Companies Act Amendment (Corporate Governance) Bill

The resistance of shareholder meeting resolutions to "breaches of procedure" within the proposed changes to the Spanish Companies Act

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A salient feature of the proposed changes to the Companies Act (CA) is the legislature's intention of limiting the circumstances in which a shareholder meeting resolution may be contested. But are all the articles of the amending Bill consistent with the aforementioned purpose?

I. Contesting resolutions and causal relevance of breaches of procedure. Introduction.

1. In the current legislative structure there is an automatic correlation between a "breach of procedure" and the standing to contest the resolution affected by such breach. The most abundant examples of (mostly unsuccessful) challenges are precisely of the kind where the contestant was not provided with the information he believed to be due before or during the meeting. A breach of the rules on convocation, quorums and majorities can give standing to contest, and the determination of the court decision on the merits of the case does not hinge on the "breach of procedure" being causally adequate to produce a negative outcome for the shareholder or, at the very least, an outcome other than that which would have been the case if the procedural requirement had been observed. Challenges often degenerate into opportunistic strategies which, through an annulment, attempt to restore a situation that would not exist for the shareholder in any hypothetical lawful procedure.

2. The proposed changes do not go so far as to produce a rule by virtue of which any resolution shall be deemed valid when the outcome resulting from such resolution would have been the same had an alternative lawful course of action been followed. This "iron law" of the absolute resistance of a resolution supported by the majority is not assumed by the Bill, but I will discuss how far the rule goes down this path. As we shall see below, the changes as a whole are inconsistent.

3. The four events listed in art. 204(3) of the Bill, according to which the annulment fails, are enunciated with abstract legal concepts that are inexplicably divergent and at times excessively vague, all of which will lead to even more litigation than there already is.

II. The "mere breach of procedural requirements"

4. According to art. 204(3)(a), "mere" breaches relating to the convening and constitution of the body, the adoption of resolutions and the rules (unless essential)

on the constitution of the body or the majorities necessary for a resolution shall not constitute grounds for annulment. Breaches relating "to the method and notice period of the call" and any other rule of relevance are excepted.

5. This provision should be deleted in the legislative passage on account of the numerous third-party litigation costs, plus the costs of loss of legal certainty, it would create. Are there *essential* rules (on constitution or majorities) and *relevant* rules? Can one such characteristic occur without the other? Can an essential rule not be relevant in a particular case, as may well be the case of an erroneous calculation of majorities or a failure to comply with notice periods if the shareholder had otherwise already been informed? Moreover, breaches relating to "the method and notice period of the call" are identified in practice as less relevant and less essential. Case law reveals that breaches relating to a failure to comply with rules concerning the method of convening end up being discussed from the correct standpoint of abuse of rights by the company or the shareholder, not the "essentiality" of the method requirement; i.e. in principle, there are no "essentialities". Also questionable is whether the procedural rule is "relevant" provided it can be abstractly regarded as an "important" rule of the corporate legal system or if it further requires *de facto* relevance ["decisive" in the case of point (d)] to produce the resolution in question.

6. The extensive case law in this area – apparently unknown by the authors of the proposed changes – makes it advisable to replace this terminological scramble with a much cleaner rule. Namely, the rule that no annulment would lie where the inobservance of procedural requirements could have been subsequently rectified upon notice or complaint from the shareholder who failed to give such notice or make such complaint when able to do so (cf.. art. 206(5) of the Bill) nor shall the contest lie when the breach of procedure has not adversely affected the interest that was sought to be safeguarded, or, ultimately, where respecting the shareholder's right of participation, the outcome produced by the vote would not have differed in the absence of the breach in question.

III. Breach of duty to provide information

7. According to art. 197(5) of the Bill, a breach of the right to information "provided in paragraph 2" (information required when holding the meeting of shareholders) – therefore, not the right relating to information to be provided prior to the meeting – gives standing for an action for specific performance (delivery of the information) and, where appropriate, compensatory damages, but will not be grounds to challenge "the general meeting". Note that art. 197 is not a rule related to the contesting of company resolutions, which belongs in art. 204.

8. The rule appears to collide with art. 204(3) (b) of the Bill. According to the latter, the incorrectness or inadequacy of the information provided in "response" to the exercise of the right of information, does not constitute grounds for contesting the relevant resolution, unless the information "would have been essential for the reasonable exercise by the average shareholder of voting rights or any other rights of participation." There is a clear reference too to the exercise of the right to information in art. 197(5)(2) (that requested in the meeting itself), but also includes the case of information requested before the meeting, omitted by art. 197(5).

9. According to art. 197(5), in no event a breach of the right to information would be grounds to impugn the company resolution. According to art. 204(3)(b), such breach would be ground to challenge if incorrect or omitted information had been "essential" for an average shareholder to "reasonably" exercise his right to vote. This inconsistency might be remedied proposing that art. 197(5)

refers – as textually expressed – to the annulment of the meeting as such, while art. 204(3)(b) refers to the annulment of the resolution. Alas it cannot be done so, as the meeting is not as such a legal transaction and therefore is not subject to annulment outside the resolutions passed therein.

10. Furthermore, neither of the rules adequately addresses the problem in question. It is reasonable that if the "breach of procedure" was causally decisive in a resolution that otherwise would not have been passed, the breach of art. 197(5) would have to be relevant as grounds of contest. But it is not enough that the vote of the affected shareholder would have been different or, against the wording of art. 204, that the possession of such information would have been "essential" to determine the vote of an average shareholder, if such voting would have been similarly exercised if the individual shareholder in question had voted otherwise. What would have been decisive is (only) if the resolution, not the individual vote, would have been different if there had been no breach of procedure. Had it not been so, the residual, and unique, remedy is a claim for damages.

IV. The "resistance test" of the majority required for the resolution

11. Points (c) and (d) of art. 204(3) save the resolution even where individuals without entitlement took part in the voting or "one or several of the votes" turned out to be invalid or the calculation was erroneous; unless, in both cases, the breach of procedure was decisive for the valid constitution of the body (in the case of participation of persons without entitlement) or to achieve the required majority (in the case of invalid votes or erroneous calculation). Note that the sequence of points (c) and (d) does not involve separate situations. A person without entitlement may take part to constitute a quorum, and such case is found in point (c); if said person also votes, the hypothesis is now covered by point (d). That is, the "participation of non-entitled persons" will result in "invalid" votes if they vote. Here again where the required votes in an alternative procedural route without legal breaches or inobservances would have been equally achieved, the final determination of sanctioning the validity of a resolution is not reached.

12. Not summoning entitled shareholders, or not allowing them to vote, directly leads to the invalidity of the resolution, even if their votes would not have altered the outcome. Why? It would be said that the reason is that the right of participation is absolutely "resistant", even when obviously ineffective, and that the minority shareholder has a quasi-constitutional right to participate in company debates, even if his aim is always to be defeated. Although art. 204 does not formulate – should it? – this kind of quasi-constitutional right of a powerless shareholder to an irrelevant participation in organizational procedures, it is implicitly recognized in the design of the rule.

V. What happens to the information requested by qualified minority shareholders before or during the meeting?

13. Such shareholders represent at least 25% of the share capital. In this case, "the requested information may not be denied" (art. 197(4) of the Bill). Suppose that the information "that may not be denied" is denied. Will art. 204(3)(b) be applied so that the resolution is not contestable unless involving information "essential" for a "reasonable" exercise of the right to vote? Will art. 197(5) be applied without room for contest in any event, at least when it involves information requested during the meeting itself? In my opinion, arts. 197(5) and 204(3)(b) do not apply to cases of information denied to qualified minority shareholders. The resolution is contestable under normal terms.

VI. Resistance of the resolution and minority to contest

14. Regardless of the nature and extent of the breach incurred by the resolution – even if it is a resolution made with willful omission

of a shareholder whose vote would have been relevant! – the resolution resists any challenge if the shareholder(s) with an interest in the same does or do not account for 1% of the share capital [0.1% where listed, art. 495(2)(b)], according to art. 206 of the Bill. In a listed company, this rule effectively means that the minority investor is institutionally left outside the corporate game; an odd result judging by the aims of the Bill. The rule adds that the affected shareholder may claim compensation if proven that the uncontestable resolution causes a damage or loss.

15. The rule seeks to avoid the effect that complainant minority shareholders may opportunistically exercise contests in order to extract transactional payments or other extra-corporate advantages. In this sense, the aim is correct. But it has the disadvantage shared by all rules with quantitative anchoring.

16. Once the threshold in percentage terms has been surpassed, the resolution is uncontestable. Of course it is not only in the permission-to-proceed stage, i.e., under no circumstances may the contest claim be struck out as abusive. Neither is it regarding the merits. In other words, if it is proven that there are reasons rendering the resolution challengeable, may the judge dismiss the claim on the sole ground that such contest (not the resolution) constitutes an abuse of right because it involves a minority exclusively seeking an economic advantage prejudicial to the interests of the company? Does 1% [or 0.01% where listed] have a right to blackmail a final transaction with payments into private pockets?