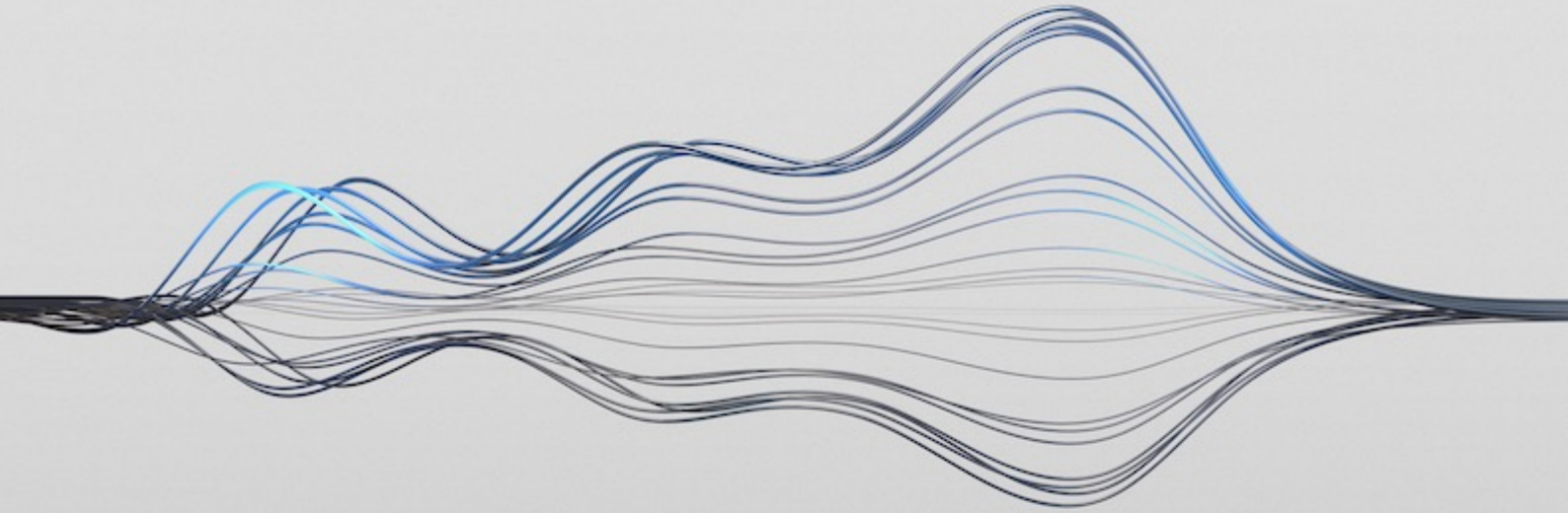
SPAIN

Global Guide to Directors' Duties



Spain

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Corporate entities

What type of company is typically used in group structures?

The most common type of company used in group structures in Spain is the limited liability company (*sociedad de responsabilidad limitada* or *S.L.*). This guide therefore focuses on the management of this type of company.

Although there are some differences with other types of companies such as joint-stock companies (*sociedad anónima* or *S.A.*) or public listed companies (*sociedad cotizada*), please note that, according to the Spanish Companies Act (*Ley de Sociedades de Capital*), most of the particular provisions applicable to limited liability companies are also applicable to these types of companies.

Types of director

What is a "director"?

Company directors are natural persons or legal entities (in the latter case represented by a natural person) who are in charge of managing and representing the company. They are responsible for making business decisions and overseeing the affairs of a company.

What are the different types of director?

Directors are appointed by the shareholders. A company may have the following types of directors:

- **Sole director.** The sole director is the sole representative of the company and therefore acts individually.
- **Multiple directors.** Either joint and several directors, each one of them can act separately and the actions carried out by one of the joint and several directors will bind the company, or joint directors, who must necessarily act jointly.
- **Board of directors.** The board of directors shall not have less than three and no more than 12 members. The bylaws may establish the number or a minimum and maximum number of members for the board of directors. In the latter case the shareholders shall determine the exact number. In addition, the board must appoint a chairperson and a secretary. If the company has a board of directors, individual directors do not have authority to bind the company unless powers are delegated to them. The board may delegate some of their functions to a managing director/CEO (*consejero delegado*) or an executive committee (*comité ejecutivo)*. Please note that a board of directors is mandatory for joint-stock companies (*sociedad anónima or S.A.*) when there are more than two directors and for public listed companies (*sociedad cotizada*).

In all cases, powers of attorney can be granted by the management body of the company in favour of other persons (subject to some restrictions).

Directors may be shareholders of the company (*consejero dominical*) or not (*consejero indepediente*).

Finally, company's directors may be *de jure*, as they are validly appointed through the procedures provided for by law and the company's bylaws, or *de facto*, by exercising its functions in spite of not have been formally appointed. Nevertheless, all of them are subject to the same duties.

Eligibility

Who can be a director?

Everybody (shareholder or not) is eligible to be a director and a director is not required to be a Spanish resident. It is possible to be a natural person or a legal entity. In the latter case, the legal entity must appoint a representative for the performance of its functions as director.

The above is the general rule. However, Spanish law establishes some exceptions for certain people who cannot be directors:

- Non-emancipated minors and judicially incapacitated persons.
- People judicially disqualified under the Insolvency Law, for the period of disqualification.
- People convicted of certain crimes.
- Those who, due to their position, cannot carry out commercial activities.
- Civil servants whose functions are related to the activities of the company.
- Judges and magistrates.
- Whoever is affected by other legal incompatibilities (e.g. auditors of the company's accounts and those engaged in the same commercial activity or analogous).

There is also a special feature specific to public listed companies (*sociedad cotizada*), whose board of directors may only be composed of natural persons.

Minimum / maximum number of directors

The number of directors shall be that specified in the company's bylaws. The company's bylaws may provide for a single management system which will be one of those indicated in What are the different types of director? (i.e. a sole director, multiple directors (two or more) or a board of directors), or establish several management systems as alternatives. In the latter case, the shareholders can, without the need to amend the bylaws, decide which of the various systems provided for in the bylaws will be effective. If a single management system has been included in the bylaws, the change from one system to another will necessarily require an amendment of the bylaws to be approved by the shareholders.

If the shareholders resolve to appoint a board of directors as the management body of the company, the following rules must be followed:

- There must be a minimum of three and a maximum of 12 directors for limited liability companies (*sociedad limitada* or *S.L.*).
- There must be a minimum of three directors, without upper limit, for joint-stock companies (*sociedad anónima* or *S.A.*).

Appointment and removal

How are directors appointed?

Directors are appointed by the company's shareholders, with effect from the acceptance of the concerned person.

The appointment of the directors, once accepted, must be filed for registration with the relevant Commercial Registry, stating the identity of those appointed and, in relation to the directors who have been assigned to represent the company, whether they can act individually or need to do so jointly.

How are directors removed?

Directors may be removed by resignation or, at any time, by the company's shareholders even if the removal is not included on the general meeting's agenda.

The removal of a director must be registered with the Commercial Registry in order to be effective against third parties.

Board / management structure

Typical management structure

A company may have the following types of management body structure:

- Sole director. The sole director is the sole representative of the company and therefore acts individually.
- Multiple directors. Either joint and several directors, each one of them can act separately and the actions carried out by one of the joint and several directors will bind the company, or joint directors, who must necessarily act jointly.
- Board of directors. The board of directors shall not have less than three and no more than 12 members. The bylaws may establish the number or a minimum and maximum number of members for the board of directors. In the latter case the shareholders shall determine the exact number. In addition, the board must appoint a chairperson and a secretary. If the company has a board of directors, directors do not have authority to bind the company unless powers are delegated to them. The board may delegate some of their functions to a managing director/CEO (*consejero delegado*) or an executive committee (*comité ejecutivo)*. Please note that a board of directors is mandatory for joint-stock companies (s*ociedad anónima* or *S.A.*) when there are more than two directors and for public listed companies (*sociedad cotizada*).

How are decisions made by directors?

The company's bylaws contain the manner in which a decision/resolution is made by the directors (in any case subject to the requirements of the Spanish Companies Act), likewise the quorum (if applicable), the deliberation process and the majority required for the adoption of these decisions/resolutions. All the decisions and resolutions of the management body are transcribed in a minutes book *(libro de actas*).

Authority and powers

Directors manage and represent the company. They are responsible for making business decisions and overseeing the affairs of a company.

The representation of the company, in court or outside it, corresponds to the directors in the form determined by the company's bylaws. In the case of a sole director, the power of representation shall necessarily correspond to them. In the case of joint and several directors, the power of representation shall correspond to each joint and several director. In the limited liability company, if there are more than two joint directors, the power of representation shall be exercised jointly by at least two of them in the manner determined in the company's bylaws.

In the case of a board of directors, the power of representation corresponds to the board itself, which shall act jointly. However, the company's bylaws may attribute the power of representation to one or more members of the board, either individually or jointly. In the latter case, the permitted scope of their actions shall be indicated.

Representation extends to all acts included in the corporate purpose defined in the company's bylaws. Any limitation of the representative powers of the directors, even if registered with the Commercial Registry, shall be ineffective against third parties. Note that the company shall be bound to third parties acting in good faith and with no gross negligence, even when it appears from the company's bylaws filed with the Commercial Registry that the act is not included in the corporate purpose.

Delegation

Powers of attorney can be granted by the management body of the company in favour of other people. Nevertheless, some functions cannot be delegated. These functions are, among others:

- The determination of the company's general policies and strategies.

- Drawing up the annual accounts and its presentation to the general meeting.
- The calling of the general shareholders meeting, the preparation of the agenda and the proposal of resolutions.

In addition, in the case of a board of directors, the board may also delegate some powers to an executive committee (*comité delegado*) or one or multiple managing directors (*consejero delegado*), unless prohibited by the company's bylaws.

Duties and obligations of directors

What are the key general duties of directors?

The main duties of directors are the following:

- A duty of care (***deber de diligencia*****).** Directors must perform their duties with the diligence of an "orderly businessman" (*ordenado empresario*) and comply with the various duties imposed by applicable law, by company's bylaws and by other internal rules of conduct of the company with this level of diligence. The duty of care includes:
  - the duty to exercise the office effectively
  - the duty of vigilance or supervision
  - the duty to be informed and
  - the duty to subordinate their particular interest to the "interest of the enterprise" (*interés de la empresa*).

  For strategic and business decisions, which are subject to business judgement, diligent conduct can be reviewed by applying the "business judgement rule" (*regla de la discrecionalidad empresarial*). Under this rule, the diligence standard is met when the director has acted in good faith, without self-interest, with sufficient information and in accordance with an appropriate decision-making procedure.
- A duty of loyalty (***deber de lealtad*****).** This duty requires the directors to exercise their functions at all times in the interest of the company. This duty of loyalty obliges the director to act in good faith and be guided by what is most favourable to the company. It includes, among others, not to exercise their powers for purposes other than those provided, to keep the confidentiality of the received information or to refrain from participating in decisions in which the director has a direct or indirect conflict of interest.

What are directors' other key obligations?

Among other obligations laid out by the Spanish Companies Act, the directors must call the general shareholders' meeting, draw up the annual accounts and file them with the Commercial Registry. They also shall, if necessary, apply for a declaration of insolvency.

Transactions with the company

With the exception of usual transactions, in standard conditions and with low relevance, directors and their connected persons or companies shall not enter into transactions with the company unless a specific exemption is generally granted by the general shareholders meeting. Please note that this is the general regime. In the special regime for public listed companies (*sociedad cotizada*) there are some particularities.

Liabilities of directors

Breach of general duties

Directors shall be liable to the company, shareholders and creditors, for the damage caused by their acts or omissions against the law or the company's bylaws or for those incurred in breach of their duties, provided that there is fraud or negligence. Guilt shall be presumed, unless proven otherwise, when the act is contrary to the law or the company's bylaws.

All the members of the management body that execute the damaging act or adopt the damaging resolution are, in principle (the opposite can be proved), jointly and severally liable.

The director shall not be exonerated from liability to the company and shareholders when the act causing the damage has been adopted, authorised or ratified by the general shareholders meeting. In addition, the liability of the directors also extends to the de facto directors. To this end, a person who actually performs the functions of a director in the business without a title, with a title that is null or extinguished, or with another title, as well as a person under whose instructions the directors of the company act, is considered a de facto director.

There are two main legal actions against directors:

- Corporate liability claim (*acción social de responsabilidad*). This action is taken by the company or by the shareholders under certain circumstances and, on a subsidiary basis, in the absence of a corporate claim by the company or by its shareholders, by creditors to compensate the damages caused to the company insofar as the company's assets are insufficient to meet their claims.
- Individual liability claim (*acción individual de responsabilidad*). This action allows the shareholders and third parties to take legal action for acts carried out by directors that directly harm their interests.

Liabilities on insolvency

Directors' liability may also exist in case of insolvency proceedings of the company and becomes particularly serious if the insolvency is classified by the judge as "guilty of fraud" (*concurso culpable*), which means that the insolvency was caused or aggravated by the wilful misconduct (*dolo*) or gross negligence (*negligencia grave*) of the company's directors (including *de facto* directors). In this case, the directors may be declared liable for the damages caused, and it could lead, under certain circumstances, to them being responsible for covering the shortfall in assets.

Other key risks

An important issue is the possible liability for company's debts (*responsabilidad por deudas sociales*): directors are jointly and severally liable for obligations arising after the occurrence of a cause for dissolution, when they have not called the general shareholders meeting within two months to adopt the dissolution or, where appropriate, when they do not apply for the judicial dissolution or the declaration of insolvency.

Personal liability for directors may, in certain circumstances, arise under Spanish legislation including liability relating to civil, employment, tax, corporate and environmental matters. In certain cases, criminal liability may arise.

Protection against liability

How can directors be protected from liability?

- Authorization. Directors may request authorization from shareholders to carry out some actions that could otherwise imply a breach of the duty of loyalty. The company may waive the prohibitions by authorising a director to carry out a specific transaction with the company, to use certain assets, to take advantage of a specific business opportunity, or to obtain an advantage or remuneration from a third party.
- Ratification. Shareholders can ratify the conduct of a director. However, ratification by shareholders does not absolve a director from any liability to a third party in relation to the matter concerned.
- Insurance. This is effected through a directors' and officers' (D&O) insurance agreement. It typically provides both cover for individual directors against claims made against them in their capacity as director, including, generally, defence costs. Policy exclusions include claims in respect of a director's fraud, dishonesty, wilful default or criminal behaviour.

What practical steps can directors take to avoid liability?

Directors should keep informed about the affairs of the company, particularly its financial position. In this regard, directors should have access to up to date financial information, prepare thoroughly for and regularly attend board meetings and familiarise themselves with key legislation affecting the business.

They should also make full disclosures to the board and shareholders if they have outside positions or interests which may give rise to a conflict of interest and/or if they have a personal interest in any proposed or existing transaction or arrangement with the company. In addition, they should also keep records and ensure that full written records of board proceedings are made reflecting the reasoning behind key decisions.

Key contacts

Jose Maria Gil-Robles
Partner
T +34 91 788 7315
jmgr@dlapiper.com
View bio

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