Company/Commercial - Spain

Cooption Mechanism for Appointment of New Directors

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Background

A number of problems arise when it comes to filling vacancies on the board of directors of a Spanish company.

The standard legal mechanism is to appoint new directors at the general shareholders meeting. This is the sovereign organ within the company with the competence to carry out such a task. On the other hand, Spanish law provides for a procedure known as cooption, which is carried out by the board of directors. This procedure is exceptional and must satisfy a series of requirements which are examined in this update, in light of the difficulties that surround them and the practical problems that they raise.

In other jurisdictions, alternative solutions are available, such as:

- the intervention of another body to replace directors who leave or to convene a general shareholders meeting;
- an obligation on directors to fill the post until a replacement is appointed; or
- the temporary appointment of an administrator to fill the vacant position.

However, under Spanish law the solution is limited to the provision of a cooption mechanism to fill board vacancies.

Cooption

Cooption is established as a faculty of the board, rather than an obligation. The law previously required that the company bylaws stipulate the mechanism for covering vacancies on the board. Nowadays, this requirement has disappeared, so the stability and continuity of the board is left to the arbitrary discretion of the bylaws. The bylaws may or may not establish procedures to ensure the continuity of the board or to cover vacancies within it. For example, the bylaws may foresee cooption as mandatory to resolve this problem or may even exclude it as a method of resolution, requiring that the remaining directors call the pertinent meeting and appoint a new director.

The faculty of cooption is set forth in Section 138 of the Corporations Act

as a solution to the situation where a vacancy arises during the term of office for which the directors have been appointed. In such event, the board of directors may appoint any shareholder to fill the vacancy until the next general shareholders meeting is held.

General Obligation

As cooption is a right which may only be employed by directors, what occurs when the bylaws do not provide a mechanism for covering vacancies on the board? Are the directors exonerated from responsibility if they do not adopt any measures to resolve the situation? The directors are subject to a general obligation to act diligently, which is the basic principle governing the conduct of those who are entrusted with the management of a company. Therefore, they must solve the problem in which a company finds itself when it is deprived of its essential leadership. The liability of a director is indisputable where that person has remained inactive in such a situation. He or she is obliged to adopt one of the measures at his or her disposal in order to appoint replacements for the former directors.

Quorum

Section 139 of the Corporations Act requires that in order for a meeting of the board of directors to be lawfully held, one-half plus one of the members must attend or be represented. This is the legal minimum; the bylaws may increase but not lower this quorum requirement. Thus, if the board meets without a quorum, the meeting is not validly constituted and thus may not adopt valid resolutions.

Therefore, an additional dilemma appears when vacancies reduce the board to a number that is less than one-half plus one of the original members. The question is whether the cooption right may be exercised if it means covering a number of vacancies equal to or greater than the majority of the board.

The exceptional nature of this situation might be resolved through exceptional solutions, such as considering the incomplete or deficiently constituted board as empowered to convene a general shareholders meeting, during which persons would be appointed to cover the existing vacancies. This is the prevailing solution under French and Italian law. Spanish law does not provide a satisfactory solution to such a situation.

Therefore, the cooption right is of little consequence in Spanish law, given that the quorum problem often arises because boards usually consist of the minimum three members. Thus, whenever a member leaves, the cooption right is automatically excluded, unless the board has more than three members, as in the case of Finantia Sofinloc Bank (formerly Esfinge Bank), Telefónica or Puleva, companies in which shareholders were recently appointed as directors through cooption. In such cases, a shareholders meeting can be called so that the shareholders may fill the board vacancies. However, a shareholders meeting would not be legitimately convened, given that it would be called following a resolution of a board which lacked the necessary quorum to adopt such a resolution.

Comment

In comparison with other systems which provide multiple mechanisms to avoid these situations and ensure the correct functioning of companies, the Spanish system suffers from rigidity due to the lack of alternative legal options available to remedy abnormal situations such as the premature departure of a board member.

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