearing of the directors, by the Judicial Secretary or Commercial Registrar of the registered office.

Location of General Shareholders' Meetings
Unless otherwise provided in the articles of association, the General Shareholders' Meeting shall be held in the municipality where the company has its registered office.

Shareholders have a right to attend to the General Shareholders' Meeting in person or duly represented. Directors have a duty to attend.

Quorum
In the case of Public Limited Companies, the general meeting shall be validly held at first call if the shareholders that are either attending or represented by proxy hold at least 25% of the subscribed voting capital (the articles of association of the company may establish a higher quorum). If at first call the referred quorum is not met, there shall be quorum to hold a second meeting whatever the capital present or represented, unless the articles of association require a specific quorum, which must be lower than the quorum set for meeting at first call.

As opposed to Public Limited Companies, Private Limited Companies do not have a quorum for meetings to be valid.

Regime for the Approval of Resolutions
The resolutions adopted by the General Shareholders' Meeting that meet the legal requirements are binding on all shareholders even if they did not attend or voted against them.

The resolutions must be adopted by the legal majorities or provided for in the articles of association, which cannot require unanimity.

Please refer to **3.3 Decision-making Processes**, above for information on the specific majorities required in each type of entity for the adoption of resolutions.

5.4 Shareholder Claims

According to the Spanish Law, corporate resolutions that are against the law, contrary to the articles of association or the regulations of the General Shareholders' Meeting, or that harm the corporate interest for the benefit of one or more shareholders or third parties, can be challenged. Harm to the company's interests also occurs when the resolution, even if it does not cause any damage to the company's assets, is imposed in an abusive way by the majority. It is understood that the resolution is imposed in an abusive way when, without answering a reasonable need of the company, it is adopted by the majority in its own interest and to the unjustified prejudice of the other shareholders.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Any shareholder (individual or legal entity) acquiring or transferring (whether directly or indirectly) shares with voting rights in a listed company must report such transaction if, as a result of the transaction, the percentage of voting rights held by the transferor or the acquirer reaches, exceeds or falls below any of the following thresholds: 3%, 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 60%, 70%, 75%, 80% and 90%. However, these percentages shall be replaced by 1% when the reporting party is resident in a tax haven or in a country or territory where there is no taxation or where there is no effective exchange of tax information.

Moreover, in the case of a public offer to acquire securities, the shareholders of the offeree company who acquire securities that attribute voting rights must notify the CNMV of such an acquisition when the proportion of voting rights in their possession reaches or exceeds 1%.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

At the end of the financial year, the company must draw up and approve its annual accounts, which shall comprise the balance sheet, the profit and loss account, a statement of changes in net assets for the financial year, a cash flow state-

ment and the annual report. These documents constitute a single document.

The drawing up of the annual accounts corresponds is carried out by the management body as part of its general powers to manage the company. Approval of the accounts takes place at the General Shareholders' Meeting.

In addition to these obligations, listed companies have specific obligations, as mentioned in **2.1 Key Rules and Requirements**, above.

6.2 Disclosure of Corporate Governance Arrangements

Since the approval of Law 11/2018 of 28 December, which amends the CCo, the LSC and the Auditing Accounts Act, in matters of non-financial information and diversity, a statement of non-financial information, individual or consolidated, must be disclosed by companies that:

- have an average number of employees (either within the company or the group of which it is part) during the financial year of more than 500; and
- are either considered public interest entities or, on the closing day of two consecutive financial years, meet on an individual basis or consolidated, meet at least two of the following three thresholds:

  (a) total assets exceeding EUR20,000,000;
  (b) net annual turnover exceeding EUR40,000,000; or
  (c) an average number of employees during the financial year exceeding 250.

Companies failing to meet any of the requirements referred to above for two consecutive financial years shall cease to be obliged to disclose this statement of non-financial information.

Three years after the approval of this law, the obligation to disclose a statement of the non-financial information shall apply to all companies with more than 250 employees which are either considered to be entities of public interest (with the exception of small and medium-sized companies) or, for two consecutive financial years, at the end of the financial years in question, meet at least one of the following thresholds:

- total assets exceeding EUR20,000,000; or
- net annual turnover exceeding EUR40,000,000.

The statement of non-financial information shall mainly include:

- detailed information on the current effects and of the company's activities in the environment, health, safety, use of natural resources, and renewable energies or pollution;
- measures taken to ensure the right to work, gender equality, fundamental conventions of the International Labour Organization, working conditions, social dialogue and respect for workers' rights;
- information on the prevention of violations of human rights and international covenants and partnerships in this field and the measures to implement and prevent them;
- information on existing instruments for fighting against corruption and bribery; and
- information on the due diligence procedures applied by the company, where relevant and proportionate, in relation to its supply chains.

There are also specifications for listed companies in this case. In this sense, the CNMV requires listed companies to disclose general information about the company (such as communication channels with shareholders, shares and share capital, dividends, public offerings for the sale and admission of securities, takeover bids, shareholders' agreements), as well as economic, financial and corporate governance information, on their websites.

Information on corporate governance shall include the internal governance regulations (regulations of the general meeting and of the board of directors, internal rules of conduct), notices and agendas of general meetings, full texts of the proposed resolutions to be adopted and of the documentation available to shareholders for holding general meetings and remote proxies and voting, requests for information or clarifications requested by shareholders, information on the evolution of general meetings, composition and other information relating to the internal governing bodies, Annual Report on Corporate Governance and the remuneration of directors. Companies must also make all information available to shareholders through a forum.

All price-sensitive information will be disclosed immediately by companies through the publication of relevant facts (*hechos relevantes*).

6.3 Companies Registry Filings

Spanish companies must register with the Commercial Registry, inter alia:

- the incorporation of the company, which will necessarily be the first registration;
- the modification of the corporate contract and the articles of association, as well as share capital increases and reductions;
- extension of the term of the company;
- the appointment and removal of directors, liquidators and auditors – likewise, the appointment and removal of the secretaries and deputy secretaries of the collegiate management bodies, even if they are not members of the same, must be registered (the registration shall include

both the full members and, where applicable, the alternates);
- general powers of attorney and delegations of powers, as well as their modification, revocation and substitution;
- the opening, closing and other acts and circumstances relating to branches;
- the transformation, merger, spin-off, partial rescission, dissolution and liquidation of the company;
- the designation of the entity in charge of keeping the accounting record in the event that the securities are represented by means of book entries;
- suspension of payments and insolvency, and administrative intervention measures;
- judicial or administrative resolutions, in the terms established in the Spanish Law;
- the issuance of bonds or other negotiable securities, grouped into issuances, carried out by Public Limited Companies or authorised entities, and other acts and circumstances relating thereto; and
- the registration of the admission and exclusion of any class of securities for trading on an official secondary market is also mandatory.

These events are public and can be consulted in the Commercial Registry, as well as in other public registers in the case of listed companies.

7. Audit, Risk and Internal Controls

7.1 External Auditors

According to Spanish Law, the annual accounts and, if appropriate, the management report of the companies, must be reviewed by an auditor. However, a company is not obliged to do so when, on the closing date of two consecutive financial years, it meets at least two of the following requirements:

- the total of its assets does not exceed EUR2,850,000;
- the net amount of its annual turnover does not exceed EUR5,700,000; or
- the average number of employees during the financial year does not exceed 50.

In addition, in the first financial year since their incorporation, transformation or merger, companies are exempt from the obligation to be audited if, at the end of said financial year, they meet at least two of the three circumstances stated above.

The relationship with external auditors and companies is subject to the Auditing Accounts Act, its implementing regulations, as well as the auditing, ethics and independence and internal quality control standards for auditors and audit firms.

7.2 Management Risk and Internal Controls

The mandatory duties imposed on directors under Spanish Law are:

- diligent fulfilment – with adequate dedication – of the specific duties imposed by the laws and the articles of association of the companies;
- the specific duty to demand (and the right to obtain) from the company the adequate and necessary information that will help to comply with its obligations; and
- adoption of the necessary measures for the good management and control of the company.

It is also important to note that, in the case of companies with significant assets, turnover and organisational structure, the Spanish Criminal Code requires directors to appoint a body (committee or delegated official) specifically responsible for internal control in the exercise of their function of adopting and executing organisational and management models that include appropriate monitoring and control measures to prevent crime.

In terms of internal control, the Spanish legal framework also makes certain specifications for listed companies in this way.

Listed companies are required to describe in the Annual Corporate Governance Report their policy of identifying and controlling general risks and reporting on the degree of compliance with the recommendations of the Good Governance Code of Listed Companies.

Moreover, the audit committees must be familiar with the process of preparing financial information, the internal control systems and supervise the internal audit function.

In addition, the external auditors must evaluate the internal control systems to determine the scope, nature and timing of the audit tests to express their opinion on the financial statements. At the end of their work, they shall report significant internal control weaknesses identified to management and the audit committee of the audited companies.

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