NEW ACT AIMS TO FOSTER GREATER CORPORATE TRANSPARENCY - ROCA JUNYENT

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Category: Corporate

On 3 December, 2014, Law 31/2014 (the 'Act'), which modifies the Corporate Enterprises Act to improve corporate governance was approved. The Act, which was published in the Official State Gazette on 4 December, became effective – with the exception of the specific instructions for certain precepts of its transitional provision – on 24 December, 2014. One of its main objectives is to foster transparency in corporate enterprises and improvements in corporate governance. In this way, the legislator tries to generate value in companies, improve economic efficiency, and strengthen the confidence of the investors.

One of the aspects that has generated most discussion because of its practical transcendence is, without a doubt, the modification of the directors' remuneration rules.

First, the reform intends to guarantee the shareholders' ability to control the directors' remuneration and the sufficient transparency of those payments; and at the same time, make the directors' remuneration adequate in the market in which the company is operating and in accordance with its financial situation at all times.

Innovations implemented by the reform in the Act in the field of payments to directors, can be summarised as follows:

- Firstly, the legislator provides the General Shareholders' Meetings of the corporate enterprises with additional competencies in this field (for example, the General Shareholders' Meetings is able to establish the distribution of the payments among the different directors; but, if they do not do so, that duty is left to the actual directors or to the board of directors by default, considering the duties and responsibilities attributed to each board member).
- The legislator expressly lists, among others, possible remuneration systems which will be set forth in the Articles of Association: i) fixed allocation; ii) attendance *per diems*; iii) profit participation, and so on. However, other remuneration systems are allowed, except for those expressly listed (for example, payment in kind). In this regard, it is necessary to determine one or more specific remuneration systems, so that in any case their choice or the option selected as the different remuneration systems, which may be cumulative, but not alternative, is not left to the General Shareholders' Meeting's will.
- It is required that the general shareholders' meeting approves the maximum amount of the annual directors' total remuneration; one maximum amount that will remain in force as long as it is not modified by the general shareholders' meeting (217.3 LSC). Likewise, when several remuneration systems are set forth in the Articles of Association, the referenced "maximum limit set by the general shareholders' meeting" will need to be understood by each one of them as, if the referenced limit was as a total, it would be possible to alternatively apply the systems provided in the Articles of Association by concentrating the entire retribution in only one of the systems, which exhausts the maximum and leaves the other without contents.
- The remuneration of the executive board members is especially regulated, applied to cases in which the company's administration body is the Board of Directors. With regards to that remuneration, the legislator establishes the following: i) it is up to the board of directors, applying the principles of proportionality and reasonableness; ii) it is compatible with what they may receive in their position as such; or with the gratuity of the managing position in their position as such; iii) it applies when a member of the board of directors is named Chief Executive Officer "or has had executive functions attributed to him/her by virtue of another title" (for example, a board member who has been delegated directing duties and who directly reports to the board of directors or to any of its members); and finally, iv) demands the execution of a contract between the Chief Executive Officer and the company.

The execution of the contract referenced in the preceding paragraph is precisely the most controversial one of the developments raised among legal advisors of corporate enterprises; to the point of becoming the most recurring question in the different discussion forums organised by the different law firms and business organisations following the enactment of the reform. We have captured below our conclusions on the legal obligation of signing the referenced contract:

a) The contract between the executive director and the company must be approved by the board of directors by the vote of two-thirds of its members.
b) The executive director must abstain from deliberating and voting.
c) In that contract, all the concepts by which the executive director may receive a retribution for performing executive duties must be outlined, including, where appropriate, the eventual compensation for the anticipated cease in those duties and the amounts to be paid by the company on account of insurance premiums or contributions to savings systems.
d) The director may not receive any retribution for performing executive duties when the amounts or concepts are not provided for in said contract.

Notwithstanding the above, one of the most controversial issues has been if a contract should or should not be celebrated in cases where the exercise of the executive duties are free. Well, in our opinion, the execution of that contract does, in fact, result in it being necessary, as its object and content will not only be the remuneration, but other aspects as well, such as the faculties delegated and the manner in which they will be exercised. In any case, we are not dealing with a peaceful topic and some authors consider it will not be necessary to execute a contract in the case of performing executive duties for free. Some registrars have been demanding an answer on compliance after singing the referred contract to register the appointment of the Chief Executive Officer or the persons empowered with broad faculties. This criterion is being widely discussed by some authors when considering that the violation of the signing of the contract does not render the appointment as ineffective.

In depth, another one of the recurring questions in those forums relates to what happens with the appointments celebrated prior to the reform becoming effective. From a business point of view, since we are dealing with a new requirement, we consider it would not be essential to celebrate a contract in order for the appointment to be valid. However, our recommendation is to execute the contract – if it has not been done yet – among the counselor and the board of directors for their approval with the requirements demanded by the new Act, that is, with the reinforced majority of two-thirds and non-participation in the debate and vote of the affected board member.

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