RESTRICTION OF VOTING RIGHTS IN LISTED COMPANIES UNDER THE NEW SPANISH COMPANIES ACT - ALLEN & OVERY

Posted on 30/11/2010

Category: Capital Markets

The Royal Legislative Decree 1/2010, dated 2 July, which approves the Consolidated Version of the Companies Act (the Spanish Companies Act), has integrated in a single text the former rules governing Spanish Joint Stock Companies, Limited Liability Companies and the limited partnerships by shares.

The explanatory statement of the Spanish Companies Act indicates that the Act is provisional in nature and will be updated and substituted with a complete regime for Spanish corporations in the near future.

Therefore, the Spanish Companies Act has consolidated rather than implemented changes to the former regulations. Notwithstanding this, article 515 of the Spanish Companies Act contains a new rule which renders null and void the quantitative limitation of voting rights (typically 10% per shareholder) included in the by-laws of many Spanish listed companies. Although the Spanish Companies Act entered into force last 1 September 2010, article 515 will not come into force until 1 July 2011.

The approval of this rule has been controversial. Among the arguments in favour of the new rule are, of course, those of proportionality and democracy. An example, if I own 20% of the share capital of a company, why would I not hold the same percentage of voting rights? This argument is also supported by those who accuse directors of failing to truly represent the shareholders and of spending efforts on defending their own positions and generous remunerations rather than managing the affairs of the company. In fact, the Corporate Governance Code (*Código Conthe*) already supports these voting limitations.

But things are not quite that simple for many reasons. Proportionality is not a dogma, even within the context of parliamentary elections. The "*one man, one vote*" principle is sacred in theory. After all, this is the core of the principle of equality, which is essential to a constitutional state. However, even where such principle is expressly stated in the Spanish Constitution, the system provides for a multitude of exceptions and qualifications. For instance, in Spanish general elections a vote in Soria is worth about 100 times more than a vote in Madrid or Barcelona due to rules of proportionality.

At a company law level and, more particularly, in respect of listed companies, a number of questions are worth mentioning. First, if the purpose of article 515 is to ensure that directors may not put their own (or third parties') interests above those of the company, it would be much better to apply corporate governance rules rigorously. This is difficult to reconcile with any proportional system, but it is not the only point to consider. For a long time now, legislators have considered that in order to govern or "*control*" a company, a specific takeover bid should be launched to defend those shareholders who, whatever the size of their holdings, do not participate in management decisions.

Obviously, it is very difficult to define control purely in percentage terms. In Spain, it is understood that a company can be governed effectively without the need to own 50% of its share capital and thus lower figures are considered. However, setting control at a 30% threshold is as conventional as deciding on higher or lower figures. Legislators themselves realised that this rule is not sufficient, and as a result, a second rule was enacted whereby control is placed on those who are able to appoint the majority of the company's directors. But even in this case, the reality supersedes any rule expressed in abstract terms.

Considering the above, which shareholders are affected by article 515 – most probably, those shareholders owning between 10% and 30% of the share capital who (for whatever reason) do not participate in the company's management as they might wish to. Such shareholders may well have bought their initial stake in contemplation of a takeover bid, but then lost the strength to continue with the intended acquisition.

Such shareholders, affected by the limitation of voting rights, are in an apparently contradictory position: they are the biggest stakeholders in the company, yet since they hold a minority position in terms of the share capital as a whole, they are excluded from the board of directors; they are important shareholders, yet they do not exercise any control. They are in an uncomfortable grey area.

This is an issue with no easy solution. Limitations of shareholder voting rights in the by-laws (which, incidentally, do not only exist in Spain) may be criticised and are in fact controversial everywhere. But the analysis cannot be made without taking into account how much progress has been made in the areas of corporate governance and compulsory takeover bids. It is from this broad perspective that the controversial content of article 515 shall be judged. Even if article 515 seeks to defend proportionality and democracy in listed companies, the proposed amendment still does not appear very realistic and effective in its purpose.

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