THE BOARD OF DIRECTORS OF NON-LISTED COMPANIES IN SPAIN

1.- Introduction

The managing body of a company can adopt different forms: a sole director; various members acting jointly and severally, or jointly; or a Board of Directors. The managing body of a company, no matter which of the aforementioned forms it adopts, shall manage and represent the company. The managing body of a company organises and manages the company, in its internal sphere, determining the policies and strategies that the company will follow and in its outer sphere representing the company before third parties. Therefore, the managing body of a company has different purposes that shall be developed with due diligence and responsive to the company's interests.

The Shareholder's General Meeting shall determine which shape will the managing body adopt.

In this article, we are going to approach how the Board of Directors works in non-listed companies, both limited liability companies and public limited companies, and the differences there exist between these two types of companies.

2.- The Board of Directors

The Board of Directors is one of the forms that the governing body of a company can adopt (art. 242 Companies Act). The Board of Directors is a collegiate body, which implies that the Board of Directors shall only act by the majority, therefore the members of the Board of Directors cannot decide anything individually, meaning that any decision shall be approved by at least the majority of its members. The fact that the Board of Directors is a collegiate body, implies several formalities as well when it comes to the call of the Board and to adopt any decision.

The company's bylaws shall foresee the functioning of the Board of Directors, mainly in the case of limited liability companies, as the Board of Directors of public limited companies is acknowledged to develop its own internal regulations.

2.1.- Composition of the Board of Directors

The bylaws of the company, besides deciding which form will the managing body of the company adopt, its composition and organisation, should establish some basic ground rules of its functioning.

The bylaws of the company should establish how many members will the Board of Directors have, both the minimum and the maximum. As a mandatory rule of the Companies Act, the Board of Directors shall have no less than three directors, in both cases, limited liability companies and public limited companies (art. 242.1 Companies Act). The Board of Directors, only in limited liability companies may have no more than twelve directors.

It is advisable that the Board of Directors is composed of an odd number to avoid the paralysation of the body and ties that might result from the voting.

Once the directors of the Board have been elected, the positions of the Board of Directors shall be distributed among its members, such distribution shall correspond to the General Meeting or to the Board of Directors itself, according to what has been determined in the company's bylaws.

The Board of Directors is composed by:

- **President**: the president calls the Board of Directors and chairs the meetings. Among its tasks, gives approval to the certifications issued by the secretary, signs the Board minutes, receives any communication and notification addressed to the company, and holds the presidency of the Shareholders' General Meeting.

- **Secretary**: together with the president, is in charge of preparing the Board's meetings, drafting the minutes of the Board, issuing the Board agreements and executing notarial deeds.

- **Members**: they do not have specific functions, but still, they can request the call of the Board, take part in the meetings and include in the record its intervention or its opposition to the Board's agreements, etc.

There are other possible positions such as vice-president or vice-secretary, that will only intervene or act whenever the president or the secretary are absent.

2.2.- Election and appointment of the Directors of the Board

The procedure to elect and appoint the members of the Board changes from limited liability companies to public limited companies:

a) Limited liability companies

The Shareholders' General Meeting has the exclusive competence for appointing the directors of the Board. Once the shareholders have voted, the elected members shall accept its appointment, so that its appointment is valid and effective. Once accepted, the appointment shall be registered in the Mercantile Register.

It is important to take into account that the appointed members cannot be bound by legal incompatibility.

b) Public limited companies

Just like it happens in limited liability companies, the shareholders elect the members that will form the Board of Directors, however, there are two different proceedings to appoint its members:

b.1) Proportional representation (art. 243 Companies Act)

The proportional representation system entitles minority shareholders to appoint members of the Board of Directors, this way it is possible to ensure that minority shareholders are duly represented in the Board of Directors.

This mechanism allows the shares with a right to vote to come together with the aim to appoint exclusively a proportionate number of members to the grouped shares. The Companies Act foresees that "*shares that are voluntarily grouped to constitute share capital amounting to or exceeding the sum resulting from dividing the capital by the number of members of the Board of Directors, shall be entitled to designate the number of members deduced from the proportion of share capital so grouped*". So, for example, in a public limited company with an equity capital of 1.000.000 euros and that has 10 members of the Board of Directors, every 10.000 euros that come together as shares, it will be possible to appoint a member.

This mechanism improves the position of minority shareholders with regard to the position of majority shareholders. We must remember that the Board of Directors manages and represents the company, in which there are minority shareholders. However, the fewer members of the Board there are to elect, the more difficult will be for the minority shareholders to group enough shares to elect a member.

To dismiss the directors elected by the minority according to the proportional representation system, there still must exist just cause, just like the Supreme Court established in the case of Iberdrola, S.A.: "*to dismiss the members elected by minority shareholders, it is necessary the existence of just cause, after evaluating the particular circumstances of the case, to avoid emptying the right of minority shareholders*" (Court decision of the Spanish Supreme Court number 609/2014, 11 November)

b.2) Election by co-optation

The election by co-optation attributes the Board of Directors to appoint the members of the Board to fill vacancies when there are no predetermined substitutes.

This system is an exception to the general rule that the Shareholders General Meeting is the one to elect the members of the Board.

The appointed director by the co-optation system has to be a shareholder (not bound by any legal incompatibility) and will stay in that position until the next General Meeting– ordinary or extraordinary–, that shall ratify or dismiss the shareholder, having to elect a new member to fill such position.

The appointment of a member of the Board according to this system will have to be registered in the Mercantile Register, being necessary the previous acceptance of the appointed member (arts. 138, 139 and 141 Regulation of the Mercantile Register).

2.3.- Internal functioning rules of the Board of Directors

As a rule, the bylaws of the company will rule the internal functioning of the Board of Directors, such as the deliberation and the way to adopt the Board's agreements, however, the internal functioning of the Board of Directors changes from limited liability companies to public limited companies. Different from the Board of Directors of limited liability companies, the Board of Directors of public limited companies is acknowledged to have its own internal regulation.

The Law foresees that the bylaws of limited liability companies determine the organisation and functioning rules of the Board of Directors, including the rules for the call and constitution of the Board, the way to deliberate and adopt the decisions by majority agreement of its members (art. 245.1 Companies Act).

The bylaws of public limited companies may as well include the internal functioning rules of the Board of Directors, but in the case that the bylaws do not regulate it, the Board of Directors itself can regulate its own internal functioning (art. 245.2 Companies Act). In such a case the internal regulations shall determine the rules to call and constitute the Board, the way to deliberate and adopt decisions, therefore the Board of Directors of a public limited company will have its own internal regulations.

The Board of Directors, as we have explained before, is a collegiate body, which means that to adopt any decision it is necessary to follow several formalities, regarding the call, the deliberation, and the voting of the decision. That implies that the Board of Directors acts as a whole, and its decisions are adopted by majority agreement of its members. The Board of Directors must at least meet on a quarterly basis.

a) Calling the Board's meeting (art. 246 Companies Act)

The Board of Directors' meeting has to be convened by the president. However, in the case that the president does not call the Board, the members that represent at least a third of the members of the Board may call the Board, if they have previously requested the president to call the Board, and the president had not called it within a month.

The fact that the call of the Board has to be done accordingly to the established legal procedure is important, given that it "*is necessary the prior call of the Board of Directors so that the Board can adopt its decisions because without the prior call of the Board, the Board's will not be valid*" (Court decision of the Appeal Court of Madrid number 46/2009, 6 of march)

There are, however, exceptional situations in which the confrontation among the members of the Board, may require calling the Board without the intervention of the president or without the established legal procedure. The Spanish case law has determined that the call of the Board by the rest of the Board members, can only be done to unblock the Board of Directors. The Supreme Court, says the Court decision of the Appeal Court of Madrid, "*admitted that the call of the Board of Directors shall be done by the rest of the members of the Board, formalised by the secretary and calling the president, giving a more flexible interpretation of the call the board to unblock*" the confrontation between the president and the rest of the Board members.

Lastly, regarding the faculty to call the Board of Directors, it is allowed that the company's bylaws may include more favourable provisions for the rest of the members to call the Board, but the bylaws cannot limit the recognised faculty in the law to call the Board (Resolution of the Directorate General of Registries and Notaries of 11th of July 2012).

b) Constitution of the Board of Directors (art. 247 Companies Act)

The decisions adopted by the Board of Directors are subject to the Board being validly constituted. The minimum quorum required for both limited liability companies and public limited companies, is the majority of its members present or duly represented.

The bylaws of the company of a limited liability company may provide for a higher quorum, for example, the bylaws of the company may require the majority plus one.

The calculation of the majority must be made on the basis of the number provided in the company's bylaws, and not on the basis of the number of directors with a valid mandate at the time of the constitution.

The attendance at the meeting by the members of the Board is an obligation implicit in the duty to perform diligently (art. 225 Companies Act). The Directorate General of Registries and Notaries has established that "*different from the shareholder that has the right to attend the general meetings, a member of the Board not only has the right to attend but has the obligation to attend the meetings of the Board. That is why unjustified non-attendance to the Board's meetings can constitute a serious fault of the member's duties and shall bear responsibility, that will be enforceable through the exercise of social or individual liability actions*" (Resolution of the Directorate General of Registries and Notaries of 7 of October 2013).

c) Adoption of agreements

The bylaws of limited liability companies shall foresee the way to deliberate and adopt the agreements by the majority of the members of the Board of Directors. Therefore, the bylaws of limited liability companies shall state that the Board's agreements have to be adopted by the majority notwithstanding the possibility that some agreements have to be approved by an enhanced majority.

On the other hand, the adoption of agreements in public limited companies require the absolute majority of the members attending the meeting, that is half plus one of those present members, notwithstanding that the bylaws foresee that some agreements have to be approved by an enhanced majority of its members. Agreements may be validly adopted in writing and without holding a meeting, provided certain requirements are met, and if none of the members oppose to it.

In both cases, it is not valid to require that agreements have to be adopted by unanimity, given that unanimity would distort the collegiate nature of this body, which shall adopt any agreement by the majority of its members.

Limited liability companies and public limited companies require that any agreement regarding the delegation of faculties from the Board of Directors shall be approved by the enhanced majority of its members.

Even though the Board of Directors adopts its decisions by the majority, does not mean that such agreements cannot be challenged, due to relevant causes.

If by any chance there is a tie, it shall be understood that the agreement is not adopted. In these situations, and if the company's bylaws foresee it, it is possible to give the president of the Board a qualified vote to break the draw (Resolution of the Directorate General of Registries and Notaries of 27 of April 1989).

2.4.- Delegation of faculties

The management of a company requires agility in the decision making. This will not be possible when the Board of Directors is composed of a high number of members, slowing down the decision-making process and the Board of Directors will no longer be able to manage the company in its internal sphere or represent the company.

The Law foresees the possibility to delegate certain faculties with the aim to streamline the management of the company. To this end, the law provides that one or several members of the Board may be appointed to be at the same time managing directors or creating executive committees.

The delegation of faculties shall be done through a contract, that will include the limitations and functions of the delegation.

There are some specific functions that exclusively correspond to the Board of Directors. The law foresees a quite exhaustive list, but most of them are regarding the own internal functioning of the Board of Directors, the definition of the company's policies and strategies to follow, authorizing or discharging the obligations derived from the duty of loyalty, and calling the shareholders' general meeting, etc.

3.- Conclusion

The functioning of the Board of Directors of a company highly depends on what the bylaws of the companies establish, in the case of limited liability companies, and on what is established in the internal regulation of the Board of Directors in the case of public limited companies. This way, the Companies Act shall have a supplementary character that shall cover those aspects that the bylaws do not.
It is remarkable the formalities there exist in the functioning of the Board of Directors, mainly procedural formalities that need to be strictly followed– call of the Board, constitution, deliberation and adoption of agreements– following such procedures is essential to determine that the agreements adopted by the Board are valid.

Down-below find a table with the existing differences between limited liability companies and public limited companies in the composition and functioning of the Board of Directors.

<table>
<tr><th></th><th colspan="2">THE BOARD OF DIRECTORS</th></tr>
<tr><th></th><th>LIMITED LIABILITY COMPANY</th><th>PUBLIC LIMITED COMPANY</th></tr>
<tr><td>Number of members</td><td>Minimum: 3
Maximum: 12</td><td>Minimum: 3</td></tr>
<tr><td>Appointment of members</td><td>Agreement of the Shareholders General Meeting</td><td>- Agreement of the Shareholders General Meeting
- Proportional representation (minority shareholders)
- Election by co-optation (vacancies)</td></tr>
<tr><td>Internal functioning</td><td>Bylaws of the company</td><td>- Bylaws of the company
- Internal regulation</td></tr>
<tr><td>Calling the Board's meeting</td><td colspan="2">- President
- The rest of the members, previous requirement to the president</td></tr>
<tr><td>Constitution</td><td colspan="2">The Board shall be validly constituted when the majority of its members are present or represented</td></tr>
<tr><td rowspan="2">Adoption and voting</td><td>Agreements shall be adopted by the majority of its members, notwithstanding that the bylaws foresee the enhanced majority to adopt specific agreements</td><td>Agreements shall be adopted by the absolute majority of its members, notwithstanding that the bylaws foresee the enhanced majority to adopt specific agreements</td></tr>
<tr><td colspan="2">- The enhanced majority is required to adopt those agreements regarding the delegation of faculties from the Board of Directors
- It is not valid to require the unanimity of the members
- If there is a tie in the voting and if the bylaws foresee it is possible to give the president a qualified vote</td></tr>
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