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THE COMMERCIAL REGISTRY

FUNCTIONS OF THE COMMERCIAL REGISTRY

(i) The essential function of the Commercial Registry is to give legal publicity to certain situations and acts that affect the business persons inscribed in it. This legal publicity is conceived as an obligation imposed on the commercial business person. The fundamental objective is to provide legal certainty to commercial traffic and protect those that enter into commercial relations with the business person inscribed.

Obviously, this does not mean that all third-parties are aware of the contents of the Commercial Registry, but rather that there is a legal presumption that the information inscribed is known (given that it is publicly available) since the date of its inscription.

FUNCTIONS OF THE COMMERCIAL REGISTRY

(ii) This is not the only function ascribed to the Registry. The Registry is also charged with legalising the account books of the commercial business person (in accordance with Article 16.2 of the Code of Commerce).

(iii) The Commercial Registry, according to Article 67.1 of the Corporate Enterprises Act, is responsible for appointing independent experts to evaluate non-cash contributions made to joint-stock companies. It is also required to appoint independent experts to compile a merger report when one of the companies of the proposed merger is a joint stock company or limited partnership (Articles 34 and 78 of the Act on Structural Changes in Trading Companies Law 3/2009).

FUNCTIONS OF THE COMMERCIAL REGISTRY

(iv) The Registrar of the Commercial Registry also has the responsibility to appoint an auditor in certain cases (something we have seen before). For example Article 265.2 of the Corporate Enterprises Act determines that:

In companies that are not bound to have their financial statements audited, shareholders representing at least 5% of the share capital may apply to the mercantile registrar serving the place where the registered office is located to appoint an auditor to, at the company's expense, audit the financial statements for a given financial year within the three months following the end of such financial year.

SUBJECTS AND ACTS THAT CAN BE INSCRIBED

The Commercial Registry is a register of persons (whether physical or legal) and acts.

Subjects – Law 19/1989 considerably increased the number of subjects that could/must be inscribed in the Commercial Registry. This currently includes sole traders, trading companies, credit institutions and insurance firms, mutual guarantee societies, economic interest groups, Collective Investment Institutions and investment funds.

SUBJECTS AND ACTS THAT CAN BE INSCRIBED

Additional Disposition 4 of Law 7/1996 concerning the regulation of the retail sector, imposes on “entities whatever legal form they may take” the obligation to inscribe the business in the Commercial Registry (excluding physical persons), whether they sell goods wholesale or retail, if their annual sales are greater than 601,010 euros.

Section 2 of Law 14/2013 (the law in support of business -people and their internationalization), obliges the entrepreneur (physical persons) to inscribe herself in the Commercial Registry if she wishes to enjoy the condition of a limited responsibility-entrepreneur.

SUBJECTS AND ACTS THAT CAN BE INSCRIBED

Sole Traders can apply for inscription in the Commercial Registry, or even be inscribed against their will (this happens in the case we have already seen in which the spouse of the sole-trader revokes the consent previously given for his or her personal patrimony to cover the debts incurred by the business).

This general rule is contained in Article 19.1 of the Commercial Registry:

Registration at the Commercial Registry shall be discretionary for sole-traders, with the exception of ship-owners.

ACTS THAT CAN BE INSCRIBED

Certain acts that affect the subjects inscribed must also be entered into the Commercial Registry.

In the page devoted to **sole traders**:

- 1) Resolutions relating to the capacity of the sole trader (such as the judicial declaration that he does not have legal capacity to act).
- 2) The marriage articles that regulate the economic statute of the spouses.
- 3) The general powers granted to branches of the business.
- 4) The bankruptcy of the sole trader.

ACTS THAT CAN BE INSCRIBED

In the case of legal persons:

- 1) The statutes of constitution of the legal business person
- 2) The naming of managers, auditors and liquidators
- 3) Modifications to the legal statutes of the business
- 4) Structural modifications to the business (such as mergers)
- 5) The opening and closing of branches
- 6) The dissolution or liquidation of the company

THE INSCRIPTION PROCEDURE

On the page opened for each sole trader or legal business person all the information necessary to identify her or the company must be inscribed.

The inscription must be carried out by way of a public document (i.e. through a notary) except in those cases where the law specifically allows the inscription to be done through a private document (for example the first inscription of the sole trader, and the opening or closing of branches). In these cases, inscription is carried out by a simple declaration addressed to the Registrar.

TERRITORIAL ORGANIZATION

The Commercial Registry is a public agency with offices in the capital of each Province, and in Ceuta, Melilla and some of the islands that make up the kingdom of Spain.

The subject that wishes to be inscribed in the Commercial Registry must apply for inscription in the Province corresponding to the domicile of the business.

THE CENTRAL COMMERCIAL REGISTRY

The Central Commercial Registry is merely an information service.

- a) It centralises all the information regarding inscriptions made at the various Commercial Registries located in Spanish territory, although it contains only the essential information contained in each entry.
- b) It publishes the Official Bulletin of the Commercial Registry, which is published daily and serves as a means of effective publicity for the contents of the Registries.
- c) It has the task of ensuring that companies are not registered under identical names or names so similar that they could lead to confusion. Those wishing to register a company name must obtain a certificate from the Central Registry to the effect that the name they have chosen has not already been taken. To help it in its task the Registry is obliged to keep a reserve list of possible company names (1,500) approved by the Registrar. If the interested party chooses a name from this list, then a certificate will be issued to the effect that the name is available. However, this certificate does not by itself guarantee registration, as a Notary cannot authorize nor the Registrar inscribe companies whose names could lead to confusion with notorious brands or trade-marks.

FORMAL PUBLICITY

The Commercial Registry is a public registry. Anyone may consult it, without having to justify their reason for doing so. They may also request:

- a) A copy or simple description of the contents of an inscription.
- b) A certificate that accredits the existence of an inscription or the lack of an inscription. The certificate differs from the simple description in that only the certificate serves as a legal proof of the contents of the Registry on the date it was issued.

FORMAL PUBLICITY

The information contained in the Registries may also be consulted by computer, although Article 79 of the Regulation of the Commercial Registry states that this information will be limited to “the essential content of the entries”, which in practice means the information sent by the Provincial Registries to the Central Registry.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

A) **The principle of effective publicity** – this principle establishes the consequences that inscription (or lack of inscription) in the Commercial Registry and publication in The Official Bulletin of the Commercial Registry produce on third parties acting in good faith. The legal presumption is that everything inscribed and published is known to all parties (even if the parties concerned are not really aware of the information). If this presumption did not exist, then the public registry would serve no purpose at all, as it would be sufficient to plead ignorance of the content of the inscription for it to have no effect.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

This principle of publicity has a negative as well as a positive effect, in the sense that third parties acting in good faith cannot be adversely affected by those subjects, acts or information that should have been inscribed but were not. However, if it can be proved that this third party did not act in good faith and was aware of the information not inscribed or published, then this presumption can be overturned.

In the case that there is a discrepancy between the information published and the actual content of the inscription, then third parties acting in good faith can rely on the published information for all effects which are favourable to them. Those responsible for the error will also be responsible for compensating the parties affected by it (Article 213 of the Code of Commerce).

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

B) **The principle of legality** – this states that no act or contract can be inscribed in the Registry that does not fulfil the legal requirements necessary for its inscription.

The Registrar is obliged to examine the legality of acts or contracts and the legal capacity and authority of subjects requesting inscription.

If the Registrar gives her approval then the information will be inscribed in the Registry, if the Registrar refuses inscription then the inscription will not be practised. Those affected by this refusal can appeal the decision within two months. The appeal is reviewed by the same Registrar. If the Registrar repeats her refusal then the appeal can be taken to The Directorate General of Registries and Notaries. This appeal must be resolved within 4 months.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

The decision they come to can be to:

- a) Authorise the inscription without further delay.
- b) Declare that the defect can be remedied (in which case it must be done by the interested party within 15 days).
- c) Declare that the defect cannot be corrected and so inscription is not possible.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

The decision taken by The Directorate General of Registries and Notaries can be appealed in the Law Courts and comes under the jurisdiction of Commercial Law judges. The legal claim must be placed before the Courts within two months of the communication to the parties of the decision taken by the DGRN.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

C) **The principle of the presumption of validity** – once inscribed an act or contract is presumed to be valid and correct. However, this does not mean that inscription validates acts or contracts that are void in law.

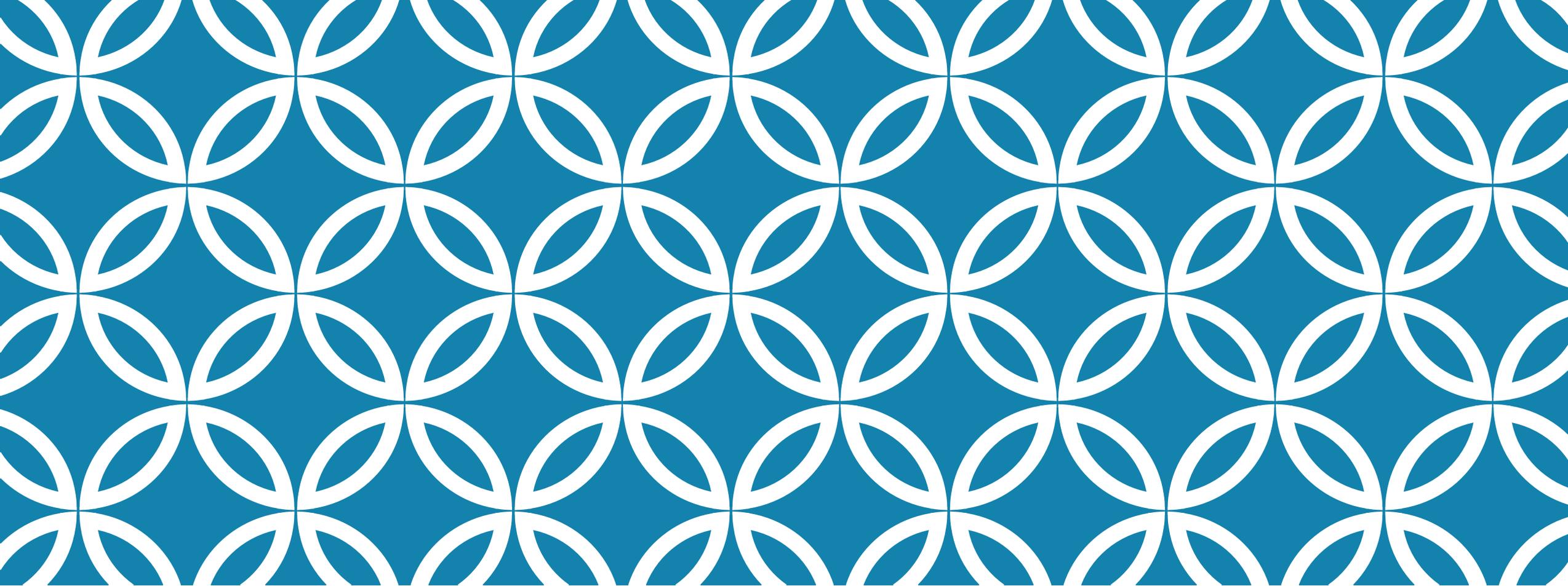
What it does mean is that the error or voidance of the information inscribed cannot negatively affect the rights acquired as a result of the inscription by third parties acting in good faith.

Article 20.2 of the Code of Commerce states that:

Registration does not endorse acts or contracts that are null pursuant to the Laws. The statement of inexactness or nullity shall not affect the rights of third parties in good faith, legally acquired.

THE PRINCIPLES OF THE COMMERCIAL REGISTRY

Because of this the inscription is (generally) declarative and not constitutive, however the inscription is constitutive (it confers rights) in the case of certain types of company (which we will study in due course), that do not acquire their legal personality until they have been inscribed.

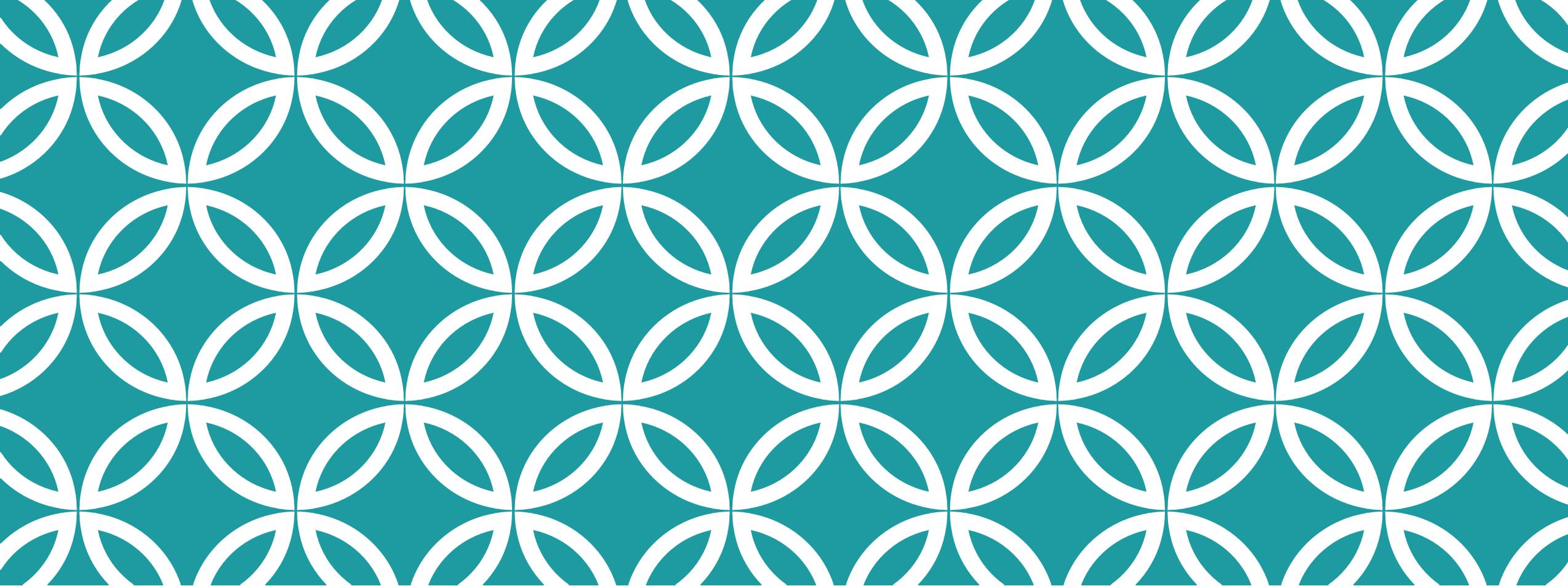


SOURCES OF COMMERCIAL LAW

CONSISTING OF SECTIONS 1 -7

THE SOURCES OF COMMERCIAL LAW

1. The relationship between Articles 2 and 50 of the Code of Commerce
2. The meaning of “Commercial Law”
3. The distribution of legislative competences in Commercial Law between the State and the Autonomous Communities in the Constitution
4. Commercial Practices
5. The European Union
6. The Spanish Constitution and Commercial Law
7. The Commercial Courts



1. THE RELATIONSHIP BETWEEN ARTICLES 2 AND 50 OF THE COMMERCIAL CODE

1. SOURCES OF COMMERCIAL LAW

Article 2 of the Code of Commerce:

Acts of commerce, whether performed by businesspersons or not, and whether or not they are specified in this code, shall be governed by the provisions thereof; failing that, by the business practice generally observed in each city and, if not covered by either of these rules, by those of ordinary Civil Law.

1. SOURCES OF COMMERCIAL LAW

So Article 2 seems not only to list the sources of Commercial Law, but also to establish a hierarchy between them:

- (a) The Code of Commerce (or specific dispositions of Commercial Law)
- (b) Commercial customs or practices
- (c) Civil Law

This means that, unlike the Law sources listed in Article 1 of the Civil Code, the Code of Commerce places commercial practices above Civil Law in the normative hierarchy.

1. SOURCES OF COMMERCIAL LAW

However, that said, the general rules concerning the interpretation of contracts contained in the Civil Code (in Articles 1281 to 1289) and the rules relating to the capacity of the parties take precedence over commercial customs or practices according to Article 50 of the Code of Commerce which states that:

Business contracts, in all matters related to their requisites, amendments, exceptions, interpretation and extinction and capacity of the parties to the contract, shall be governed in all matters not specifically set forth in this Code or in Special Laws, by the general rules of ordinary Civil Law.

And this article does not mention commercial customs or practices

So commercial customs and practices could only be used to interpret a contract if there were no rules governing the interpretation of contracts applicable to the case in question either in Special Laws, the Code of Commerce or the Civil Code (which is highly unlikely).

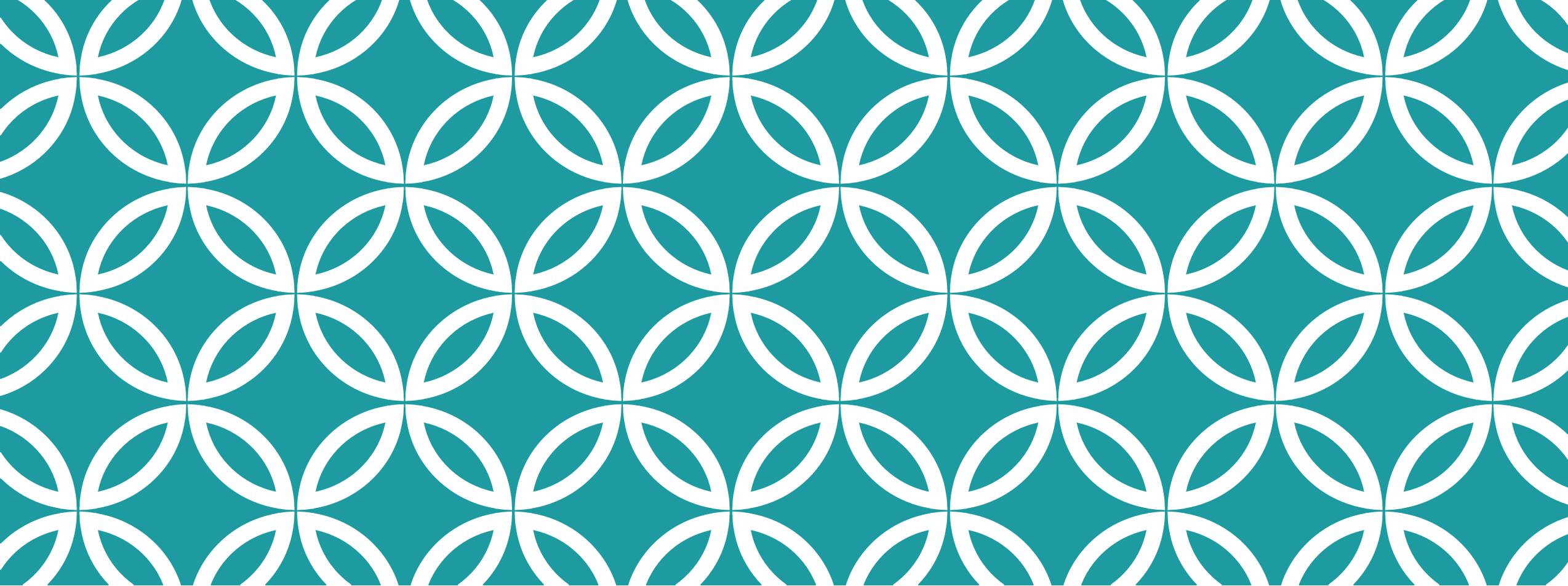
1. SOURCES OF COMMERCIAL LAW

What therefore is the function of Article 2?

The Code of Commerce does not seem to contain an article concerning the integration of contracts (such as Article 1258 of the Civil Code). This is the real function of Article 2.

Article 2 lists the sources of contractual integration, that is, how are gaps or holes in the contractual regulation of a matter to be filled. So in the case that a specific problem is not solved by the terms of a contract in Commercial Law, the solution to the problem must be found by referring to:

- (a) The Code of Commerce (or specific dispositions of Commercial Law)
- (b) Commercial customs or practices
- (c) The Civil Law



2. THE MEANING OF COMMERCIAL LAW

2. THE HIERARCHY OF SOURCES

COMMERCIAL LAW

This should be understood in the broad sense of the term. The set of legal dispositions (whatever their position in the normative hierarchy) that can be applied to Commercial Law.

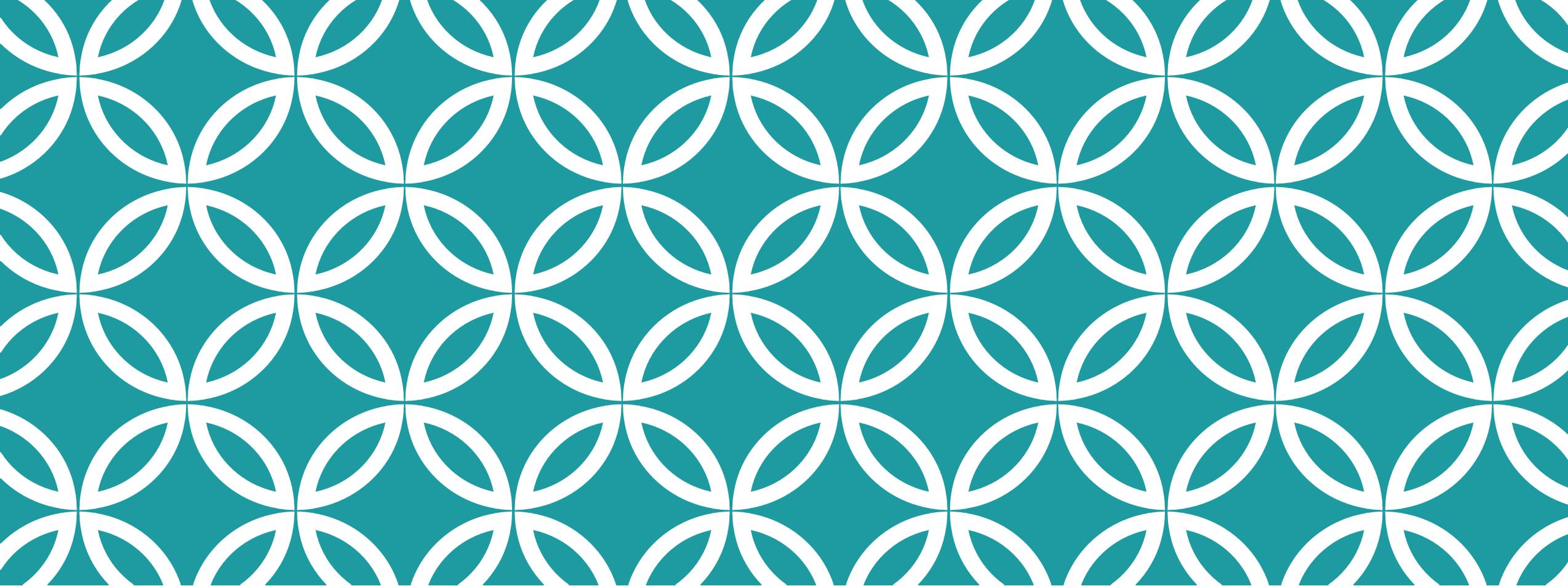
The fundamental law is the current Code of Commerce (dated the 22nd of August of 1885). The obvious fact that this is largely outdated has been partially remedied in two main ways:

2. THE HIERARCHY OF SOURCES

COMMERCIAL LAW

(a) The fact that the parties to commercial relations have a large degree of autonomy in deciding how their affairs are regulated (given that most of the precepts of the Code of Commerce are **voluntary** rather than obligatory).

(b) The passing of a large number of special laws that complete or revoke the inadequate sections of the Code of Commerce.



3. THE DISTRIBUTION OF LEGISLATIVE COMPETENCES IN COMMERCIAL LAW BETWEEN THE STATE AND THE AUTONOMOUS COMMUNITIES IN THE CONSTITUTION

3. THE HIERARCHY OF SOURCES

Articles 148, 149, 150.1, 152.1 and 153 (a) recognise the legislative powers of the Autonomous Communities.

- 1) Article 149.1.6 SC awards the state exclusive competence over Commercial Legislation.
- 2) 149.1.9 grants the state exclusive competence over legislation concerning copyright and Industrial Property.
- 3) 149.1.11 does the same for the legislative bases for the regulations concerning credit, banking and insurance and there are further examples of this conferring of exclusive competencies.

HOWEVER...

3. THE HIERARCHY OF SOURCES

In certain sectors, the Statutes of the Autonomous Communities have configured dual competencies over legislative powers and powers of execution:

- (i) The State and the Autonomous Communities must collaborate on legislation regulating advertising.
- (ii) Autonomous Communities can create legislation defending consumers, regulating internal trade and the banking and insurance industries etc. but are obliged to respect the bases and the basic legislation laid down by the State.
- (iii) In some sectors, the Autonomous Communities only have the power to enforce the law (Intellectual Property).

3. THE HIERARCHY OF SOURCES

Sometimes state laws can confer legislative capacity, or the capacity to enforce the law, on Autonomous Communities. This is permitted by Articles 150.1 and 150.2 of the Spanish Constitution.

3. THE HIERARCHY OF SOURCES

Article 150.1 of the Spanish Constitution states that:

The Cortes Generales, in matters of State jurisdiction, may confer upon all or any of the Self-governing Communities the power to pass legislation for themselves within the framework of the principles, bases and guidelines laid down by a State act. Without prejudice to the jurisdiction of the Courts, each enabling act shall make provision for the method of supervision by the Cortes Generales over the Communities' legislation.

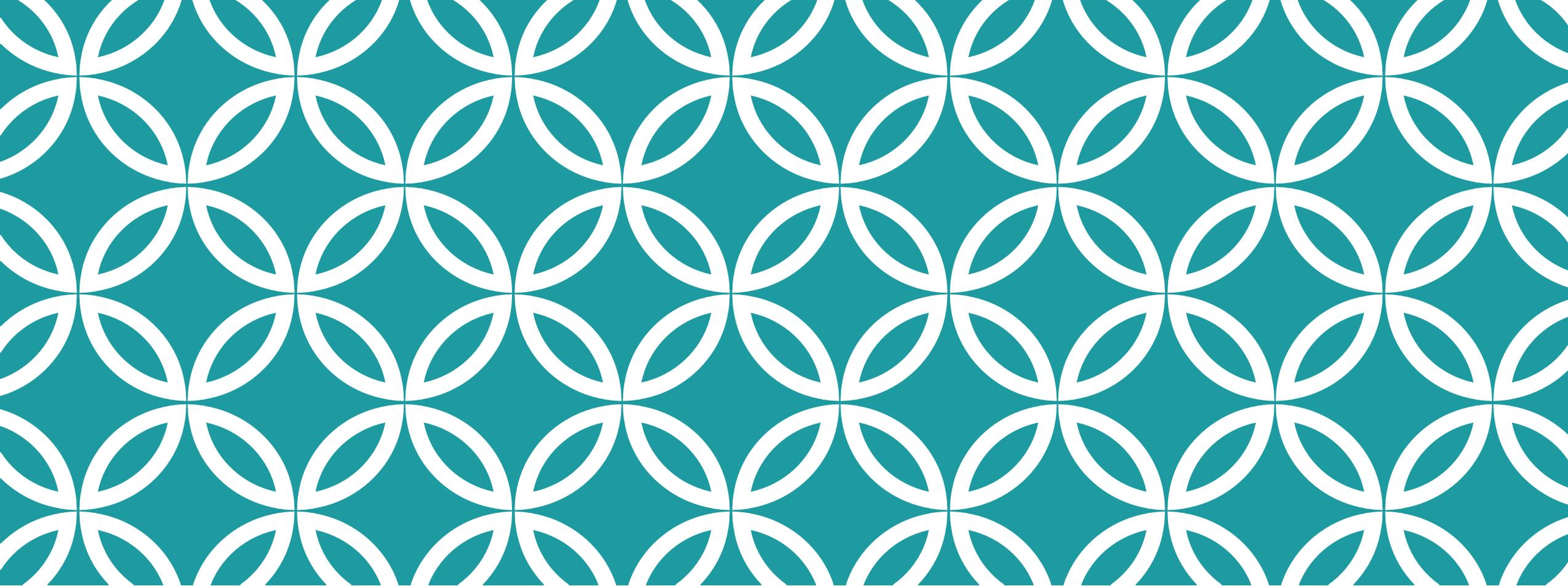
3. THE HIERARCHY OF SOURCES

While Article 150.2 of the Spanish Constitution determines that:

The State may transfer or delegate to the Self-governing Communities, through an organic act, some of its powers which by their very nature can be transferred or delegated. The law shall, in each case, provide for the appropriate transfer of financial means, as well as specify the forms of control to be retained by the State.

THE HIERARCHY OF SOURCES

The Constitutional Court has placed limits on the legislative powers of the Autonomous Communities in Commercial Law. They cannot distort the unity of the internal market, or modify the rights and obligations of the parties to private contracts.



4. COMMERCIAL PRACTICES

4. THE HIERARCHY OF SOURCES

Commercial law was, to a large extent, formed by practitioners, who created the rules and institutions necessary to regulate commercial traffic. As time passed, legislators incorporated these practices into written law, and commercial practices began to lose some of their importance. However, they still play a role in Commerce.

The Code of Commerce published in 1885, while establishing the hierarchical superiority of written law over commercial practices and customs, took into account two salient points:

- (a) Written law cannot encompass the entire objective reality of the manner in which commercial relations are regulated, and so it very sensibly recognised the validity of commercial practices when there was no written law applicable (Article 2 of the Code of Commerce).
- (b) An equally important recognition of the limitations of written law was that, due to its ever changing nature, commercial practices may be needed to regulate unforeseen institutions or situations.

4. THE HIERARCHY OF SOURCES

From an examination of the Code of Commerce commercial practices can be said to have four uses:

- (a) To regulate when the law has nothing to say about a certain topic (Article 2 Code of Commerce).
- (b) To make specific/concrete the abstract content of a law that, due to its lack of specificity cannot be made sense of without reference to a commercial practice.
- (c) Determine the content of a contract when neither the parties nor the written law have done so.
- (d) Resolve doubts about the correct interpretation of a contract.

4. THE HIERARCHY OF SOURCES

However, the mere repetition of a practice does not convert it into a source of law. In order for that to happen it is vital that there is a general consensus concerning its existence and its obligatory nature (*opinion iuris*). It is necessary that this practice will be automatically applied **unless** the parties to the commercial act in question stipulate otherwise.

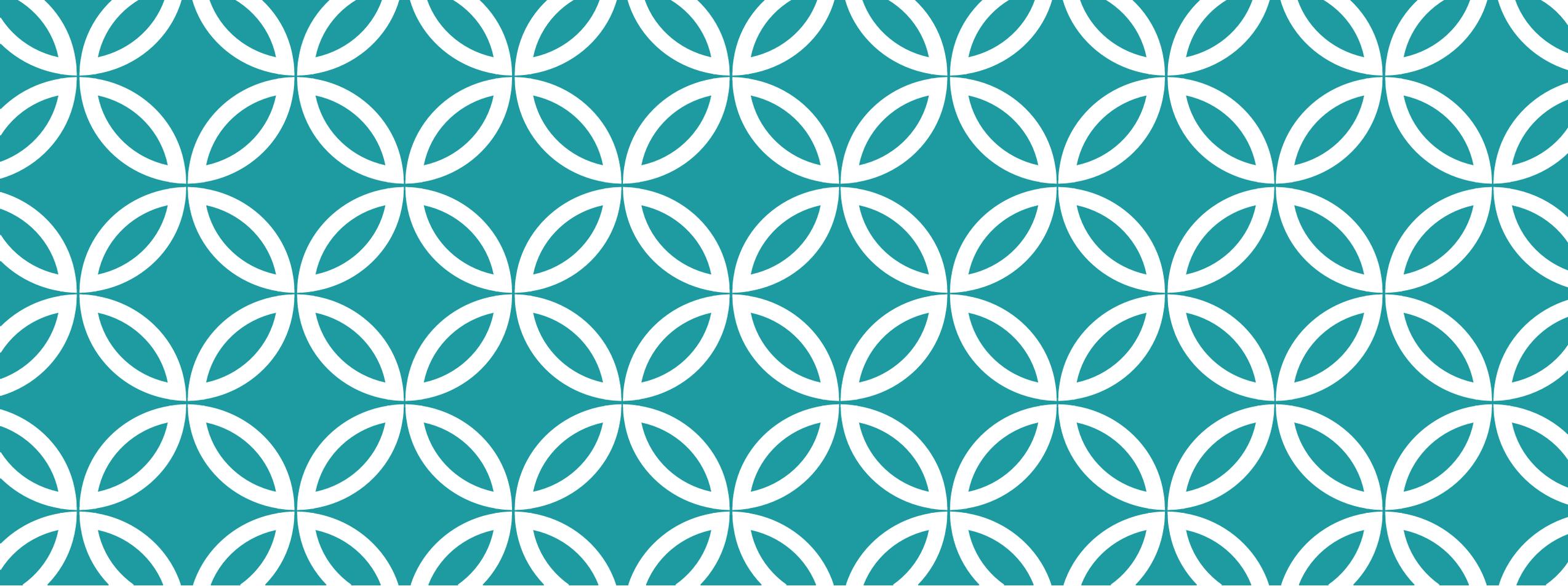
One might reasonably assume that this very characteristic of commercial practices would exempt the parties concerned from having to prove their existence (given that judges have the obligation to know the law). This is not always the case according to the Supreme Court, who has stated that, unless the commercial practice is **notorious**, then its status must be alleged and proved by the party that desires its application (see the judgements of the Supreme Court dated the 27th of April 1945 and the 8th of July 1977 among others).

This criterion has since been incorporated in Article 1.3 of the Spanish Civil Code.

4. THE HIERARCHY OF SOURCES

The reliance on Commercial Practices in internal commerce has been in steady decline in recent decades for a variety of reasons:

- (i) Commercial practices are not written laws but have evolved differently in different regions of Spain. This difference produces uncertainty and goes against the grain of modern tendencies in commercial contracts (such as speed of contraction and the uniformity of mass contracts).
- (ii) As much of commercial law relies upon the will of the contracting parties, the parties can and normally do exclude the application of commercial practices and agree to provide their own solutions to fill any gaps in existing legislation.



5. THE EUROPEAN UNION

5. THE HIERARCHY OF SOURCES

The relationship between the internal law of Spain and the legislation created by the European Union can be characterized in the following ways:

- (i) The primacy of European law over national law.
- (ii) The direct application of certain types of acts and dispositions in the member states.
- iii) The recognition of the legally binding nature of a collection of legal norms that are indispensable in order to guarantee the efficiency of the Common Market and the Unity of EU law.

5. THE HIERARCHY OF SOURCES

i) The primacy of European law over national law

According to the precedence principle, European law is superior to the national laws of Member States. The precedence principle applies to all European acts with binding force. Therefore, Member States may not apply a national rule which contradicts a European law.

The precedence principle guarantees the superiority of European law over national laws. It is a fundamental principle of European law. As with the **direct effect principle**, it is not inscribed in the treaties, but has been enshrined by the European Court of Justice.

5. THE HIERARCHY OF SOURCES

The ECJ enshrined the precedence principle in the *Costa versus Enel* case of 15 July 1964. In this case, the Court declared that the laws issued by European institutions are to be integrated into the legal systems of Member States, who are obliged to comply with them. European law therefore has precedence over national laws. Therefore, if a national rule is contrary to a European provision, Member States' authorities must apply the European provision. National law is neither rescinded nor repealed, but its binding force is suspended.

The Court later clarified that the precedence of European law is to be applied to all national acts, whether they were adopted before or after the European act in question.

With European law becoming superior to national law, the principle of precedence therefore ensures that citizens are uniformly protected by a European law assured across all EU territories.

5. THE HIERARCHY OF SOURCES

ii) DIRECT APPLICATION

In principle, regulations are the only source of European law that are directly applicable in the member states and directives require implementation by a national law, leaving the form, methods and procedures necessary to attain the objectives pursued by the directive up to the Member State.

The European Court of Justice (ECJ) has ruled that, in cases where a member state has failed to meet its obligation to incorporate a directive into its legal system within the fixed time limit (which in most cases is no more than two years), then the following consequences take place:

5. THE HIERARCHY OF SOURCES

- A) It becomes directly applicable upon the expiry of the time limit.
- B) If its provisions are **directly effective**, an individual may rely on them in proceedings before a national court upon the expiry of the time limit.
- C) The Commission may bring an action under Article 258 TFEU against the Member State concerned for breach of EU law. The Commission may also bring proceedings when, during the transposition period, a Member State has adopted national measures liable seriously to compromise the result prescribed by the directive.
- D) An individual may, upon the expiry of the time limit, sue a defaulting Member State for damages, provided certain conditions are satisfied.

THE HIERARCHY OF SOURCES

These consequences apply to the **vertical direct effect** of non-implemented directives (i.e. an individual vs the State).

However, the ECJ has denied **the horizontal direct effect** (with some exceptions) of directives that have not been implemented.

THE PRINCIPLE OF DIRECT EFFECT

The principle of direct effect enables individuals to immediately invoke a European provision before a national or European court.

There are two aspects to direct effect: a vertical aspect and a horizontal aspect.

Vertical direct effect is of consequence in relations between individuals and the country. This means that individuals can invoke a European provision in relation to the country.

Horizontal direct effect is consequential in relations between individuals. This means that an individual can invoke a European provision in relation to another individual or legal person (for example a Corporation).

THE HIERARCHY OF SOURCES

Still, in order to compensate for this lack of horizontal direct effect the ECJ has imposed on national courts the obligation **to interpret national law in line with unimplemented directives**, when the expiry date for their incorporation into the national legal system has passed.

This has not prevented the Spanish Supreme Court from sometimes (erroneously) attributing horizontal direct effect to directives.

THE HIERARCHY OF SOURCES

iii) The recognition of the legally binding nature of the collection of legal norms that are indispensable in order to guarantee the efficiency of the Common Market and the unity of EU law.

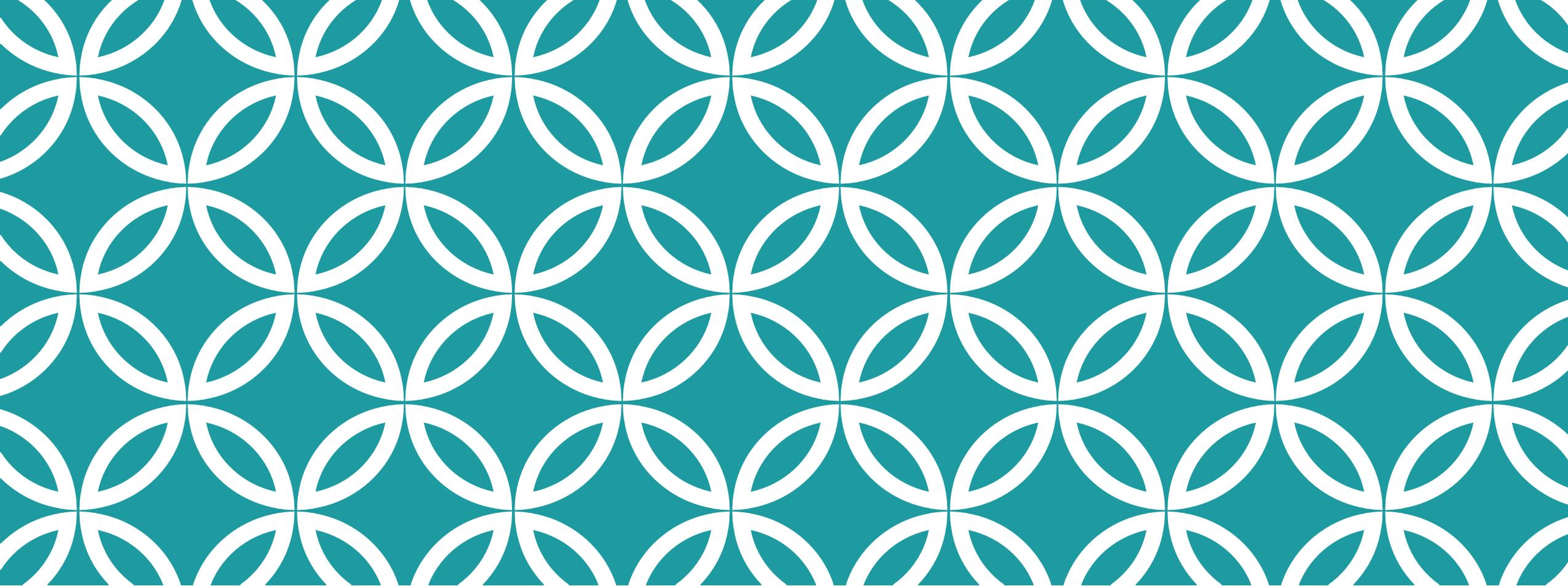
There are a number of coercive measures designed to enforce this binding character:

Articles 37.2, 169, 170, 187 and 192 TFEU

THE HIERARCHY OF SOURCES

In the area of Commercial Law the legal precepts created by the organs with legislative powers (the Council, the Commission and the European Parliament) are aimed at complying with and expanding upon the following fundamental objectives of the European Union:

- (a) The free circulation of goods (28 to 37 TFEU)
- (b) The free circulation of capital (63 to 67 TFEU)
- (c) The rights of establishment and to provide and receive services (49 to 62 TFEU)
- (d) The rules regarding competition (101 to 113 TFEU)
- (e) The necessary uniformity of the internal legal systems of the Member States (114 to 118 TFEU).



6. THE SPANISH CONSTITUTION AND COMMERCIAL LAW

6. THE HIERARCHY OF SOURCES

The Constitution establishes a group of rights and principles that serve as the basis for economic life and business activity in Spain. This is often referred to as the Economic Constitution.

While the Constitution does not preconfigure a single economic system, it is not neutral with respect to the economy and opts for a social market economy.

6. THE HIERARCHY OF SOURCES

Some of the characteristics of a social market economy are that it respects the principle of private property and supports private initiative, but these are tempered by a recognition of the demands of the general economy and the possibility of central economic planning, the reservation of essential resources or services to the public sector, and State intervention in private companies if needed.

6. THE HIERARCHY OF SOURCES

The main economic principles contained in the Constitution are:

- (i) 33.1 SC - The right to private property and inheritance (it is therefore legitimate to own the means of production).
- (ii) 38 SC - Free enterprise within the framework of a market economy – this allows business people to create, manage and order their business activities and public authorities are obliged to guarantee that it is the market (via the laws of supply and demand) that fixes the price and quality of goods and services. However, certain legal limits, proclaimed in the Constitution and developed in special legislation, apply (for example the laws on consumer protection, and competition).

6. THE HIERARCHY OF SOURCES

(iii) 22.2 and 34 SC - The right to found associations (and the freedom of association) to carry out economic activities that the law recognises as licit.

(iv) 35.1 SC – The freedom to choose a profession or trade.

This last freedom (developed further by special legislation), means that both physical and legal persons that possess the economic means to do so are free to carry out the economic activity of their choice (and so of course to cease in that activity). They are however constrained by the limitations imposed by labour law.

6. THE HIERARCHY OF SOURCES

CONSTITUTIONAL LIMITATIONS

The Constitution contains further principles and dispositions that limit those just mentioned. Among the most important of these limitations are:

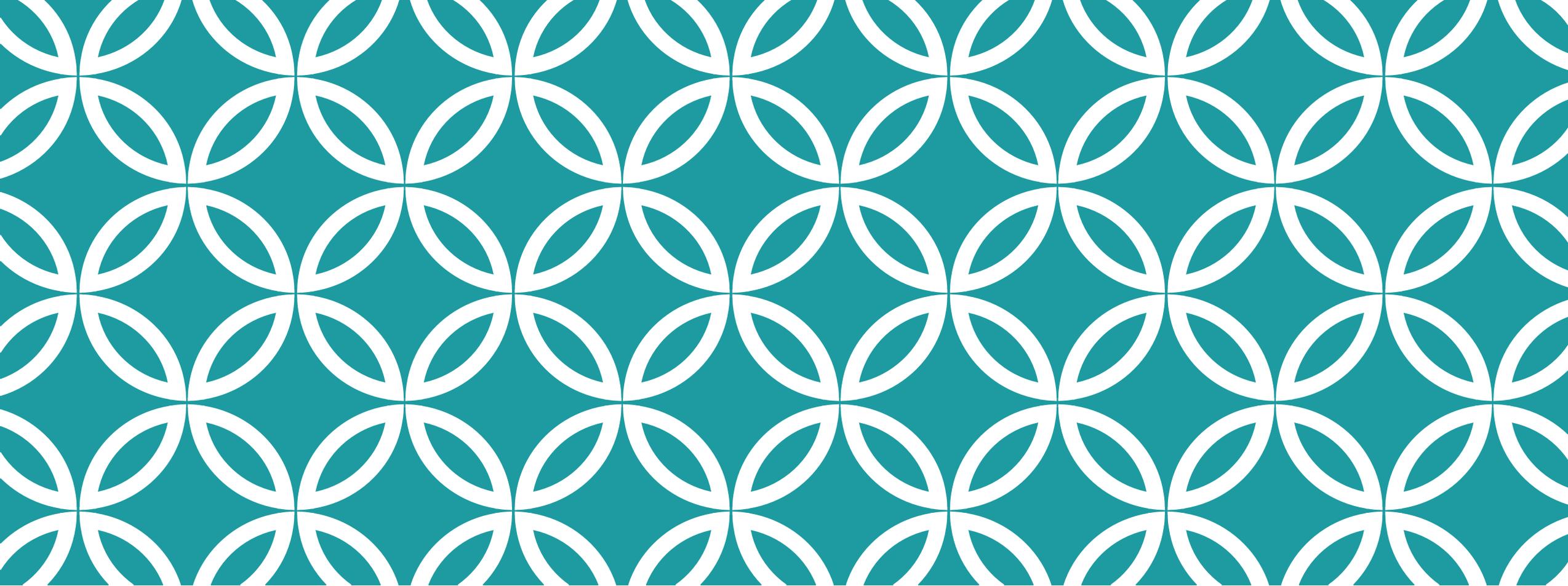
- (i) The restraints placed on free enterprise by the general interests of the economy and the possibility of central planning (38 SC and 128.1 SC)
- (ii) The recognition of public initiative in the economy (128.2 SC)
- (iii) The pledge to encourage cooperatives (129.2 SC)

6. THE HIERARCHY OF SOURCES

CONSTITUTIONAL DECLARATIONS

The Constitution makes three (rather bold) declarations that limit naked capitalism:

- (a) The entire wealth of the country in its different forms, irrespective of ownership, shall be subordinated to the general interest (128.1 SC).
- (b) The public authorities shall efficiently promote the various forms of participation in businesses (129.2 C).
- (c) The State shall be empowered to plan general economic activity by an act in order to meet collective needs, to balance and harmonize regional and sectorial development and to stimulate the growth of income and wealth and their more equitable distribution (131.1 SC).



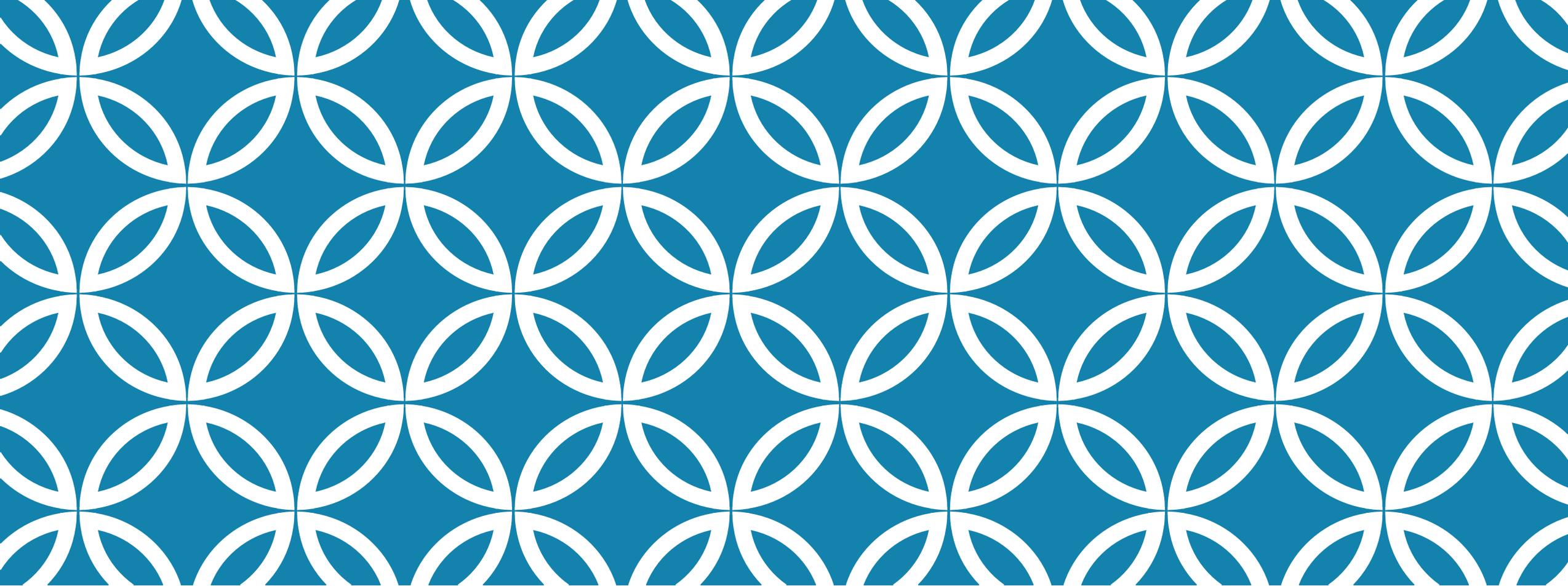
7. THE COMMERCIAL COURTS

7. THE HIERARCHY OF SOURCES

4) COMMERCIAL COURTS

The Commercial Courts were originally introduced by a reform to the Judicial Power Organic Act in 2003. They have competence to deal with cases relating to bankruptcy (as we shall see in much greater detail later on) but in addition they are competent to deal with:

- (a) Claims relative to unfair competition, industrial property, advertising, and all general questions of Civil Law that arise from claims grounded in the legislation governing trading companies and cooperatives.
- (b) Claims founded in legislation regulating national and international transportation.
- (c) Claims founded in Maritime Law.
- (d) Claims based on the legislation governing the general terms and conditions of contracts.
- (e) Appeals against decisions made by the DGRN (The General Directorate of Registries and Notaries) relating to appeals against the evaluations of the Commercial Registrar, in accordance with the Law on Mortgages.
- (f) The procedures contained in Articles 101 and 102 of the TFEU and the Law on Protection of Competition.



LESSON 3: BUSINESSPEOPLE AND THEIR REGULATION

BUSINESSPEOPLE AND THEIR REGULATION

From a legal perspective, a businessperson can be defined as:

The physical or legal person that acts, either in his or her own name for himself or herself or on behalf of others, and carries out, in an organized and professional manner, an economic activity that produces goods and/or provides services for the market.

There are, however, several important distinctions that have to be made between different types of businesspersons and companies.

BUSINESSPEOPLE AND THEIR REGULATION

A) BUSINESSPERSON AND COMMERCIAL BUSINESSPERSON

- (i) *The commercial businessperson can be defined as the physical or legal person who, acting either under his or her own name for himself or herself or on behalf of others, carries out a commercial or industrial activity and/or provides commercial services.*

The salient points of this definition are that:

1. The businessperson acts under his/her own name.
2. He/she carries out commercial activities.

BUSINESSPEOPLE AND THEIR REGULATION

A) BUSINESSPERSON AND COMMERCIAL BUSINESSPERSON

This confers a specific legal regime on the businessperson that entails:

1. The obligation or the faculty (depending on the type of businessperson) of inscription in the Commercial Registry.
2. The obligation to keep orderly accounting records.
3. The bankruptcy procedure applicable under the Bankruptcy Act.

BUSINESSPEOPLE AND THEIR REGULATION

A) BUSINESSPERSON AND COMMERCIAL BUSINESSPERSON

This legal regime is subject to a number of exceptions, excluding for example all qualified professionals (that require a professional qualification to practice) such as lawyers and doctors.

BUSINESSPEOPLE AND THEIR REGULATION

A) BUSINESSPERSON AND COMMERCIAL BUSINESSPERSON

In the case of

- (i) Public Limited Companies
- (ii) Private Limited Companies

it is not necessary that the activity carried out be a commercial activity, as the law automatically attributes the condition of commercial businessperson to these companies, irrespective of the activities that they actually carry out.

BUSINESSPEOPLE AND THEIR REGULATION

B) NON-COMMERCIAL BUSINESSPERSONS

Although it looks like a contradiction in terms, the law allows for what may be classified as non-commercial businesspersons (even though they carry out commercial activities in the market place).

These companies are generally regulated by the Civil Code and include the following:

BUSINESSPEOPLE AND THEIR REGULATION

- (i) **Certain small businesses** – These are businesspersons that, while carrying out an economic activity in the market place, cannot be said to have a business as such. Rather, through their own work or with the help of members of their family, they produce goods or provide services. An example of this would be artisans, which according to Article 326.3 of the Code of Commerce, cannot be classified as commercial businesspersons:

The following shall not be considered as having a business nature:

Sales of objects built or manufactured by craftsmen that they perform at their workshops.

BUSINESSPEOPLE AND THEIR REGULATION

The concept of the artisan is not contained in Commercial Law but rather in Administrative Law. Royal Decree 1520/1982 concerning the Ordering and Regulation of Craftsmen defines their activity in the following way:

The activity of producing, transforming or repairing goods or providing services carried out via a process in which the intervention of the individual is the predominant characteristic, and through which is obtained an individualized result that is unlike that resulting from industrial, fully-mechanized or mass production.

BUSINESSPEOPLE AND THEIR REGULATION

An important indicator of whether the activity should be classified as a commercial activity is the number of workers from outside the family circle (which the Administrative law just referred to limits to ten if the company wishes to be eligible for certain grants designed to stimulate artisanship).

A similar example of a non-commercial business activity is the case of agricultural workers who own and work their own plots of land.

BUSINESSPEOPLE AND THEIR REGULATION

ii) Civil businesspersons – classified as such because of the civil and not commercial nature of the economic activity that they carry out

An example of this type of civil businessperson is the agricultural worker that can be said to run a company, which (given its organisational structure and the type of resources at its disposal) constitutes the practice of a liberal profession.

This example requires a certain degree of explanation and is in fact challenged by some academics.

BUSINESSPEOPLE AND THEIR REGULATION

Individual agricultural businesspersons are not recognised as commercial businesspeople because their activity is not described in Article 1 of the Code of Commerce (which refers to businesses or industrial companies) and is excluded by Article 326.2 of the Code of Commerce:

The following shall not be considered as having a business nature:

Sales by owners and agricultural workers or farmers of the fruit or product of their crops or cattle, or of the species in which they are paid the rents.

BUSINESSPEOPLE AND THEIR REGULATION

However, a number of objections have been raised concerning this exclusion. The exclusion was founded on historical circumstances that have radically changed over the centuries:

Agriculture was traditionally carried out by workers tied to the land and was often a question of pure survival (producing all the food a family consumed) rather than a way of making profit. Agricultural production was at the mercy of the elements and could be wiped out by disease or infestations, and so was not the type of activity that could be planned and ordered in advance in the way that other commercial activities could be.

BUSINESSPEOPLE AND THEIR REGULATION

This is no longer the case and perhaps in the future individual agricultural businesspeople and those that adopt the form of a limited liability company should be considered commercial companies, provided that they constitute a true business and use the methods and techniques of commercial companies (financing, recourse to credit, mechanization, commercialization of products etc.).

It should also be noted that this exclusion from the consideration of a commercial company must be applied very restrictively. That is, to the activities directly connected to working the land. It does not apply to the transformation of agricultural and animal products, which are considered commercial business activities.

BUSINESSPEOPLE AND THEIR REGULATION

And again it should be remembered that all Public and Private Limited companies are commercial businesses by definition, regardless of their actual activity.

CLASSES OF COMMERCIAL BUSINESSPERSONS

The Code of Commerce draws a distinction between the following types of commercial businesses:

a) **Sole traders** –

A sole trader is the term used to describe a physical person that, through the medium of a company carries out a commercial activity or industrial activity or provides services.

Spanish law provides these individuals with their own statute.

CLASSES OF COMMERCIAL BUSINESSPERSONS

Their legal standing can be summarized in the following way:

- (i) All the relations that they establish with third parties in the sphere of their commercial activity can be imputed to them.
- (ii) They are answerable to creditors with all their patrimony, present and future in accordance with article 1911 of the Civil Code which states that: *the debtor is liable for the performance of his obligations with all present and future property.*
- (iii) There is no distinction made between their civil and commercial obligations (which means that the debts they incur in the exercise of their professional activity can be met with their personal patrimony).

CLASSES OF COMMERCIAL BUSINESSPERSONS

Legal persons

Legal persons are created when two or more people agree to pool money, goods or labour to carry out a commercial or industrial activity with the objective of distributing the financial benefits obtained between them.

In this case the commercial businessperson is not any of the individuals that have formed the company, nor the administrators that may represent it, but the legal person is the company itself, a new and distinct legal entity, created specifically to carry out the activity in question.

CLASSES OF COMMERCIAL BUSINESSPERSONS

Legal persons

The legal person, as we shall see shortly, has to comply with certain legal requisites, both formal and requisites of publicity (this means giving public notice of its existence).

Since 1995 legal persons formed by a sole physical person are possible, but the modern tendency is for legal persons to be constituted by several individuals, motivated above all by the desire to limit legal responsibility.

CLASSES OF COMMERCIAL BUSINESSPERSONS

Large and small businesses

The Code of Commerce does not establish clear legal distinctions between businesses according to their size, so in principle their legal statute is exactly the same.

However, in economics businesses are grouped into large, medium and small businesses (although the factors used for their classification may vary, for example it might be the number of workers, or yearly income). These economic distinctions began to be reflected in law, firstly through administrative law, and later in special commercial law legislation.

CLASSES OF COMMERCIAL BUSINESSPERSONS

An example of this is the concept of the small and medium sized business (called small and medium sized enterprises or SMEs in English). The concept is used as part of the definition of the reciprocal guarantee company featured in Article 1 of Law 1/1994 of the 11th of March.

This article states that:

Small and medium sized enterprises may, with the objectives of facilitating access to credit and related services, and improving their financial condition in general, form reciprocal guarantee companies with variable capital, in which the associates will not be personally liable for the debts incurred by the company.

For the purposes of this law, small and medium sized companies shall be defined as companies with 250 employees or less...

CLASSES OF COMMERCIAL BUSINESSPERSONS

The obligation to hold organized accounting records, which is an integral part of the responsibilities of the commercial businessperson, is not as demanding in the case of small businesses. Article 25.1 of the Code of Commerce states that their duty to keep orderly accounts must be “in keeping with their business activities”, suggesting a degree of flexibility.

The General Accounting Plan for Small and Medium Sized Businesses (Royal Decree 1515/2007) also provides for a less demanding set of obligations for small businesses, and Article 4 contains specific criteria for micro-businesses.

CLASSES OF COMMERCIAL BUSINESSPERSONS

Finally, the Corporate Tax Act (Law 27/2014 of the 27th of November) establishes differentiated tax rates and discounts depending on the declared turnovers of businesses.

CLASSES OF COMMERCIAL BUSINESSPERSONS

Private and Public Businesses

The central or autonomous governments as well as other public entities (such as city councils) carry out commercial and industrial activities by way of public businesses. This is often (but not always) a way of managing a situation of monopoly.

The constitutional support for these activities is Article 128.2 SC, which states:

Public initiative in economic activity is recognised. Essential resources or services may be reserved by law to the public sector especially in the case of monopolies. Likewise, State intervention in companies may be imposed when the public interest so demands.

CLASSES OF COMMERCIAL BUSINESSPERSONS

These may be formed through the process regulated by Articles 53 and following of Law 6/1997 concerning the Organisation and Function of the General Administration of the State. According to Article 53.1 they are to be used to provide or manage services and produce goods of public interest.

The public businesses formed this way must be created by Law and, despite their public nature, are regulated by Private Law (i.e. not Administrative Law), except in their decision making processes (Article 53.2).

CLASSES OF COMMERCIAL BUSINESSPERSONS

More commonly, because of their greater flexibility and wider ambit of activity, the public sector uses the state business companies defined in Article 166 of Law 33/2003 of the 3rd of November, the Law on the Patrimony of the Public Administration.

According to this article, state business companies are those in which the direct or indirect participation of the state in the share capital of the company is greater than 50%.

CLASSES OF COMMERCIAL BUSINESSPERSONS

These state business companies are regulated entirely by private law, except in relevant areas relating to their budgets, accountancy rules and contracting. They must also comply with the rules of Competition Law (something which will be studied in detail later).

Despite the widespread use of this mechanism, it must be noted that in recent decades there has been a tendency to privatise public services, in Spain this has been the case of Repsol, Telefónica and Iberia.

THE SOLE TRADER IN THE CODE OF COMMERCE

Article 1.1. of the Code of Commerce states that:

Those who are considered businesspersons for the purposes of this Code include:

Those who, having the legal capacity to engage in business, do so habitually.

So it would seem at first that capacity and the habitual exercise of that capacity are configured as the only requisites for being a businessperson.

However, the definition leaves out the notion of acting on one's own behalf, which is essential to the concept of the businessperson.

THE SOLE TRADER IN THE CODE OF COMMERCE

Without this essential part of the definition then sales representatives would, for example, be considered businesspersons or entrepreneurs, as they possess legal capacity to engage in business and conduct that business habitually.

The definition provided in the first part of the Code of Commerce also ignores the fact that minors and those who have been incapacitated by a Court Order may carry out commercial activities through legal representatives. This is later stated specifically by Article 5 which declares that:

THE SOLE TRADER IN THE CODE OF COMMERCE

Minors under the age of eighteen years and the incapacitated may continue the commerce previously conducted by their parents or predecessors by means of their guardians...

Following the distinction made by the renowned legal scholar GARRIGUES, it is important to differentiate between the capacity to be a businessperson and the capacity to act as a businessperson (or entrepreneur).

THE SOLE TRADER IN THE CODE OF COMMERCE

In order to obtain the capacity to be a businessperson it is sufficient to have general legal capacity. Therefore, the legally incapacitated and minors can be said to have the capacity to be a businessperson, but cannot act for themselves.

In order to possess the capacity to act for oneself it is necessary that the person in question has legally come of age (18 according to article 12 SC) and has not been legally incapacitated.

THE SOLE TRADER IN THE CODE OF COMMERCE

Article 4 of the Code of Commerce establishes that: *Those who are of legal age and have free disposal of their assets shall have the legal capacity for the habitual practice of commerce.* This article resolves the question of whether emancipated minors can carry out a commercial activity. They cannot. Article 323 of the Civil Code states: *Until he or she comes of age the emancipated minor may not borrow money, encumber or dispose of immovable properties and commercial or industrial undertakings or objects of extraordinary value without his or her parents' consent, and, in the absence of both, without his or her conservator's support.* This of course means that the emancipated minor does not enjoy the free disposal of his assets.

THE LEGAL CAPACITY OF THE FOREIGN BUSINESS PERSON

The legal capacity of foreigners is determined by their national law. With regard to the capacity to set up businesses or carry out an economic activity in Spanish territory it is necessary to refer to article 15 of the Code of Commerce which states that:

Aliens [meaning foreigners] and companies incorporated abroad may engage in business in Spain, subject to the Laws of their country, with regard to their capacity to contract, and pursuant to the provisions of this Code, in all matters regarding creation of their establishments in Spanish territory, their business operations and the jurisdiction of the Courts of Law of the Nation.

THE LEGAL CAPACITY OF THE FOREIGN BUSINESS PERSON

With respect to members of the European Union it is important to remember the right of establishment contained in Article 49 of the Treaty on the Functioning of the European Union. The article states that this freedom:

Shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

THE LEGAL CAPACITY OF THE FOREIGN BUSINESS PERSON

In the case of nationals from non-Member States, it is necessary to check whether their state of origin is a signatory to a Treaty with the European Union. In default of such a treaty, Spanish national law will be applied.

For questions regarding authorisations and rights of establishment for non-EU members one must refer to the dispositions contained in Organic Law 4/2000 that regulates the rights and freedoms of foreigners in Spain and their social integration.

BUSINESS ACTIVITIES CONDUCTED BY MARRIED PERSONS

Article 66 of the Civil Code states that:

The spouses are equal in rights and duties.

This has a series of legal consequences:

(a) The married couple are individually both free under the law to adopt the decision to initiate a commercial activity and to pursue this activity throughout their married life, without either one requiring the authorisation of the other.

BUSINESS ACTIVITIES CONDUCTED BY MARRIED PERSONS

(b) Logically this means neither spouse can (legally) prevent the other from continuing in this commercial activity (this was not always the case, until 1975 married women could not initiate or continue with a commercial activity without the permission of their husbands).

(c) In order to determine the patrimonial effects that the business activity may have on the goods belonging to the married couple, or specifically over the goods belonging to the spouse not engaged in this commercial activity, one must turn to the agreement made between the spouses. As we shall see, this freedom to pact the patrimonial consequences is subject to restrictions.

BUSINESS ACTIVITIES CONDUCTED BY MARRIED PERSONS

(d) The consent of the spouse of the businessperson (entrepreneur) is not necessary in order for the businessperson to carry out his or her commercial activity but it does determine the group of goods/belongings that are assigned to cover the commercial liabilities of the entrepreneur over and above his or her personal goods.

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

The question that needs to be answered here is what properties of the married couple can be used to cover the debts incurred by the economic activity carried out by the spouse? This question is particularly relevant when the couple has chosen an economic matrimonial regime which establishes that they have a pool of common goods.

To answer the question one must first examine certain dispositions of the Civil Code.

Chapter 11 of the Civil Code (in Articles 1325ff) concerns articles of marriage (agreements which determine how the patrimony of the spouses is to be divided).

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

The inscription of the sole trader in the Commercial Register, according to Article 19 of the Code of Commerce is purely optional.

However, Article 88.3 of Royal Decree 1784/1996 on the Regulation of the Commercial Register permits: *the spouse of the sole trader to request inscription in the Commercial Register in the circumstances and with the effects contemplated in Articles 6 and 10 of the Code of Commerce.*

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

In fact we need to examine the content of Articles 6 to 12 of the Code of Commerce.

Article 6:

*In the case of engagement in business by a married person, the assets pertaining only to the spouse engaging in business shall be held subject to liability, and those acquired with the proceeds [of the business], being entitled [the sole trader] to dispose of and to encumber with a mortgage either or both [of these assets]. For the other common assets to be subject to liability, **the consent of both spouses** shall be required.*

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

Article 7

The consent referred to in the preceding Article shall be assumed to be granted when business is carried out with knowledge and without specific opposition of the spouse who should provide it.

Article 8

The consent referred to in Article 6 shall also be assumed to have been provided when, on contracting marriage, one of the spouses is conducting commerce and continues to do so without objection by the other.

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

Article 9

*Consent for the businessperson to bind the **personal property** of the spouse must be **specifically** provided in each case.*

Article 10

*The spouse of the businessperson may **freely revoke the specific or assumed consent** to which the preceding Article refers.*

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

Article 11

The acts of consent, opposition and revocation to which Articles 7, 9 and 10 refer must be recorded, for third party purposes, in a public deed registered at the Business Registry. Those of revocation may not, under any circumstance, detract from rights previously acquired.

Article 12

What is set forth in the preceding Articles is understood not to be notwithstanding the terms to the contrary contained in the pre-nuptial agreements duly registered at the Business Registry.

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

It is possible to talk about two basic situations regarding the patrimonial responsibility of the spouse.

1) The responsibility configured in Article 6 is imperative, and as such cannot be reduced by articles of marriage. However, if the patrimony of the couple is governed by the separation of property regime, then there is no common group of belongings that can be referred to as common assets.

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

2) The second situation of patrimonial responsibility only comes into play when both spouses give their consent. By granting this dual consent the liability for the commercial activity can be extended to cover:

- (i) The common assets of the couple even when they have not been acquired with the proceeds of the commercial activity.
- (ii) The private property of the spouse who has given his or her consent (Article 9 of the Code of Commerce).

THE STATUTE OF PATRIMONIAL RESPONSIBILITY AND THE CONSENT OF THE SPOUSE

The situation just described results in a curious fact:

The common goods of a couple whose patrimony is regulated by the participation regime and that have been acquired by the proceeds derived from the economic activity of the sole trader, are liable for the debts incurred by the sole trader in the course of his or her business activity. However, if we read the text of Article 1365.2 of the Civil Code, if the spouse practices: *a profession, art or trade (and therefore is not covered by the terms of the Code of Commerce)* then **all** the couple's common property is liable to the debts incurred in the course of this activity.

TYPES OF CONSENT

As we have just mentioned, the consent granted by the spouse of the person engaged in commercial activity is indispensable in order to widen the range of goods liable for the debts incurred by the economic activity in question.

This consent may be:

1) Presumed: This is the most frequent type of consent in practice. Consent is presumed when the spouse of the businessperson, while being aware of the economic activity of his or her partner does not oppose it actively. This presumed consent is the type mentioned in Article 7 of the Code of Commerce.

TYPES OF CONSENT

A second type of presumed consent is recognised in Article 8 of the Code of Commerce, according to which a spouse continues the economic activity he or she had engaged in before marriage, without the opposition of his or her partner. The only difference between Articles 7 and 8 therefore is that in Article 8 the spouse in question continues an activity whilst in 7 he or she initiates it.

These types of presumed consent do not require any special formalities. They produce the effect of extending liability for debts over all the common goods acquired by the couple, not only those purchased with the proceeds of the economic activity carried out by the spouse.

TYPES OF CONSENT

2) Express consent

Express consent is granted in writing or by public inscription in the Commercial Registry.

THE END OF CONSENT

A) The opposition of the spouse of the businessperson.

The opposition of the spouse is contemplated in Articles 7 and 8 of the Code of Commerce. In order for this opposition to be effective against third parties it must be given in a notarised public document/deed and inscribed in the Commercial Registry. If the businessperson in question is not inscribed in the Commercial Registry, then, exceptionally, the spouse of the businessperson may apply for his or her opposition to the presumptions previously mentioned to be inscribed in the Registry. Article 88.3 of the Regulation of the Commercial Registry (Royal Decree 1784/1996) grants authorisation to make a first inscription in the Commercial Registry to: *the spouse of the sole trader (...) in the cases and with the effects described in Articles 6 and 10 of the Code of Commerce.*

THE END OF CONSENT

B) The revocation of consent.

The spouse who has given his or her consent, whether expressly or tacitly, to increase the patrimony liable to cover the debts of the commercial activity of his or her partner is entitled to change his or her opinion and revoke that consent.

This revocation must be given in a notarised public document and inscribed in the Commercial Registry in order to be valid against third parties. As we have mentioned before, revocation cannot affect any rights that had been previously acquired by third parties.

LEGAL IMPEDIMENTS

The principle of free competition allows, as a general rule, for anyone who has reached the age of legal maturity and who has not been incapacitated by court order to begin to practice a commercial or industrial activity.

However, there are some legal impediments to consider.

LEGAL IMPEDIMENTS

Broadly speaking, there are three kinds of legal impediment.

- a) Prohibitions
- b) Incompatibilities
- c) Disqualifications

LEGAL IMPEDIMENTS

- a) **Prohibitions** – The prohibition to exercise a particular economic activity is **justified by the unfair competition** it would suppose for other commercial businesspersons.

Article 136 of the Code of Commerce states that:

*In general partnerships that **do not have a specific type of business**, the members thereof may not perform operations on their own account without preceding consent from the company, which may be withheld, **without having to accredit that this causes it an effective and manifest loss**. Partners who breach this provision shall contribute the profit arising from these operations to the common assets and shall individually bear the losses, if any.*

LEGAL IMPEDIMENTS

Article 137 of the Code of Commerce:

*If the company has determined in its articles of incorporation the type of business it is to carry out, the partners may licitly conduct all business operations they may see fit on their own account, **provided this does not belong to the kind of business performed by the company that they are partners of**, if there is no special agreement to the contrary.*

LEGAL IMPEDIMENTS

Article 288 of the Code of Commerce:

Factors may not deal on their own behalf, nor take an interest on their own behalf or that of others in negotiations of the same kind as performed on behalf of their principals, unless these specifically authorise them to do so.

If they negotiate without that authorisation, the profit from the negotiation shall be for the principal and the losses shall be borne by the factor.

LEGAL IMPEDIMENTS

If the principal has granted the factor authorisation to deal on his account or in partnership with other persons, he shall not be entitled to the profits or share in the losses suffered.

If the principal has provided the factor a share in the operation, the share he has in the profit shall be, except for agreement to the contrary, proportional to the capital he provides, and if no capital is contributed, he shall be considered a working partner.

LEGAL IMPEDIMENTS

Royal Legislative Decree 1/2010. The Corporate Enterprises Act article 230 – (**Ley de Sociedades de Capital**)

1. Directors may not, for their own account or on the account of others, engage in a business that is the same as or analogous or supplementary to the business constituting the corporate purpose, without explicit authorisation from the general meeting. To obtain such authorisation they shall provide the information described in the preceding article.

2. In limited liability companies, any partner may request the commercial court with jurisdiction in the place where the registered office is located to remove any director in breach of the above prohibition.

3. In joint stock companies, at the behest of any shareholder, the general meeting shall decide on the dismissal of directors who are also directors of a competing company.

LEGAL IMPEDIMENTS

b) Incompatibilities

The incompatibility of carrying out a commercial activity or industrial activity is based on the function or condition of certain individuals. The justification of these incompatibilities is normally to **preserve the neutrality of the post and prevent abuses of power.**

Article 14 of the Code of Commerce states that:

Persons performing the offices hereinafter stated may not engage in business acting in their own name or through another, nor may they hold offices or have direct administrative or financial intervention in business or industrial companies within the limits of the districts, provinces or towns in which they carry out their functions:

LEGAL IMPEDIMENTS

b) Incompatibilities

1. Magistrates, judges and officers of the State Prosecution Service in active service.

This provision shall not be applicable to municipal mayors, judges and public prosecutors, nor to those who occasionally carry out judicial or fiscal duties.

2. Civil, economic or military governors of districts, provinces or enclaves.

PROHIBITIONS AND INCOMPATIBILITIES

b) Incompatibilities

3. Employees of State departments for the collection and administration of funds appointed by the Government.

4. Stock Brokers and agents.

5. Those who due to the laws or special provisions cannot engage in business in a specific territory.

PROHIBITIONS AND INCOMPATIBILITIES

Special attention should be given to the incompatibility of the members of the Spanish Government and high ranking members of the General Administration of the State who are unable to conduct commercial activities while in office.

Law 3/2015 – regulates the exercise of senior posts in the General Administration of the State.

Article 1 defines the concept of the high ranking post in the General Administration, examples of which include the members of the Government and the Secretaries of State, and the Delegated members of the Government in the Autonomous Communities.

PROHIBITIONS AND INCOMPATIBILITIES

Article 13 concerns the exclusive dedication to the post and letter c of this article states that the exercise of a high ranking post will only be compatible with:

1. The administration of their private patrimony.
2. The production of literary, artistic or scientific works – providing they are not the consequence of an ongoing working relationship or the provision of services.
3. The participation in charitable or non-profit making entities without reimbursement.

PROHIBITIONS AND INCOMPATIBILITIES

Article 14 limits the participation (either direct or indirect) of these high ranking members of the Administration in corporations to 10 %, when the corporations in question have any type of agreement or contract with the public sector, whether that be in the ambit of the State, an Autonomous Community or a city or town council, or when that corporation receives any type of subsidy from these bodies.

PROHIBITIONS AND INCOMPATIBILITIES

Articles 98.3 and 159.4 of the Spanish Constitution prohibit the engagement in Commercial Activity of members of the Government and the Constitutional Court.

PROHIBITIONS AND INCOMPATIBILITIES

c) Disqualifications

Article 172.2 of the Act on Insolvency– **Law 22/2003** provides for the disqualification of individuals **found to have acted blamefully in the insolvency of a corporation**, from the administration of commercial assets or commercial representation, for a period of between two and fifteen years.

THE ACQUISITION AND LOSS OF THE STATUS OF BUSINESSPERSON

The acquisition of the status of businessperson, in the case of individuals is achieved by the effective exercise of a commercial or industrial activity.

The loss of this status in physical persons comes about with:

- (a) The death of the businessperson, but not his or her legal incapacitation, as the person in question may continue the commercial activity through legally appointed guardians.
- (b) The transmission of the business activity.

THE ACQUISITION AND LOSS OF THE STATUS OF BUSINESSPERSON

In the case of legal persons, the loss of the condition of businessperson comes about with its extinction; either the liquidation of the legal person or the global transfer of its assets and the cancellation of its entry in the Commercial Registry.

THE OBLIGATIONS OF THE COMMERCIAL BUSINESSPERSON

Article 25 of the Code of Commerce stipulates that:

All businesses must keep orderly accounts, in keeping with the activity of their businesses, that allow for the chronological monitoring of all their operations, as well as the periodic preparation of balance sheets and inventories. Notwithstanding the terms set forth in laws or special provisions, all businesses must necessarily keep an inventory, an annual accounts book and a daily accounts book.

THE OBLIGATIONS OF THE COMMERCIAL BUSINESSPERSON

Article 34.2 of the Code of Commerce determines that:

The annual accounts must be drafted clearly and provide a true image of the assets, financial situation and results of the company pursuant to the legal provisions. To that end, accounting for the operations must reflect the real economic situation and not simply the format required by law.

THE OBLIGATIONS OF THE COMMERCIAL BUSINESSPERSON

These accounting obligations are intended to serve not only the self-interest of businesspersons (allowing them to take informed decisions regarding the management of their firms), but are also meant to provide reliable information to third parties (who may use the information to decide whether or not to concede credit to the firm), and to the State (for tax purposes for example).

THE OBLIGATIONS OF THE BUSINESSPERSON

The importance of proper accounting records is confirmed by certain dispositions of the Criminal Code relating to acts of falsification:

Article 290 punishes the falsification of annual accounts.

Article 392 punishes the falsification of Commercial documents.

And article 310 castigates those who, in the context of their fiscal obligations, absolutely fail to keep proper accounting records, or who falsify them.

THE OBLIGATIONS OF THE BUSINESSPERSON

The accounting obligations of Spanish firms are regulated in detail by Royal Decree 1514/2007 which passed the General Accountancy Plan, or, in the case of Small and Medium Size Enterprises by Royal Decree 1515/2007, which passed the General Accountancy Plan for SMEs.

SPECIFIC ACCOUNTING OBLIGATIONS

1) Accountancy books – The accounts of commercial businesspersons are carried out through a number of different books. Some of these are common to and obligatory for all businesses persons (such as the inventory, and the yearly and daily account books already mentioned).

The law requires some firms to keep additional, special accounting books.

SPECIFIC ACCOUNTING OBLIGATIONS

The **daily accounts book** – Keeps a registry of all daily operations relating to the business (or as a minimum, of periods of less than a month).

The inventory and annual accounts books – begins with a detailed description of the company balance at the start of the trading period, and must provide tri-monthly statements updating the company's balance. The inventory closes at the end of the financial year.

SPECIFIC ACCOUNTING OBLIGATIONS

Article 26.1 of the Code of Commerce states that:

Business companies [not therefore sole traders] shall also keep a book of minutes, in which they shall record all the resolutions passed in the general meetings and Special Meetings, as well as of those passed by other collegiate bodies of the company, stating the date on the calling and constitution of the body, a summary of the matters debated, the interventions for which a record was requested, the resolutions passed and the results of the votes.

SPECIFIC ACCOUNTING OBLIGATIONS

Article 27.3 of the Code of Commerce makes it compulsory to keep a register book of the nominative shares of Public Limited Companies and share partnerships and the register book of shareholders of Private Limited Companies. These books mention all the actions or participations held in the firm and the name of the physical or legal person that holds them.

SPECIFIC ACCOUNTING OBLIGATIONS

2) The formalities and requisites of keeping accounts

The Code of Commerce tries to ensure that the content of the accountancy books are not easy to falsify. It therefore establishes two sets of general rules, one providing external guarantees and the other internal guarantees.

a) The external guarantees

Businesses have to present the books they are obliged to keep to the Commercial Registry in which the company is registered. Article 27.1 of the Code of Commerce explains that this is so that: *prior to their use, the relevant certification required for the book may be placed on the first page, and the stamp of the Registry be placed on each sheet. (...)*. This measure is obviously aimed at preventing falsification of the books.

SPECIFIC ACCOUNTING OBLIGATIONS

As most firms carry out their accountancy procedures by computer, Article 27.2 of the Regulation of the Commercial Registry allows for the entries to be printed up and then taken to the Registry within 4 months of the close of the period they cover.

This system looks as if it will be replaced in the next few years by the posterior electronic legalisation of accountancy records by the Commercial Registry.

SPECIFIC ACCOUNTING OBLIGATIONS

b) Internal guarantees

These are the rules concerning how the accounting process should be carried out. Article 29.1 of the Code of Commerce states that:

All the accounting books and documents must be kept, whatever the procedure used, with clarity, in chronological order, without blank spaces, interpolations, crossings out or erasures. As soon as errors or omissions in the accounting annotations are noticed, they shall be noted. No abbreviations or symbols may be used whose meaning is not clear according to the law, the regulations or generally applicable business practices.

SPECIFIC ACCOUNTING OBLIGATIONS

Additionally businesspersons have the obligation to conserve the accountancy books and all the documentation relating to the firm, in an orderly fashion for six years, dating from the last entry, even when the businessperson in question has ceased trading. Article 30.1 of the Code of Commerce.

This duty extends to those that inherit a business (in the case of physical persons) and to the liquidators of a firm (Article 30.2 of the Code of Commerce).

THE INTERESTS PROTECTED BY THE OBLIGATION TO KEEP ACCOUNTING RECORDS

- a) Accurate accounting is necessary for the planning and organisation of a business. Without it, it is impossible to take responsible decisions concerning a firm's activities.
- b) The State has an obvious interest in knowing the true condition of a firm's finances for tax reasons, but also so that it can gauge the performance of certain sectors of commerce and industry and plan where and when to make investments or grant concessions.

THE INTERESTS PROTECTED BY THE OBLIGATION TO KEEP ACCOUNTING RECORDS

- c) Accurate accounting records also favour the position of creditors, both present and future, who can have reliable data to determine whether to give credit to the business or not.
- d) It is also of use to the employees of the business. Who can better justify their grounds for pay increases or defend themselves employees against redundancies that are falsely justified by “losses”.

THE INTERESTS PROTECTED BY THE OBLIGATION TO KEEP ACCOUNTING RECORDS

Although Article 32.1 of the Code of Commerce establishes that the accounts of the business are secret, this secret is not absolute, and the legal exceptions to this secrecy are founded in the legitimate interests just mentioned.

- 1) Article 133 of the Code of Commerce allows for all the partners of a general partnership to examine the accounts of the business.
- 2) Article 32.2 of the Code of Commerce, allows judges to decree (in response to a request from the party or *ex officio*) the inspection of the accounts in cases of universal succession, bankruptcy proceedings, redundancy proceedings and when the representatives of the workers request access to them.

THE INTERESTS PROTECTED BY THE OBLIGATION TO KEEP ACCOUNTING RECORDS

3) Article 32.3 states that: *outside the cases set in the preceding paragraph, the production of the books and documents of traders at the instance of the party or ex officio may be decreed, when the person to whom they belong has an interest or liability in the matter in which production is appropriate. The inspection shall be limited exclusively to the points that are related to the matter concerned.*

Article 33.1 establishes that this exhibition shall be performed on the trader's premises, in his presence or that of the person he may appoint.

Article 33.2 allows the person who made the request for inspection to be accompanied by auxiliary experts, in the manner and number that the judge considers necessary.

THE OBLIGATION TO KEEP ANNUAL ACCOUNTS

Articles 34ff of the Code of Commerce impose upon the businessperson the obligation to keep annual accounts.

However this obligation is different depending on the finances of the business in question.

Article 257 of the Corporate Enterprises Act (Royal Legislative Decree 1/2010) permits abridged accounts for Corporate Enterprises when at least **two** of the following conditions apply:

- 1) Their assets do not total over 11 million four hundred thousand euros.
- 2) Their net turnover is not in excess of 22 million, eight hundred thousand euros.
- 3) Their average number of employees during the year does not exceed two hundred and fifty.

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

Article 34.1 of the Code of Commerce states that the annual accounts shall include:

- 1) The balance sheet
- 2) The profit and loss accounts
- 3) A statement of the changes in the net assets during the business year
- 4) A cash flow statement
- 5) An annual report

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

1) The balance sheet enumerates the value of the goods and rights that form the assets of the company, and then in separate entries, the enumeration and value of the liabilities of the company. It should then specify the net patrimony of the business.

The balance in each trading year gives an instant reading of the patrimony of the business.

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

2) The profit and loss accounts are formed by the earnings and the expenses of the company during the financial year, and the result positive or negative, of these operations. These must distinguish between the results stemming from the habitual activity of the business (for example the sales of a product manufactured by the company) from those that do not (for example the sale of a warehouse). The difference between the profit and loss accounts and the balance sheet is that, while the balance sheet gives an overall picture of the health of the company, the profit and loss accounts focus on the specific operations that have led to a profit or loss in that trading year.

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

3) The statement of the changes in the net assets of the company is obligatory for all businesses. It details the earnings and expenses generated by the trading activity of the company, and the changes in the net assets of the company derived from transactions either conducted with the business partners or owners or as a result of changes in the accounting criteria employed by the company, or as the result of the correction of errors (Article 35.3 of the Code of Commerce).

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

4) Article 257.3 of the Corporate Enterprises Act states that: *Companies entitled to issue an abridged balance sheet and statement of changes in net worth shall not be bound to issue a cash flow statement.*

This obviously limits the number of companies to whom the obligation to issue a cash flow statement applies: The function of this document is to group together in an orderly fashion the collections and payments made by the company during the business year, with the specific objective of detailing cash payments.

THE DOCUMENTS THAT MAKE UP THE ANNUAL ACCOUNTS

5) **The annual report** – the annual report is both a summary and a comment on the information contained in the other documents. Its function is basically explanatory, providing the criteria for interpreting the data contained in the other documents.

THE WRITING OF THE ANNUAL ACCOUNTS

Article 37 of the Code of Commerce stipulates that:

The annual accounts must be signed by the following persons, who shall certify their veracity:

- 1. By the businessperson herself, if an individual*
- 2. By all the partners who are unlimitedly liable for the corporate debts*
- 3. By all the company directors*

THE WRITING OF THE ANNUAL ACCOUNTS

Article 34.2 of the Code of Commerce decrees that:

The annual accounts must be drafted clearly and provide a true image of the assets, financial situation and results of the company, pursuant to the legal provisions (...).

ACCOUNTING PRINCIPLES

The International Accounting Standards Board (IASB) is an independent, private-sector body that develops and approves International Financial Reporting Standards (IFRSs). Its head office is located in London.

It has had a profound influence over the legal texts of the European Union that have attempted to harmonise legislation on accounting rules, particularly Directive 2001/65 and Regulation 1606/2002 concerning the application of international accounting rules.

ACCOUNTING PRINCIPLES

These international accounting rules consist of a number of principles, some of which are contained in article 38 of the Code of Commerce. The most important of these principles are:

- 1) The presumption that the business is a working concern (as opposed to the situation in which the balance sheet is of the type required for the liquidation of the Company).
- 2) The ban on changing the criteria for evaluating the worth of assets from one financial year to another.

ACCOUNTING PRINCIPLES

3) The principle of prudent/conservative evaluation of assets.

4) The principle of evaluating assets in the operational currency generally employed by the business, that is to say the currency of their economic environment.

5) The ban on compensating assets and liabilities, as they must be evaluated and shown separately.

AUDITORS

Law 22/2015 establishes the obligation to submit the annual accounts of a business to auditors in certain cases.

- 1) Companies whose shares are traded on the stock-exchange
- 2) Insurance companies
- 3) Corporate Enterprises that do not meet the requisites of article 263.2 of the Corporate Enterprises Act

AUDITORS

Article 263 of the Corporate Enterprises Act States that:

- 1. The financial statements and, as appropriate, the management report, must be reviewed by an auditor.*
- 2. Companies to which at least two of the circumstances listed below apply on the closing date of two consecutive financial years shall be released from this obligation.*
 - a) Their assets do not total over two million eight hundred fifty thousand euros.*

AUDITORS

b) Their net yearly turnover is not in excess of five million seven hundred thousand euros.

c) Their average headcount during the year is not over fifty.

Eligibility for this privilege shall be forfeited when fewer than two of the aforementioned circumstances are in place for two consecutive years.

AUDITORS

These are not the only cases in which a business may be obliged to submit its accounts to an auditor.

A judicial secretary or the Commercial Registrar of the region corresponding to the domicile of the business may order the auditing of the accounts of any business. The Code of Commerce in Article 40 declares that:

All traders shall be obliged to submit the annual accounts of their company to audit when this is resolved by the competent court of law, even under voluntary jurisdiction, if due to a properly grounded petition by a party accrediting a legitimate interest.

THE CONSEQUENCES OF NOT PRESENTING THE ACCOUNTS

Article 282.1 of the Corporate Enterprise Act states that:

If the governing body fails to meet its obligation to file the documents referred to in this chapter by the established deadline, no company related documents shall be registered while such obligation remains outstanding.

THE CONSEQUENCES OF NOT PRESENTING THE ACCOUNTS

Article 283

Governing body failure to file the documents referred to in this chapter within the established deadline shall also give rise to a fine imposed by the Spanish Institute of Accounting and Auditing for an amount ranging from 1,200 to 60,000 euros, further to preliminary proceedings conducted in accordance with the regulatory procedure established in the Act on Public Administration and Common Administrative Procedures.

THE COLLABORATORS OF THE BUSINESSPERSON

In very general terms we can state that some of the collaborators of the businessperson help the businessperson to produce goods while others help to introduce them to the market place.

The first group of collaborators help the businessperson in the internal activity of the business, while the second group help the businessperson in his or her external activity, or in the relations between the business and the market.

THE COLLABORATORS OF THE BUSINESSPERSON

This grand classification can be further refined by distinguishing between those whose collaboration is sought on a more or less permanent basis and those whose collaboration is sporadic.

The permanent collaborators work within the framework of the organisation in a relationship of subordination or dependency. These are the collaborators in the strict legal sense of the term.

The second group is made up of subjects that are businesspersons in their own right, and they are not subordinated to or dependent on another businessperson.

COLLABORATORS THAT ARE DEPENDENT ON THE BUSINESSPERSON

The collaborators that are dependent on the businessperson can be defined in the following terms:

Those that act on a permanent basis, and within the framework of the business, in a relationship of dependency and subordination to carry out or help to carry out the economic activity of the business, to act in the name of the business in the marketplace or who realize both activities.

We shall examine the following types of collaborator:

COLLABORATORS THAT ARE DEPENDENT ON THE BUSINESSPERSON

- (1) The factor**
- (2) Assistants**
- (3) Representatives**

THE FACTOR

- (1) The factor – is the principal collaborator of the commercial businessperson. The legal regime of the factor is sketched out in Articles 281 ff of the Code of Commerce.

In modern business parlance the factor would be more commonly referred to as the general manager or the director of the company.

It is possible to make a distinction between the factor given general powers and the factor that has been conceded only specific powers.

THE FACTOR

Article 283 of the Code of Commerce states that:

The manager of a company or factory or business venture, employed and authorised to manage, direct it and enter into contracts concerning its business, with more or less powers as deemed convenient by the owner, shall have the legal status of a factor, and the provisions set forth in this section shall be applicable to him.

THE FACTOR

The factor can be defined as the collaborator of the businessperson to whom general powers of management are conferred, and who acts in the name of and under the responsibility of the principal businessperson.

The naming of the factor and conferral of these general powers can be done in two ways:

(a) In written form through a notary and the subsequent inscription in the Commercial Registry, which will therefore include the powers conferred on the factor.

THE FACTOR

(b) Tacitly.

This tacit factor is permitted on the understanding that the actions of the factor are assumed to be undertaken on behalf of the principal businessperson, providing that they are within the ambit of activity of the business in question. Therefore third parties are entitled to require the principal to respond for the obligations contracted in her name by the factor. It is not therefore permissible that the principal then alleges that the powers of the factor were limited and did not extend to the obligations in question (providing, I insist, they fall within the ambit of commercial activity of the business in question – a question of proof and reasonable expectations).

THE FACTOR

Article 286 of the Code of Commerce stipulates that:

Contracts entered into by the factor of an establishment or factory or business venture, when notoriously belonging to a known firm or company, shall be understood to be conducted on account of the owner of that firm or company, even when the factor has not stated this at the time of entering into these, or if abuse of confidence, transgression of powers or appropriation by the factor of the goods subject to contract is alleged, provided these contracts concern objects encompassed by the business and trading activities of the establishment, or, even if being of another nature, it turns out that the factor acted under orders from his principal, or that he approved his management under specific terms or by positive acts.

THE FACTOR

The requisites of the factor -

(i) Article 282 of the Code of Commerce requires the factor to “have the necessary capacity to bind himself according to this Code and with powers conferred by the person on behalf of whom he is performing the business”.

This means that the person in question should have the capacity to act as a commercial businessperson (given that he or she substitutes the principal).

THE FACTOR

(ii) The factor is also subject to the prohibition to compete unfairly with the principal, unless they have a pact to the contrary. Article 288 of the Code of Commerce states that:

Factors may not deal on their own behalf, nor take an interest on their own behalf or that of others in negotiations of the same kind as performed on behalf of their principals, unless these (the principals) specifically authorise them to do so.

THE FACTOR

The death of the physical commercial businessperson does not automatically revoke the powers of the factor, article 290 of the Code of Commerce states that:

The powers granted to a factor shall be deemed to subsist while they are not specifically revoked, notwithstanding the death of the principal or the person from whom they might have been duly received.

THE RELATIONS BETWEEN THE FACTOR AND THE PRINCIPAL

The revocation of the powers of the factor by the principal obliges the factor to cease in the exercise of those powers from the moment they are told of the principal's decision.

However, with regard to third-parties, the revocation does not come into force until the moment it is inscribed in the Commercial Registry (if the factor were to keep acting despite being informed of the revocation of his powers).

If the factor's powers were not inscribed but merely tacitly conferred, then the revocation takes effect from the moment that these third parties were notified of the principal's decision. This notification could be carried out individually or on mass (through a public declaration such as an advert), but is ultimately a question of proof (should it come to court).

FACTORS CONFERRED LIMITED POWERS

While a factor granted general powers can carry out all the functions ascribed to the commercial businessperson, factors who have been attributed only specific powers can obviously only perform the functions they have been empowered to undertake.

These factors do not have access to inscription in the Commercial Registry, as articles 22 of the Code of Commerce and 87.2 and 94.5 of the Regulation of the Commercial Registry only refer to the inscription of general powers.

ASSISTANTS

The assistants of the commercial businessperson are configured in the Code of Commerce as being authorised to sell to the public or to sell wholesale to other businesses.

Article 294 of the Code of Commerce states that:

The assistants in charge of retail selling in a public store shall be considered authorised to collect the price of the sales they perform, and their receipts shall be valid, issuing these on behalf of their principals.

ASSISTANTS

Assistants selling at wholesale stores shall have the same power, provided the sales are cash and the payment is taken at the actual store; but when collection is to take place elsewhere, or is from instalment sales, the receipts must be signed by the principal or his factor, or by the proxy legitimately appointed to collect.

ASSISTANTS

In both cases assistants are collaborators with very limited powers of representation, linked to their principal by an ordinary work contract.

REPRESENTATIVES

Businesspersons are obviously frequently obliged to extend their activities beyond their establishments to capture clients. This is often done through representatives of the business. There is a distinction to be made between commercial agents and sales representatives.

Commercial agents – are businesspersons themselves and as such are independent collaborators that normally provide services to various businesses.

Sales representatives – are dependent on the principal and are linked to her by an employment contract.

REPRESENTATIVES

Their functions depend on the stipulations of the contract, but they generally consist in:

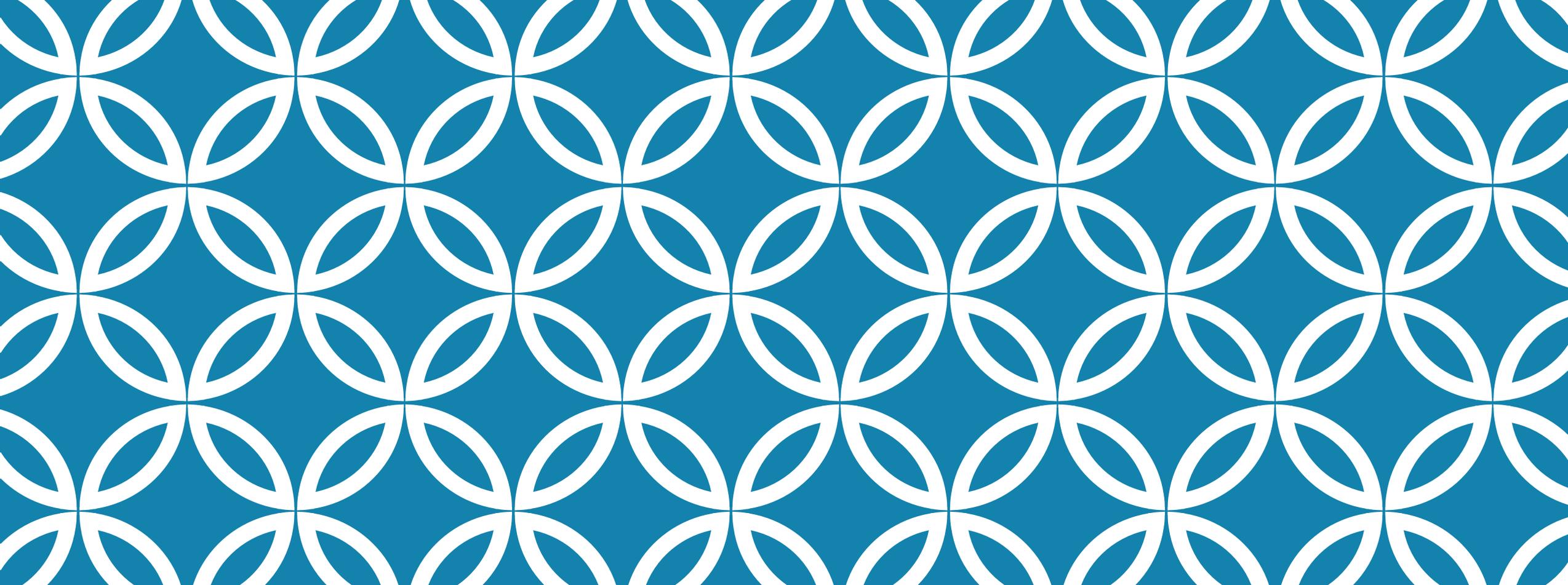
- (a) Visiting clients outside the commercial establishment.
- (b) Increasing the number of sales contracts.
- (c) Taking sales orders.
- (d) They are sometimes granted the power to sign contracts in the name of their principal, but often with the provision that the contract is only valid once accepted by the principal.

They are generally paid a commission for the sales they make.

INDEPENDENT COLLABORATORS OF THE COMMERCIAL BUSINESSPERSON

This is a category of subjects that do not form part of the business of the commercial businessperson, and are therefore not hierarchically dependent on or subordinated to her. They collaborate with the commercial businessperson to promote the external activities of the company.

Commercial agents – Are those persons that regularly provide services designed to promote the business of the commercial businessperson. They normally have the function of finding clients/customers for the businessperson and are generally paid according to the number and/or the value of the contracts signed with these clients. Their legal regime is described in detail in Law 12/1992 (the legal regime of agency contracts).



LESSON 4. THE BUSINESS

PART 1

THE LEGAL CONCEPT OF A BUSINESS

The business is a fundamental element of the modern economy that is necessary to carry out industrial and commercial activities on mass.

The Concept of a business - From an economic perspective a business may be defined as the **organisation** of work and capital with the objective of producing goods or providing services for the market, either directly or as intermediary.

This is the concept that most economists generally employ.

THE LEGAL CONCEPT OF A BUSINESS

The legal concept of a business amplifies this previous definition to:

The organisation of work and capital with the objective of producing goods and providing services for the market, either directly or as an intermediary, and planned according to the criteria of profitability and cost-effectiveness.

THE ELEMENTS THAT CONSTITUTE A BUSINESS

A business is a group of elements of varying classes and characteristics that are organised to carry out a specific type of economic activity. This includes.

a) **The employees** – the labour contracts that link the employees to the business. Obviously these contracts are governed by the terms of labour law and not commercial law.

THE ELEMENTS THAT CONSTITUTE A BUSINESS

b) **The immaterial goods** - for example patents, trade-marks and know-how (the industrial practices that are not patentable), as well as other types of contract essential for the functioning of the business such as a lease on a commercial property.

THE ELEMENTS THAT CONSTITUTE A BUSINESS

However, a business is not simply an inert collection of elements. It is rather the productive organisation of these elements, so that, as a general rule, the business is worth more than the sum of its parts.

From this productive organisation arise two other vital components of the business:

- (a) The clientele
- (b) The expected earnings/profits of the company

THE ELEMENTS THAT CONSTITUTE A BUSINESS

- (a) The clientele can be defined as the group of people who, on an ongoing basis, require the services or products of the company. This can be contrasted with the merely potential customer, who has not yet bought these goods or services.
- (b) The expected profits or earnings obviously do not depend solely on the organisation of the business (for example, the quality of its goods or services), but on a number of external variables, such as market tendencies or consumer preferences.

THE LEGAL NATURE OF THE BUSINESS

Legal doctrine and case law have centred the discussion concerning the legal nature of the business around three main points.

- 1) The business, as an organised productive unit, is worth more than the sum of its parts.
- 2) The business, while consisting of these various parts, gives the external appearance of a single unit.
- 3) The transmission of businesses creates a series of legal problems that require solutions.

THE LEGAL NATURE OF THE BUSINESS

In response, various theories concerning the legal nature of the business has been put forward.

- a) The atomist theory of the business, according to which the business is a plurality of privately owned elements, each of which maintains its own legal individuality.
- b) The unitary theory, according to which the disparate elements of the business are united by the economic objective it pursues.

THE LEGAL NATURE OF THE BUSINESS

- c) The immaterial conception of the business, by which the business is considered as an immaterial good belonging to the entrepreneur, and protected by the rules regarding unfair competition.
- d) The composite theory, which regards the business as a functioning unit recognised by the law despite the fact that it lacks a solid material identity.

THE LEGAL NATURE OF THE BUSINESS

It is this composite theory (composite in the sense that it contains elements of the three others mentioned) which is favoured by the majority of Spanish legal thinkers.

i) It is quite true that the business is not a *thing* that in and of itself gives rise to “rights in rem” (as is the case of a house). The rights in rem can only be attributed to those things which make up the patrimony of the company, but not the company itself.

THE LEGAL NATURE OF THE BUSINESS

ii) Spanish law allows for the transmission of a whole business (all of its essential elements) in a single contract, which of course means that the business, while not really a thing, is treated in a unitary fashion.

iii) Despite the possibility of treating the business as a unit in a contract for the purposes of its transmission, the legal treatment of the individual elements to be transmitted is different, as each of these elements have to be transmitted in a way that respects the laws governing their transmission. For example the laws governing the transmission of land, industrial/intellectual property, etc.

THE HEAD OFFICE AND BRANCHES

The activity of the business is obviously carried out at a physical location, often open to the public.

Article 9 of the Corporate Enterprises Act refers to the Registered Office of the Company (the office that is listed in the Commercial Registry) and states that:

Corporate enterprises shall establish their registered office at the place on Spanish soil where their actual administrative and management activities, or their main business establishment or operation, are located.

THE HEAD OFFICE AND BRANCHES

The location where the administrative and management activities are carried out may not coincide with the main business establishment (in the case of large companies), and so the enterprise is free to choose which of these locations is to be their registered office.

The business may have one or more branches, secondary establishments with a certain degree of autonomy, that represent the business in locations other than the main establishment. The rules governing the registration of these branches are contained in articles 295ff of the Regulation of the Commercial Registry (Royal Decree 1784/1996).

THE HEAD OFFICE AND BRANCHES

Branches do not have a separate legal personality from the registered business. They are located in a different place to the main establishment, represent the business on a permanent basis, and will have a manager conferred with certain powers to take decisions.

The decision to open or close branches lies with the governing body of the business, or its general managers, according to its statutes.

Branches must be inscribed in the Commercial Registry twice.

THE HEAD OFFICE AND BRANCHES

Article 296.1 of the Regulation of the Commercial Registry states that:

The opening of branches must be inscribed first on the page in which the registered office is inscribed, and then a separate inscription for the branch must be made in the Commercial Registry corresponding to the domicile of the branch.

296.2 declares that:

When the registered office and the branch are in the same province, then the branch only has to be inscribed on the page corresponding to the registered office.

However, the Registrar may decide for reasons of clarity that a separate page should be opened for the branches located in the same province.

THE HEAD OFFICE AND BRANCHES

Article 297 of the Regulation gives a list of what the inscription of the branch must contain:

- (i) The identifying features of the branch.
- (ii) The address of the branch.
- (iii) The activities that the branch has been authorised to carry out by the registered office.
- (iv) The identity of the permanent representatives of the business working at the branch and the faculties conferred on them.

THE HEAD OFFICE AND BRANCHES

In addition to these features the first inscription of the branch must also contain the company name and the first names and surnames or the company name of its administrators, indicating the post they hold.

Article 299 of the Regulation holds that:

The dissolution of the company, the appointment of liquidators, the end of the liquidation proceedings, the suspension of payments or the bankruptcy of the company, as well as the modification of any of the features mentioned in Article 297 or the closing of a branch, must be inscribed on the page of the registered office and then inscribed on the page devoted to any of its branches in the Commercial Registry corresponding to their domicile by way of certification.

THE HEAD OFFICE AND ITS BRANCHES

The inscription of foreign companies in the Commercial Registry allows them to act in Spain without the prior requirement of constituting a business under Spanish law or moving their registered domicile to Spanish territory, in accordance with the freedom of establishment consecrated in article 49 TFUE.

Articles 300ff of the Regulation are concerned with the inscription of these foreign companies. In the case of branches of companies, given that the registered office does not have an entry in a Spanish Commercial Registry, Articles 300ff of the Regulation establish a series of special requisites beyond those required for branches of domestic companies in Article 297. Among these are:

- a) The documents that accredit the existence of the company abroad.
- b) The statutes of the company.
- c) The identity of the administrators of the company and their responsibilities.

THE COMPANY AS AN OBJECT OF LEGAL TRANSACTIONS

The transmission of a company raises three main legal issues:

- 1) The assumption of debt and the transfer of credits**
- 2) The transfer of contracts**
- 3) The prohibition of unfair competition**

1) THE ASSUMPTION OF DEBT AND THE TRANSFER OF CREDITS

Business activity generates a plethora of debts and credits with third parties. When a business is transmitted it is necessary to determine if, along with the transfer of the business, the acquirer automatically receives its credits and assumes its debts, or if, on the contrary, the transmission of these is not automatic, but rather must follow the legal requisites established.

As Spanish law does not resolve this issue with any specific norm, it is necessary to turn to the general rules for an answer.

1) THE ASSUMPTION OF DEBT AND THE TRANSFER OF CREDITS

The credits held over third parties are not automatically passed on to the acquirer of the business. In order for these to be transmitted it is necessary that their transfer is the subject of a specific pact by the transmitter/creditor and the acquirer. The debtor of these credits does not have to give her consent to the transmission, it is sufficient that she be informed of the transfer, in accordance with Article 347 of the Code of Commerce.

1) THE ASSUMPTION OF DEBT AND THE TRANSFER OF CREDITS

The debts of the company are not automatically assumed by the acquirer of the company either. It is necessary that the parties to the transmission pact specifically the transfer of debts. The parties must also comply with the terms of Article 1205 of the Civil Code, which requires the express consent of the creditor.

If this consent is not forthcoming, then the agreement between the transmitter and the acquirer of the business is only effective between them, but does not affect the legal position of the creditor, who can legally enforce his claim against the original debtor.

2) THE TRANSFER OF CONTRACTS

The business to be transmitted is normally party to a large number of contracts. These contracts are generally vital to the functioning of the company (for example the lease on the property that houses the head offices or the principal establishment). It is therefore necessary to determine whether these contracts are automatically transferred when the company changes hands. Although there are some exceptions, this problem is not resolved by any specific norms in Spanish law, nor is a solution contained in the general laws of the Civil Code.

2) THE TRANSFER OF CONTRACTS

This transfer of the contractual positions cannot take place automatically and will require the consent of the third party with whom the contract in question was originally celebrated.

There are, however, some cases in which the law does require the automatic transfer of contracts, for example:

a) Article 44 of the workers statute (Royal Legislative Decree 1/1995) orders that the acquirer of a company be automatically subrogated in the position previously occupied by the transmitter of the company for all the labour contracts of its employees.

2) THE TRANSFER OF CONTRACTS

- b) Articles 280 and 290 of the Code of Commerce stipulate that the factor shall continue in **her** functions even upon the death of the principal (and the transmission mortis causa of the business).
- c) Article 27 of Law 12/1992 (On the Agency Contract) decrees that the agency contract shall not automatically terminate with the death of the entrepreneur with whom it was celebrated, although it may subsequently be terminated by those that inherit the business.
- d) Article 34 of the Insurance Contract (Law 50/1980) states that the insurance contract over the object insured will be transmitted to the acquirer of the object that changes hands.

2) THE TRANSFER OF CONTRACTS

Outside of these cases it is necessary that the parties to the transmission of the business receive the consent of the party to the original contract, (the contract that they wish to be passed on to the acquirer of the business). An exception to this rule is the lease contract of the establishment where the company conducts its regular business. Although this contract is not automatically transmitted to the acquirer of the business (and therefore a specific contractual stipulation is necessary) Article 32 of Law 29/1994 on urban leases dispenses with the necessity to obtain the consent of the lessor.

3) THE PROHIBITION OF UNFAIR COMPETITION

When a business is transferred (*inter vivos*), the transmitter is obliged to pass on all of the essential elements of the company (both material and immaterial), as well as the vital elements we mentioned earlier:

- a) The clientele
- b) The projected earning/profits

Obviously, these two elements can't be directly transmitted, but the principal way in which the transmitter can ensure that the acquirer receives the clientele and the projected earnings that accompany them is through the accessory negative obligation not to enter into competition with the acquirer.

3) THE PROHIBITION OF UNFAIR COMPETITION

Spanish law does not specifically oblige the transmitter of a company to take on this negative obligation in any single disposition, and so it is worth questioning whether it is therefore enforceable.

There are two possible scenarios.

a) The parties have stipulated this negative obligation on the part of the transmitter by contract. This is enforceable and would result in the payment of a sum in compensation if the terms of the contract were to be broken.

3) THE PROHIBITION OF UNFAIR COMPETITION

b) However, it is possible that the parties have not stipulated anything in the contract. In this case the transmitter must **still** refrain from competing against the acquirer of the company, as to do so would be contrary to the terms of article 1258 of the Civil Code which states that:

*Contracts are perfected by mere consent, and since then bind the parties, not just to the performance of the matters expressly agreed therein, but also **to all the consequences which, according to their nature, are in accordance with good faith, custom and the law.***

3) THE PROHIBITION OF UNFAIR COMPETITION

It would be difficult to maintain that whoever commits herself to the transmission of a business is not also committing herself to transmitting its clientele (which is essential to the functioning of the business) and therefore its projected earnings/income. It is also the case that **acting in good faith must include the obligation not to interfere with the economic objective pursued by the contract,** which would be threatened were there no prohibition against direct competition by the transmitter.

3) THE PROHIBITION OF UNFAIR COMPETITION

Further to this, article 57 of the Code of Commerce establishes that:

*Business contracts shall be implemented and fulfilled **in good faith**, pursuant to the terms under which they were made and drafted, without misinterpreting them through arbitrary constructions of the correct, proper and usual sense of the words said or written, or **restriction of the effects naturally arising from the way in which the parties to the contract would have explained their will and contracted their obligations.***

3) THE PROHIBITION OF UNFAIR COMPETITION

This joint reading of Article 1258 of the Civil Code and Article 57 of the Code of Commerce would seem to justify the assertion that the transmitter is bound not to compete with the acquirer of the company.

However, this ban on competition is obviously not unlimited in time and space. The ban is geographically limited to the area or areas in which there exists a reasonable expectation that rival commercial activity would constitute an infraction of good faith, and during the time period necessary for the new acquirer to consolidate the business.

THE PURCHASE OF THE BUSINESS

A business can only be said to have been sold when the object of the sales contract is the organised collection of elements that constitute a functioning company. The sale of a disorganised mass of elements (such as when a company has been liquidated or never started trading) is not the sale of the company.

In companies that have shareholders a similar result to the sale of a company is achieved when the position of majority shareholder changes hands, or one company merges with another (in which case the law applicable is Law 3/2009 on Structural Changes in Trading Companies).

THE PURCHASE OF THE BUSINESS

For the true sale of a business it is necessary (and sufficient) the stipulation of a single contract whose object is the transmission of the business, without the necessity of concluding as many contracts as there are individual material and immaterial elements that compose the patrimony of the business. This is the case because Articles 1089 and 1091 of the Civil Code provide that obligations arise from contracts and that contracts have the force of law between the parties. In the case of the transmission of a functioning business, it is essential that the business be transmitted together with all its elements (otherwise it could not function and so the contract would lose its object).

THE PURCHASE OF THE BUSINESS

As we have already had occasion to mention, the fact that the business is treated as a unified thing for the purpose of its transmission, does not except the individual constituent parts from having to conform with the laws pertaining to the transmission of elements of that type (as property, trademarks, motor-vehicles – all need to conform to the specific laws regarding their transmission).

THE OBLIGATIONS THAT ACCOMPANY THE TRANSMISSION OF THE BUSINESS

1) The obligation to hand over the company when sold – With respect to the elements that must be handed over to the acquirer of the company a distinction can be made between the situation in which an inventory has or has not been drawn up.

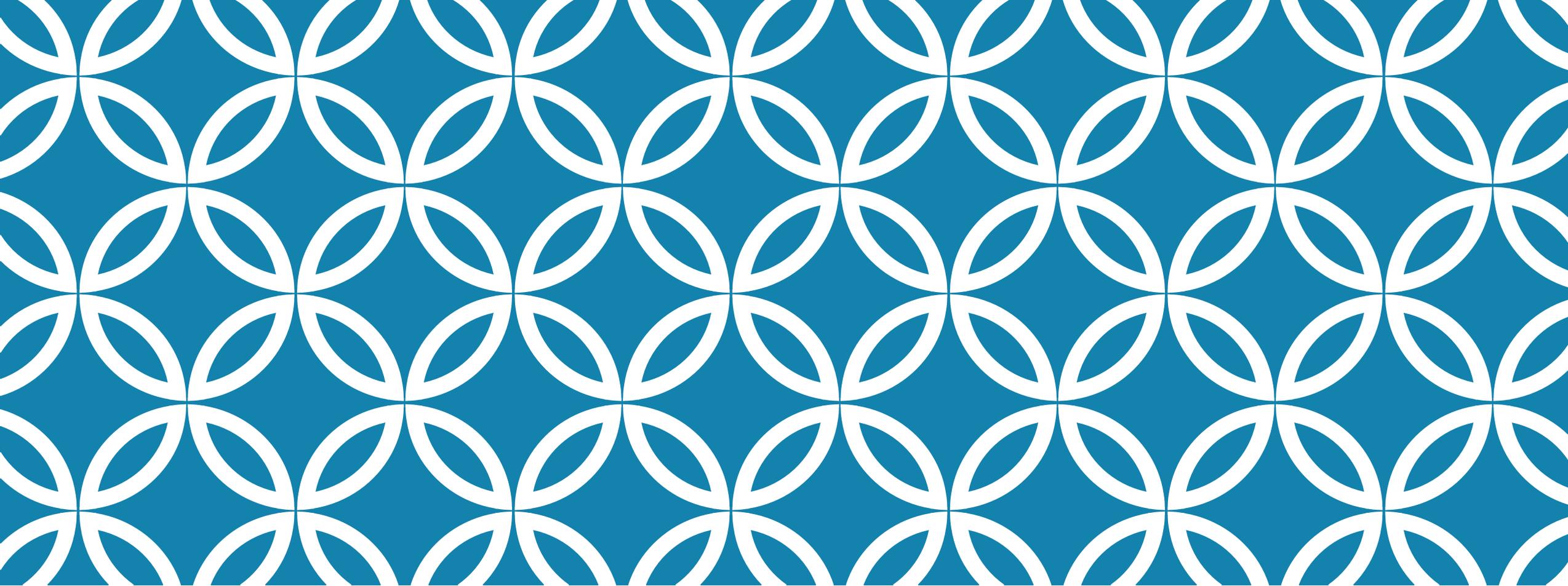
A) If an inventory has been drawn up then the transmitter of the business must hand over/deliver all of the items listed in the inventory.

B) If no inventory has been drawn up then the transmitter must hand over/deliver all the essential elements of the company, so that the acquirer can continue with the economic activity of the business. This means not simply the elements that individually constitute the patrimony of the business but also the organisation of the company. This generally includes such things as a client list, the company “know-how”, and advice on production processes or techniques.

THE OBLIGATIONS THAT ACCOMPANY THE TRANSMISSION OF THE BUSINESS

2) The prohibition to compete with the business – As we have already commented, the seller of the company not only has the obligation to transmit the business but also to abstain from frustrating the objective that the contract was created to achieve.

So there exists the obligation not to compete with the business of the acquirer within certain geographical limits during a specified time period.



LESSON 4 THE BUSINESS PART 2

BUSINESS COMPANIES

SALE FOR RESALE — A COMMERCIAL ACT

Article 325 of the Code of Commerce states that:

*The sale or purchase of moveable goods for resale, either in the same format as bought, or as another item, in order to make a **profit** from the resale, shall be considered as having a business nature.*

ACTS EXPLICITLY EXCLUDED AS COMMERCIAL ACTIVITIES

Article 326 of the Code of Commerce lists 4 types of act that are not classified as Commercial Acts:

- 1. Purchases of items intended for consumption by the buyer, or by the person under whose agency they are acquired.*
- 2. Sales by owners and agricultural workers or farmers of the fruit or product of their crops or cattle, or of the species in which they are paid the rents.*
- 3. Sales of objects built or manufactured by craftsmen that they perform at their workshops.*
- 4. Re-sale by any non-business persons of the rest of the stock obtained for consumption.*

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

Article 1665 of the **Civil Code** states that:

A partnership is a contract whereby two or more persons undertake to put in common money, property or industry with the intention of dividing any gains between them.

And article 116 of the **Code of Commerce** states that:

*The articles of incorporation by which two or more persons reach a covenant to place goods, an industry or any of these things in common fund, **to obtain profit**, shall be a business company, whatever the class thereof, provided it is incorporated pursuant to the terms of this Code.*

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

These two norms give rise to a rather complex distinction between civil companies (regulated by the terms of the Civil Code) and commercial companies (subject to the provisions of the Code of Commerce).

In order to explain this difference we should first remark that the Code of Commerce (1885) was published before the Civil Code (1889).

The text of Article 116 was interpreted to mean that Commercial companies were those that met the formal requirements of the Code of Commerce (“Incorporated pursuant to the terms of this Code”).

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

These formal requirements were detailed in Article 119.1 of the Code of Commerce:

Before commencing their operations, all business companies must record their incorporation, terms and conditions in a public deed that shall be presented for inscription at the Commercial Registry, pursuant to the terms of Article 17.

For a time it was possible to maintain that those societies which did not meet these formal requisites were irregular, and therefore Civil companies.

THE CONCEPT OF THE COMPANY IN SPANISH LAW- CIVIL AND COMMERCIAL COMPANIES

However, the argument against this interpretation was that the wording of Article 119 seems to presume the existence of the commercial company before inscription takes place. The text of the modern Corporate Enterprises Act confirms that irregular companies that have a Commercial object are governed by Commercial Law. Article 39 of the CEA determines that:

Once the intention to refrain from registering a company has been confirmed and, in any event, when no application for registration is filed within one year of the date of formalisation of the deed, it shall be governed by the rules for general partnerships or, as appropriate, non-mercantile organisations (...).

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

The eminent legal thinkers Garrigues and Uría proposed the idea of classes of legal companies which were automatically commercial in nature. This idea is supported by both Article 116 and 122 of the Code of Commerce. Article 122 states that:

As a general rule, business companies shall be incorporated by adopting one of the following forms:

- 1. General partnership*
- 2. Limited liability partnership*
- 3. Joint stock company (a corporation)*
- 4. Limited liability company (a corporation)*

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

This concept of the class of a company has to be reinforced by an analysis of the objective pursued by the company in question (in order to prevent companies that carry out a commercial activity from avoiding the obligations that this entails by choosing to characterise themselves as civil companies).

A commercial company is therefore that which:

- (i) Adopts one of the forms of a commercial business company
- (ii) Has not adopted one of these forms but nevertheless carries out a commercial activity.

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

The characterisation of a company as a Commercial company is not therefore dependent on:

- (i) Having incorporated its deeds of constitution in a public document
- (ii) Having been inscribed in the Commercial Registry.

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

However, this interpretation is threatened by article 1670 of the Civil Code, which maintains that:

Civil partnerships may hold all forms recognised by the Code of Commerce, depending on their corporate purpose, in such case, the provisions thereof shall apply to the extent that they do not oppose the provisions of the present Code.

This means that the general partnership and the limited liability partnership may be civil companies, and their characterisation as Commercial companies will be determined by the activity that they carry out. Only those whose objective is commercial will have access to inscription in the Commercial Registry.

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

This interpretation does not apply to **corporate companies** mentioned in Article 2 of the Corporate Enterprises Act (basically the joint stock company and the limited liability company), as the law states that these types of company are always to be considered commercial companies. These companies are therefore commercial companies automatically by virtue of the form they take.

THE CONCEPT OF THE COMPANY IN SPANISH LAW — CIVIL AND COMMERCIAL COMPANIES

The distinction between civil and commercial companies has practical relevance. Commercial companies have to comply with different accounting standards (as we have already seen) and pay taxes in accordance with the Law on Company Tax (Law 27/2014).

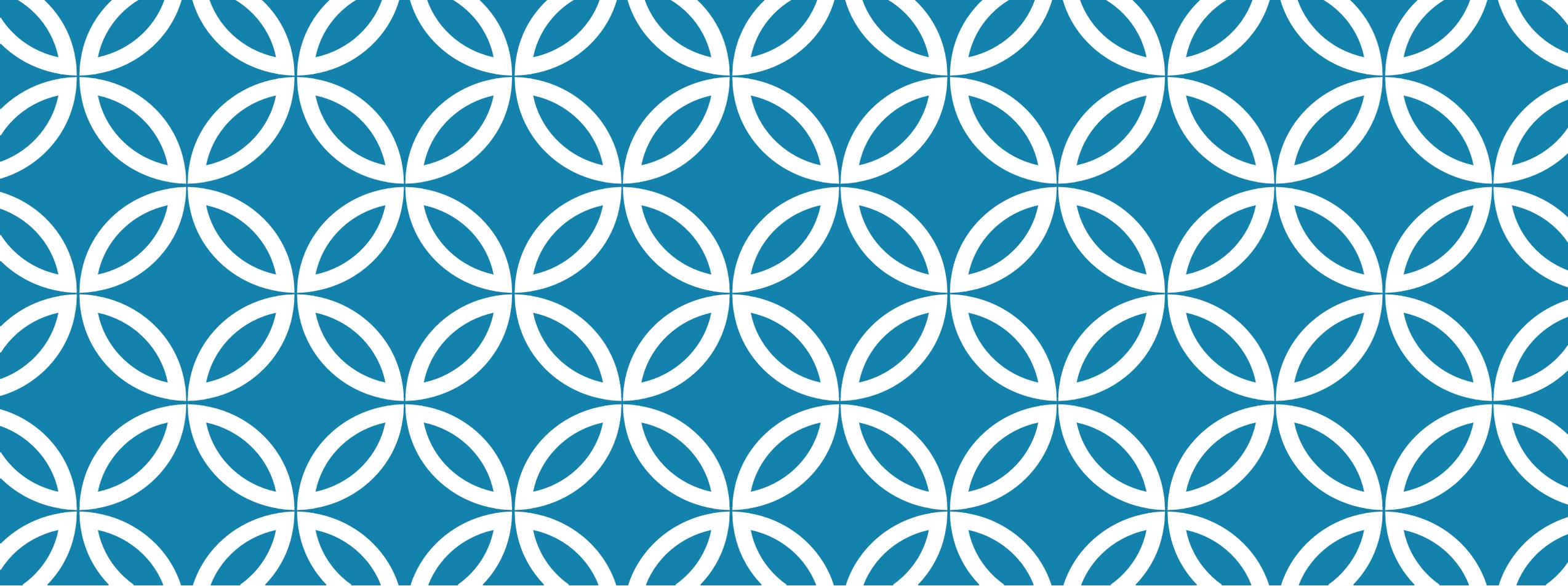
PARTNERSHIPS AND CAPITALIST COMPANIES

The distinction between partnerships and capitalist companies is based primarily on the role that capital plays in capitalist companies, something we shall examine in greater detail later.

In partnerships the partners respond personally and without limits to the debts acquired by the company. In capitalist companies the partners do not respond for the debts of the company.

COMMON TYPES OF COMMERCIAL BUSINESS

- a) **General partnerships (sociedad colectiva)** – The principal characteristic of this type of company is that the partners respond personally, jointly and severally and without limitations for the debts acquired by the company. Each of the partners has an equal right to intervene in the management and administration of the company.
- b) **Limited partnerships (sociedad comanditaria simple)** – In this type of partnership there is a distinction between those partners who actively participate in the business activity and respond jointly and severally for the debts of the company and those who only have the obligation to provide the contribution that they have promised to make to the partnership. These partners only respond to the limit of their contribution and do not have the right to intervene in the managerial decisions of the company.
- c) **Joint stock company (sociedad anónima)** – The capital of this type of company is divided into shares in the proportion acquired by the shareholders. The shareholders do not respond personally for the debts of the company nor do they have the right (derived from their mere condition as shareholders) to assume the management of the company.
- d) **Limited liability company (sociedad de responsabilidad limitada)** – The stakes of these companies are subject to different rules regarding their transmission than those of Joint Stock Company. The partners have limited responsibility with respect to the debts of the company and do not have (due to their mere condition as stake holders) the right to participate in the management of the company.
- e) **Share partnership with unlimited responsibility (sociedad comanditaria por acciones)** – The capital of the company is divided into shares but the partners are responsible without limits for the debts acquired by the company.



LESSON 4 — THE BUSINESS PART 3

TYPES OF COMPANY
CORPORATIONS —
CONSTITUTION AND NULLITY
OF CORPORATIONS

THE CLASSIFICATION OF COMMERCIAL COMPANIES

Article 122 of the Code of Commerce provides us with five types of commercial company.

- (a) General Partnerships
- (b) Limited Partnerships
- (c) Joint Stock Companies
- (d) Limited Liability Companies
- (e) Share Partnerships with unlimited responsibility

THE CLASSIFICATION OF COMMERCIAL COMPANIES

These types of company can be divided into:

- (a) Partnerships
- (b) Capital based companies/corporations

THE CLASSIFICATION OF COMMERCIAL COMPANIES

In partnerships the identity of the partner is more important than the capital that he or she contributes to the company. Of the list in Article 122 of the Code of Commerce:

General and Limited Partnerships may be classified as **partnerships**. The partners names are included in the denomination of the company and they respond without limits to the debts incurred by the company.

THE CLASSIFICATION OF COMMERCIAL COMPANIES

In capital based corporations what is of primary importance is the capital contributed, and not the identity of the legal or physical persons that have contributed it.

In the list of companies given in Article 122 of the Code of Commerce, Joint Stock Companies, Limited Liability Companies and Share Partnerships with unlimited responsibility can be described as corporations.

The members of the company do not generally respond personally for the debts of the company (although there are some exceptions such as the administrator of the Share Partnership with unlimited responsibility).

GENERAL PARTNERSHIPS – THE PERSONAL NATURE OF THE PARTNERSHIP

The **general partnership** is regulated in Articles 125 to 144 of the Code of Commerce. It conducts business under the names of the partners who comprise it, either all the partners or only one of them (in which case the words – “*and company*”) are added (Article 126 of the Code of Commerce).

The partners **are not permitted to transmit their interest in the company without the permission of the others.** Article 143 of the Code of Commerce stipulates that:

No partner may convey the interest he holds in the company to another person, (...) without prior consent from the other partners.

GENERAL PARTNERSHIPS — THE PERSONAL NATURE OF THE PARTNERSHIP

The death, the legally declared incapacity or the bankruptcy of one of the partners causes the dissolution of the company.

Article 222 of the Code of Commerce stipulates that:

General or limited partnership companies shall also be fully dissolved due to the following causes:

- 1. Death of one of the general partners, if the corporate deed does not contain a specific clause on continuation of the company by the heirs of the deceased partner, or the subsistence thereof by the surviving partners.*
- 2. Dementia or other causes giving rise to incapacitation of a managing partner to manage his own property.*
- 3. Opening the liquidation phase for bankruptcy of any of the general partners.*

GENERAL PARTNERSHIPS — THE RESPONSIBILITY OF THE PARTNERS

In general partnerships the partners agree to participate in the proportion established by the statutes of the company.

The patrimony of the company is formed by the goods placed in common by the partners (money or other types of goods). However, there can be partners whose contribution is their labour rather than any material goods. The company responds to creditors with all their patrimony, but, in the case that it is not sufficient to cover the debts, the creditors can demand the remnant from the personal patrimony of the partners, who respond with all their patrimony, not only with the part that they contributed to the company. They respond severally and jointly and without limitations for the debts of the company. Their personal responsibility is subsidiary to the responsibility of the company, which means that the patrimony of the company responds first and then the patrimony of the partners.

Creditors can claim responsibility from one or all of the partners. If the claim is made against only one of the partners, that partner has the responsibility to pay the full amount and cannot excuse herself by telling the creditor to claim a proportion of the debt from the other partners. Obviously, the partner who pays now has a right of credit against the partners who did not pay.

GENERAL PARTNERSHIPS — THE RESPONSIBILITY OF THE PARTNERS

Article 127 of the Code of Commerce states that:

All the partners forming a general partnership, whether or not they are its managers, shall be bound both personally and jointly and severally, with all their belongings, subject to the result of the operations performed in name and on behalf of the company, under its signature and by a person authorised to use it.

This article is imperative (as it is a rule designed to protect third parties), it is important to remember that the other dispositions of the Code of Commerce relating to the internal distribution of profits and losses within the general partnership are optional, and may be altered by agreement.

GENERAL PARTNERSHIPS — EQUAL RIGHTS OF MANAGEMENT

In principle, all the partners have a responsibility for the management of the company, although the law does establish special rules in the case that management of the partnership has been assigned to one or some of the partners by special deed.

Article 129 of the Code of Commerce stipulates that:

If the management of general partnerships has not been limited to any of the partners by a special deed, they shall be entitled to take part in the management and running of the common business, and the partners present shall agree over all contracts or obligations of interest to the company.

GENERAL PARTNERSHIPS — THE PROFITS AND LOSSES OF THE COMPANY

The results of the commercial activity of the partnership (both profits and losses) are, in principle, shared amongst the partners. The partners participate in the profits and losses in proportion to the amount they contributed to the partnership. However, as stated earlier, these rules are optional and not imperative.

Article 140 states that – If the articles of association have not determined the relevant part in the profit to be assigned to each partner, this shall be divided among them in proportion to the stake each holds in the company, including the working partners in the distribution, if any, in the class of the capitalist partners with the smallest stake.

GENERAL PARTNERSHIPS — THE PROFITS AND LOSSES OF THE COMPANY

Article 141 declares that - *“The losses shall be assigned in the same proportion between the capitalist partners, without including the industrial ones, unless the latter have been included in the share thereof in a specific clause”*.

This excludes working partners (those whose contribution is their work) from participating in the losses of the partnership, unless a clause of the articles of association specifically provides for that possibility.

GENERAL PARTNERSHIPS — THE PROHIBITION OF COMPETITION

Articles 136 and 137 of the Code of Commerce configure the obligation of the partners not to compete with the partnership (this prohibition of competition is something that we examined in a previous lesson).

LIMITED PARTNERSHIPS — TWO TYPES OF PARTNER

In the **limited partnerships** there are two types of partners, which we shall term collective and limited partners. The collective partners respond with all their goods to the debts incurred by the company (and therefore in the same way as the partners in a general partnership) whilst the **limited partners** only respond to the extent of their contribution to the partnership, and not with their personal patrimony. The limited partners do not have the right to participate in the management of the company.

LIMITED PARTNERSHIPS — PERSONAL CHARACTERISTICS

The modification of the statutes of the limited partnership requires the consent of all the partners, both collective and limited.

This makes transmission of the condition of partner difficult, as they must be included in the statutes of the company.

LIMITED PARTNERSHIPS — PERSONAL CHARACTERISTICS

The denomination of the company is regulated by article 146 of the Code of Commerce:

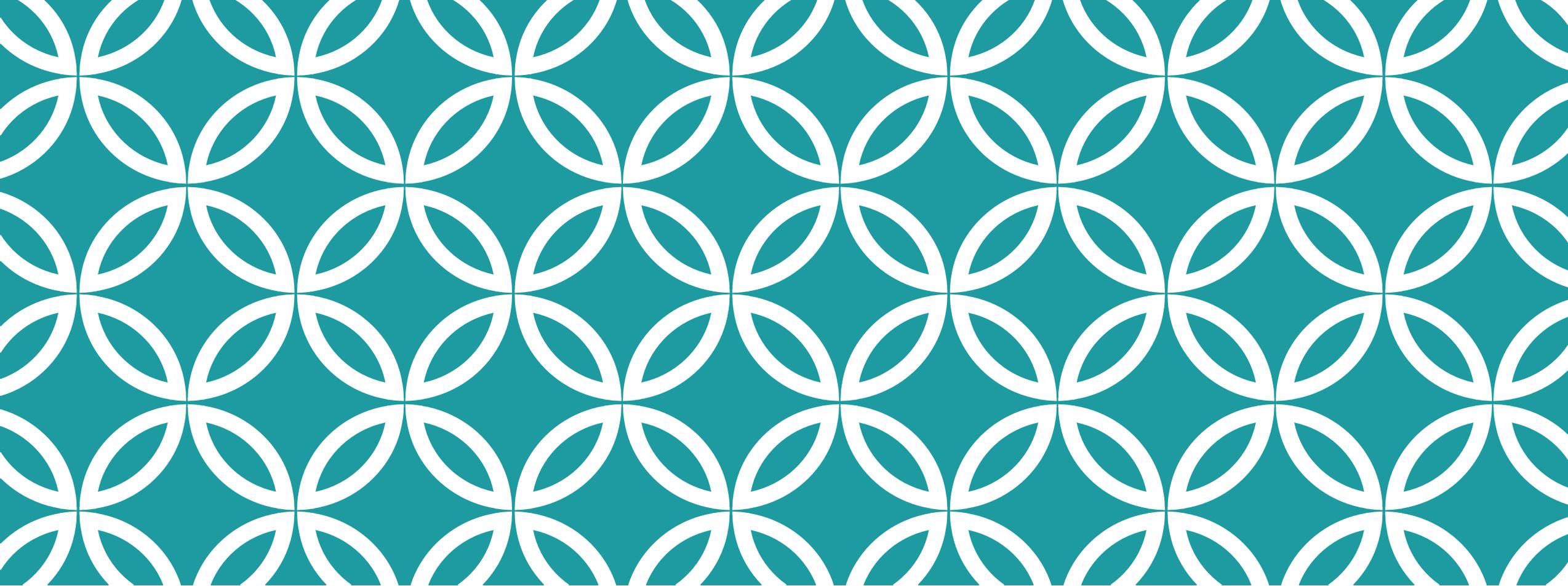
Limited partnership companies shall engage in business under the name of all the general partners, of some of them, or one alone, and in the latter two cases, the words “and Company” must be added to the name or names stated, and in all of them, those of “Limited Partnership Company”.

LIMITED PARTNERSHIPS — PERSONAL CHARACTERISTICS

The general name may not include the names of the limited partners.

If a limited partner included his name in the denomination of the company, then, in relation to third parties, that partner would respond without limitation to the debts of the company (in the same way as the collective partners), but without acquiring the rights to management that the collective partners have by virtue of their condition.

This is because the name in a partnership acts as publicity, informing third parties of those who respond for a company's debts.



CORPORATIONS

SHARE PARTNERSHIPS WITH UNLIMITED RESPONSIBILITY

The basic characteristic of these companies is the division of their patrimony in shares. This allows for the condition of partner to be transmitted more easily. This type of partnership is classified as a **Corporation**.

The partners who direct the company respond without limits for the debts of the company that were contracted during their period of management, but they are not responsible without limits for the debts contracted after their directorial role has ceased.

SHARE PARTNERSHIPS WITH UNLIMITED RESPONSIBILITY

Article 252.3 of the Corporate Enterprises Act stipulates that:

Removal from office of general partners as directors shall bring to an end their unlimited liability in relation to corporate debts incurred after registration of their severance in the Mercantile Registry.

JOINT STOCK COMPANIES

The Joint Stock Company is the prototype of the corporation. Importance is given not to the personal identity of the shareholders, but rather to the share of the company that they possess. The responsibility of the shareholders both internally and externally is limited to the shares they have in the company.

LIMITED LIABILITY COMPANIES

The Limited Liability Company possesses some of the characteristics of partnerships (the transmission of the participation in the company is subject to restrictions), but is a **corporation**. The patrimony of the company is divided into stakes that have to be distributed in their entirety in the moment that the company is constituted. The stakeholders do not respond personally for the debts of the company.

**DO NOT CONFUSE THE LIMITED LIABILITY COMPANY – A CORPORATION
WITH THE LIMITED PARTNERSHIP – NOT A CORPORATION**

THE DIFFERENCE BETWEEN CIVIL AND COMMERCIAL COMPANIES

Articles 1665ff of the Civil Code state that Civil companies:

- (a) Do not require any special form for their constitution (unless the contribution to the company consists in rights in rem or immovable goods).
- (b) Cannot be inscribed in the Commercial Registry.
- (c) Are not joint and severally bound by the debts of the partnership, although the responsibility of the partners is not limited (it is unlimited).

THE DIFFERENCE BETWEEN CIVIL AND COMMERCIAL COMPANIES

This (reasonably) clear distinction between Civil and Commercial companies is muddied somewhat by the wording of Article 1670 CC which determines that:

Civil partnerships may hold all forms recognised by the Code of Commerce depending on their corporate purpose. In such case, the provisions thereof shall apply to the extent that they do not oppose the provisions of the present Code.

So civil companies may take the form of commercial companies.

THE DIFFERENCE BETWEEN CIVIL AND COMMERCIAL COMPANIES

However, if this article is read in conjunction with Article 2 of the Corporate Enterprises Act, then we can state that:

1. **Partnerships** (General Partnerships and Limited Partnerships) are either civil or commercial depending on the activity that they carry out.
2. **Corporations** (Joint Stock Companies, Limited Liability Companies and Share Partnerships with unlimited responsibility) are always to be classified as commercial companies, whatever the type of activity that they carry out.

THE DIFFERENCE BETWEEN CIVIL AND COMMERCIAL COMPANIES

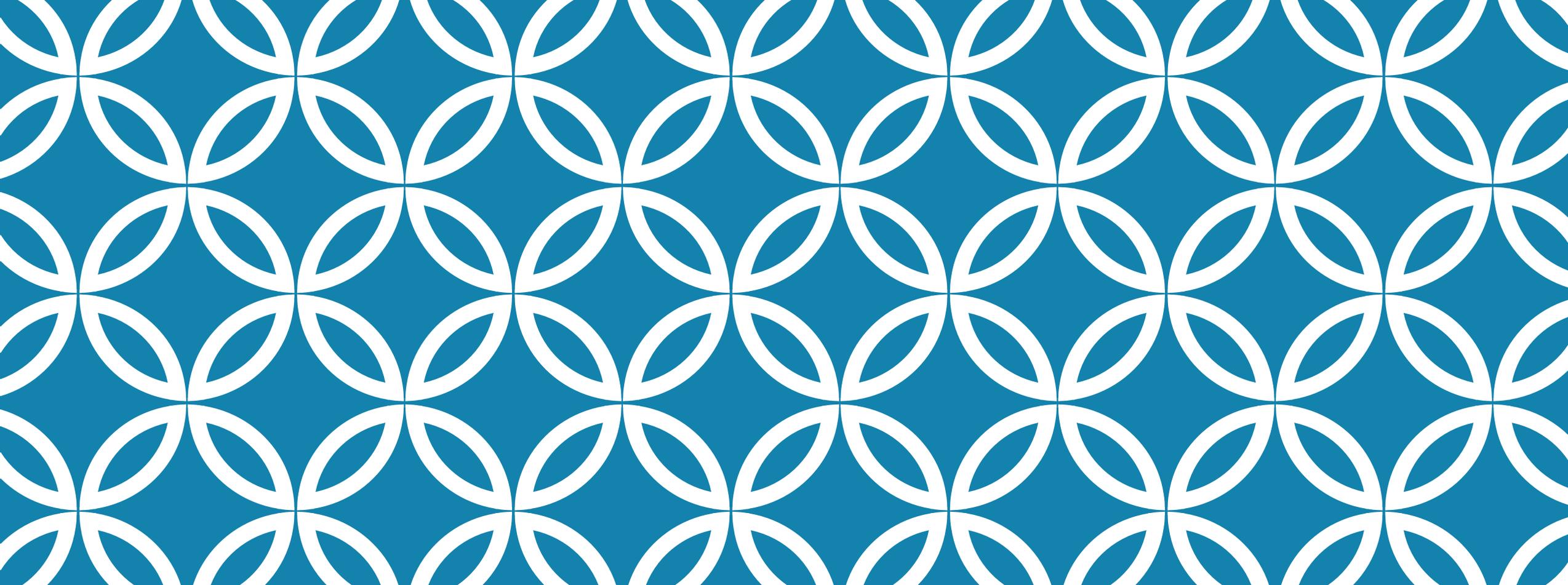
The importance of this distinction is that commercial companies are regulated by the dispositions of Commercial Law (the Code of Commerce, the Corporate Enterprises Act), while Civil societies are regulated by the dispositions of the Civil Code.

Civil companies that take the form of Commercial companies are regulated by the Code of Commerce in all aspects that are not contradicted by the Civil Code. If any dispositions of the Code of Commerce enter into conflict with the dispositions of the Civil Code, then the Civil Code is applied.

THE DIFFERENCE BETWEEN CIVIL AND COMMERCIAL COMPANIES

Some of these areas of conflict are the following:

- (i) The form of constitution of the company – 1667 of the Civil Code vs 119 of the Code of Commerce.
- (ii) The responsibility of the partners – 1698 of the Civil Code vs 127 of the Code of Commerce.



THE CONSTITUTION OF CORPORATIONS

GENERAL CONSIDERATIONS

CORPORATIONS

The Corporate Enterprises Act in Article 1.1 encompasses three kinds of Corporate Enterprises:

- a) Limited Liability Companies
- b) Joint Stock Companies
- c) Share Partnerships with unlimited responsibility

TERMINOLOGY

The first problem that we face is one of terminology given that the translation of the **Corporate Enterprises Act** and the translation of **The Code of Commerce** use different terms to translate the Spanish, and that the translation used for “La comanditaria por acciones” – does not take into account the unlimited personal responsibility of the directors of the company.

ESPAÑOL	TRANSLATION OF THE CODE OF COMMERCE	TRANSLATION OF THE CORPORATE ENTERPRISES ACT	THE TRANSLATION USED IN MY NOTES UNTIL NOW
Sociedad de responsabilidad limitada	Private Limited Company	Limited Liability Company	Limited Liability Company
La sociedad anónima	Public Limited Company	Joint Stock Company	Joint Stock Company
La comanditaria por acciones	Limited Liability Partnership	Limited Partnership	Share Partnership with Unlimited Liability (because of the unlimited responsibility of the directors). This terminology is to distinguish it from the Limited Partnership regulated by the Civil Code.

TERMINOLOGY

As the principal source of legislation that we are going to use from now until the last lessons on insolvency will be the Corporate Enterprises Act, **I will use the terminology of the Corporate Enterprises Act from this point onwards.**

Therefore, quoting the translation of Article 1.1 of the Corporate Enterprises Act:

Corporate enterprises are understood to mean:

- 1. Limited Liability Companies*
- 2. Joint Stock Companies*
- 3. Limited Partnerships.*

THE CONSTITUTION OF CORPORATIONS

THE DEED OF INCORPORATION –

The Deed of Incorporation is the public document drawn up in the presence of a notary that contains the will of the parties to constitute a Corporation.

The deed has a certain minimum content which is required by Article 22 of the Corporate Enterprises Act.

THE CONSTITUTION OF CORPORATIONS

- a) The identity of the partners or shareholders.
- b) The determination to form a corporate enterprise, specifying the type of corporation that is to be constituted.
- c) The contributions made or in the case of joint-stock companies, committed to by each partner or shareholder, as well as the number of stakes or shares that they are to receive in exchange.
- d) The internal regulations or statutes that are to govern the corporation.
- e) The identity of the person or persons initially entrusted with the management and representation of the company.

THE CONSTITUTION OF CORPORATIONS

Although the Law requires this minimum content for the deed of incorporation the partners or shareholders can include any agreements and conditions that they wish to make, within the limits established by law and the principles of the type of company they have chosen to constitute (Article of the CEA).

THE STATUTES/BY-LAWS OF CORPORATIONS

The statutes of a Corporation form the basic regulation of the functioning of the Corporation. While these statutes must be included in the Deed of incorporation their reform or modification does not constitute a change in the deeds of corporation. Article 23 CEA states that the by-laws/statutes shall contain:

- (a) The Company name
- (b) The objective of the Corporation
- (c) The Registered Office
- (d) The governance arrangements, that is, the way in which the company is to be run.
- (e) The number of company directors (or at least the maximum and minimum number that can be appointed).
- (f) The capital and the number of stakes or shares into which this capital is to be divided, their par value and consecutive numbering.

THE STATUTES/BY-LAWS OF CORPORATIONS

If the corporation in question is a Joint Stock Company, the statutes or by-laws have to mention the share class and series specifying the proportion of the par value outstanding, the method of payment, the deadline for payment and whether the shares are represented by certificates or book entries.

They shall specify whether they represent registered or bearer shares.

THE RELATIONSHIP BETWEEN THE DEED OF INCORPORATION AND THE BY-LAWS

The objective of the deed of incorporation is to embody the contract by which the corporation was created and the relationship between its partners, while the by-laws have the basic function of establishing the rules that regulate the function of the corporation (the constitution of the corporation).

While the modification of the deed of incorporation requires, in principle, a new agreement among all the partners, the modification of the by-laws can be effected by the majority shareholders.

THE RELATIONSHIP BETWEEN THE DEED OF INCORPORATION AND THE BY-LAWS

In corporations the obligatory intervention of a notary in the drawing up of the deed of incorporation is not merely a requisite for gaining access to the Commercial Registry, but it is a formal requirement for the constitution of the corporation itself.

The Joint Stock Company (for example) has to be constituted through a public document, the deed of incorporation has to be approved by a notary, it cannot be constituted in a private document. A private document only has the force of a preparatory pact or agreement to constitute the Joint Stock Company.

However, once it begins trading (even though it has not followed this formal requisite for its constitution) it shall be treated as an irregular corporation.

RESERVED AGREEMENTS

Article 29 of the Corporate Enterprises Act states that:

Inter-partner or inter-shareholder agreements not included in the by-laws shall not be effective in respect of the company.

These pacts only have force of contract between the parties in agreement but not over the Corporation itself.

Therefore a decision taken by the Board of Directors that is distinct from that made in a reserved agreement is perfectly valid.

THE SUBSCRIPTION AND FULL-PAYMENT OF COMPANY SHARES/STAKES

Articles 78 and 79 of the CEA state the following –

Article 78. *The stakes into which the capital of **limited liability companies** is divided shall be fully subscribed and the par value fully paid by the partners by the date of formalisation of the company's deed of incorporation or instrument on capital increase.*

Article 79. *The shares into which the share capital of **joint stock companies** is divided shall be fully subscribed by the shareholders and at least one-fourth of the par value of each share shall be paid up by the date of formalisation of the company's deed of incorporation or instrument on capital increase.*

THE SUBSCRIPTION AND FULL-PAYMENT OF COMPANY SHARES/STAKES

For the valid constitution of Joint Stock Companies and Limited Liability Companies articles 78 and 79 require the full payment (in the case of Limited Liability Companies) and the full subscription with at least one fourth of the par value paid for each share (in the case of the Joint Stock Company) by the date of the company's deed of incorporation.

THE SUBSCRIPTION AND FULL-PAYMENT OF COMPANY SHARES/STAKES

So in the case of Joint Stock Companies the shareholders can pay only 25% of the nominal value of each share in the moment of constitution of the Company, providing that they have undertaken to pay the rest at a later date. The deadline for payment must be included in the by-laws of the company according to Article 23 CEA.

The payment of these respective amounts for Limited Liability Companies and Joint Stock Companies is an essential requisite for the valid constitution of the Corporation.

THE SUBSCRIPTION AND FULL-PAYMENT OF COMPANY SHARES/STAKES

In limited liability companies, failure to pay up the capital in full, and in joint stock companies, failure to lay out the legal minimum is a cause of nullity (Article 56.1 (g) CEA).

INSCRIPTION IN THE COMMERCIAL REGISTRY

Limited Liability Companies and Joint Stock Companies acquire their legal personality with the inscription of the deed of incorporation in in the Commercial Registry. The process of Constitution of the Corporation is finally completed from the moment that the inscription is made (Articles 20 and 33 of the Corporate Enterprises Act).

Article 20 states that:

The formation of corporate enterprises must be recorded in a public instrument, which shall be registered in the Mercantile Registry.

INSCRIPTION IN THE COMMERCIAL REGISTRY

Article 33 goes on to say that:

Upon registration, the company shall acquire the legal status attendant upon the type of company chosen.

So from the moment of inscription these corporations can be said to exist.

THE CORPORATION IN FORMATION

Despite what has just been stated, it is obvious that if a group of partners form a corporation by a public document and there is a delay between the activity they carry out and the moment of inscription, this period of time needs to be regulated.

This regulation recognises the validity of acts carried out in the name of the Corporation during this period, but stipulates the liability of the partners in order to protect the interests of third parties.

THE CORPORATION IN FORMATION

The so-called corporation in formation – is used to describe the situation in which there is a lapse between the constitution of the Corporation by public document and the inscription of the Corporation in the Commercial Registry.

Article 36 of the CEA states that:

Whosoever may perform acts or conclude agreements on behalf of the company prior to registration thereof in the Mercantile Registry shall be held jointly and severally liable for any consequences of such acts and agreements, except where the effectiveness thereof is contingent upon and subsequent to registration and, as appropriate, subsequently assumed by the company.

THE CORPORATION IN FORMATION

1) This means that as a general rule, the partners (or shareholders) that have carried out these acts (for example, the partner or partners who have signed the lease contract on the principal establishment where the Corporation is going to carry out its business), respond jointly and severally with their own personal patrimony. This is true except when the contract signed has a condition precedent (a condition precedent is an event which must occur, unless its non-occurrence is excused, before performance under a contract becomes due, i.e., before any contractual duty exists), that the Corporation must be inscribed in the Commercial Registry, and that the Corporation assumes legal responsibility for the act. In that case, if the Corporation is not inscribed in the Commercial Registry, the contract signed has no effect.

THE CORPORATION IN FORMATION

2) However, there are certain acts and contracts that the Corporation in formation is liable for with its own patrimony, together with those of the partners (up to the limit that they have agreed to contribute to the Corporation). Article 37 of the CEA details the liability of companies in the process of formation:

THE CORPORATION IN FORMATION

- (i) Companies in the process of formation shall be held liable with any assets they may possess for acts performed or agreements concluded that are: requisite to company registration, attributable to their directors within the scope of the pre-registration powers vested therein, or stipulated in specific mandates issued by persons appointed to this end by all the partners or shareholders.*
- (ii) The partners or shareholders shall be held personally liable to the extent of the contribution committed thereby.*

THE CORPORATION IN FORMATION

So we have three kinds of acts and contracts for which the company patrimony is liable before registration, together with the limited liability of its partners:

- (i) Those necessary for the inscription of the Corporation.
- (ii) Those which the directors of the company have been empowered to carry out prior to registration according to the deed of incorporation.
- (iii) Specific mandates granted to directors agreed to by all the partners.

THE CORPORATION IN FORMATION

Furthermore, article 37.3 CEA states that:

Unless otherwise indicated in the by-laws, if the company start-up date coincides with the formalisation of the deed of incorporation, the directors shall be understood to be empowered to engage fully in any business related to the corporate purpose, performing any acts and concluding any agreements accordingly.

This supposes that the company has started to function, to operate as a Commercial entity.

LIABILITY ONCE REGISTERED

Article 38 of the CEA states that:

Once registered, companies shall be liable for all the acts and agreements referred to in the preceding article, as well as any for it may perform or conclude within three months of registration.

In both cases, partners or shareholders, directors and representatives shall be released from the joint and several liability described in the two preceding articles.

LIABILITY ONCE REGISTERED

This means that the acts described in article 36 CEA, in which acts were performed on behalf of the Corporation prior to Registration, only oblige the Corporation if the Corporation accepts them and assumes responsibility for them, within three months of its inscription. If it does not do so, then those that celebrated these acts or contracts shall bear the responsibility for them.

CORPORATIONS IN IRREGULAR SITUATIONS

A Corporation is said to be in an irregular situation if it is patent that the Corporation has no intention of registering in the Commercial Registry. This is assumed to be the case when **a year has passed without any application for registration.**

Article 39 CEA declares that:

Once the intention to refrain from registering a company has been confirmed and, in any event, when no application for registration is filed within one year of the date of formalisation of the deed, it shall be governed by the rules for general partnerships or, as appropriate, non-mercantile organisations, if the company in the process of formation has undertaken or continued operations.

CORPORATIONS IN IRREGULAR SITUATIONS

In the event of subsequent registration the provisions of Article 38.2 do not apply and the partners do not benefit from the release of joint and several liability.

CORPORATIONS IN IRREGULAR SITUATIONS

Article 40

Any partner or shareholder of companies in an irregular situation may bring proceedings for dissolution thereof in the commercial court with jurisdiction in the place where the company's registered office is located and, subsequent to liquidation of the company equity, demand his/her share, which shall be paid, whenever possible, by refund of any contributions made.

WAYS OF CONSTITUTING CORPORATIONS

Article 19.1 of the CEA states that –

Corporate enterprises are formed under an agreement concluded by and between two or more parties or, in the case of single member companies, under a unilateral instrument.

This is a common to both Joint Stock Companies and Limited Liability Companies.

However, Article 19.2 declares that:

Joint stock companies may, in addition, be formed successively through public share offerings.

Which, in practice, is a far more common way of constituting this type of Corporation.

THE CONSTITUTION OF THE CORPORATION BY CONTRACT

This procedure is obligatory for Limited Liability Companies and possible in the case of Joint Stock Companies.

The constitution is referred to as being simultaneous, given that, as Article 21 of the CEA declares:

The deed of incorporation of corporate enterprises must be signed by all founding partners or shareholders, whether individual or corporate, who must assume all of the stakes or shares therein.

There are a number of points that should be noted about this constitution:

THE CONSTITUTION OF THE CORPORATION BY CONTRACT

A) The legal figure of the founding partners – From Article 21 of the CEA we can derive the fact that the founding partners:

- (i) Subscribe to or lay claim to the stakes or shares of the company in the moment of its constitution.
- (ii) Intervene either personally or through representatives (in the case of legal persons), in their own name, in the constitution of the Corporation.
- (iii) The founder of a Limited Liability Company or a Joint Stock Company can be a single person, either physical or legal.

THE CONSTITUTION OF THE CORPORATION BY CONTRACT

B) The obligations and responsibilities of the founders –

- (i) Article 32.1 of the CEA states that: *The founding partners or shareholders and directors must submit the deed of incorporation for entry in the Mercantile Registry within two months of the date of formalisation thereof (...).*
- (ii) The failure to do so results in the following responsibility according to the continuation of the same article : *and shall be held jointly and severally liable for any damages caused by failure to comply with this obligation.*
- (iii) To which must be added the responsibility configured in article 30.1 of the CEA:

The founders shall be held jointly and severally liable by the company, its partners or shareholders and third parties for the inclusion in the deed of incorporation of the items required by law, for the accuracy of any statements made therein and the due investment of the funds paid to cover start-up expenses.

This of course includes the accuracy of all cash contributions made to the Corporation.

- (iv) The founding partners are also responsible for the existence (and not mere invention) of all non-cash contributions and their correct valuation (Article 73.1 for Limited Liability Companies and 77 in Joint Stock Companies).

THE CONSTITUTION OF THE CORPORATION BY CONTRACT

These obligations also apply to the so-called “hidden partner”. This figure is present whenever there is a discrepancy between the identity of the person who externally and formally appears as a partner in the deed of incorporation and the person who, while not appearing in the deed, is the person whose financial interest is really represented.

The responsibility of this figure is attributed by the line:

Founder liability shall extend to the persons on whose behalf they may act.”

In Articles 30.2, 73.1 and 77 of the CEA.

THE CONSTITUTION OF THE CORPORATION BY CONTRACT

The admission of the figure of the “hidden partner” raises some questions:

- (I) What type of responsibility is to be attributed to them? The responsibility will be jointly and severally attributed (as per 32.1 and 30.1 of the CEA).
- (II) The second question is, who is to be legally considered the founding partner, the person whose names appears in the deed of constitution or the hidden partner? The law limits itself to attributing responsibility severally and jointly to the hidden partner (once revealed), but nothing more. Therefore, one has to conclude that the representative who appears as a partner externally and formally in the deed of incorporation continues to be the founding partner, and this will be the person attributed voting rights.

THE RIGHTS AND BENEFITS OF THE FOUNDERS OF JOINT STOCK COMPANIES

The founders of joint-stock companies often reserve for themselves certain economic benefits. Article 27 CEA deals with the privileges for the founders of joint stock companies.

The by-laws of joint stock companies may reserve special rights of a financial nature to founders and promoters. The overall value of such rights, irrespective of the nature thereof, may not exceed 10% of the net book earnings after accounting for the legal reserve, nor may they be in place for longer than ten years. The by-laws must specify a system for compensation in the event of early expiry of special rights.

THE RIGHTS AND BENEFITS OF THE FOUNDERS OF JOINT STOCK COMPANIES

These special rights have the objective of rewarding the founders for the acts of organisation or management of the Corporation.

However, special remunerations or benefits can potentially damage future shareholders and the interests of third parties if they weaken the patrimony of the joint stock company. Therefore, Article 27 limits these economic privileges.

THE RIGHTS AND BENEFITS OF THE FOUNDERS OF JOINT STOCK COMPANIES

The special economic rights and benefits must obviously be different to the rights that the founders acquire automatically.

They may consist of:

- a) A special cash remuneration.
- b) A greater share in the benefits of the Corporation (for example as a percentage of sales or production rates).

THE RIGHTS AND BENEFITS OF THE FOUNDERS OF JOINT STOCK COMPANIES

The limit fixed by Article 27.1 of the CEA is a maximum of 10% of the net benefits of the Corporation, once the legal reserve has been deducted.

These benefits are also subject to a time restriction, Article 27.1 states that these advantages must be limited to 10 years from the moment the Corporation was constituted.

SUCCESSIVE FORMATION

B) Successive formation – Joint Stock Companies may also be formed through successive formation. The rules regarding successive formation are **obligatory** when, prior to the formalisation of the deed of incorporation of a Joint Stock Company, a public share offering is announced, either through the media or via financial brokers.

The procedure for successive formation consists of 4 basic steps.

- (i) The formation programme
- (ii) Share subscription and the payment of a minimum of 25 % of the capital
- (iii) The incorporation meeting
- (iv) The formalisation of the deed of incorporation and registration with the Commercial Registry

(I) THE FORMATION PROGRAMME

The promoters (who initiate and manage the constitution of the corporation), write the programme for the formation of the Corporation. This formation programme must have the minimum content required by article 42 CEA.

- a) The full names and nationality of the promoters
- b) The by-laws that will govern the Corporation
- c) The deadline for subscribing shares and for payment
- d) The nature and value of non-cash contributions if they are to be accepted
- e) The Commercial Registry where the formation programme and issue prospectus are to be custodied
- f) The criteria for distributing shares in the case of over-subscription

(I) THE FORMATION PROGRAMME

The promoters have to deposit this programme, together with a technical report on the feasibility of the planned company with the National Securities Market Commission. They must also deposit an issue prospectus (Article 43 CEA).

The programme must be signed by all the company promoters.

The promoters must also submit to the Mercantile Registry a copy of the formation programme and the prospectus, an extract of which will be published in the Official Bulletin of the Commercial Registry, as well as a certificate that substantiates the deposit of the aforementioned documents with the National Securities Market Commission.

(II) SHARE SUBSCRIPTION AND THE PAYMENT OF A MINIMUM OF 25 % OF THE CAPITAL

The next step is that those members of the public who accept the offer subscribe to purchase the number of shares they wish, paying a minimum of 25 % of the par value of each share (44 to 46 CEA).

The promoters have to formalise the final list of subscribers before a public notary within one month of the subscription deadline.

(III) THE INCORPORATION MEETING

The incorporation meeting has the basic function of ratifying the collective will to constitute the company:

The items to be discussed at this meeting are listed in article 47 CEA:

- a) Approval of actions taken to date by the promoters.
- b) Approval of the by-laws.
- c) Approval of the non-cash contribution valuations, as appropriate.
- d) Approval of any specific rights reserved to promoters.
- e) Appointment of persons in charge of company management.
- f) Appointment of the person or persons entrusted with formalising the company's deed of incorporation.

(III) THE INCORPORATION MEETING

The meeting must be called no more than six months after the date of deposit of the formation programme and the prospectus with the Commercial Registry.

The promoters need to convene all the subscribers to the incorporation meeting by registered post at least 15 days in advance.

(III) THE INCORPORATION MEETING

The meeting can only be validly held if attended in person or by proxy (by means of a representative) by a quorum consisting of subscribers accounting for at least half of the subscribed capital.

Article 49 CEA stipulates how decisions may be adopted.

- (a) Subscribers' voting rights must be proportional to their respective contributions.
- (b) Decisions can be adopted when approved by at least one fourth of the subscribers attending the meeting, representing at least one fourth of the subscribed capital.

(III) THE INCORPORATION MEETING

However there are exceptions to that general rule:

- (i) Where proposals involve the approval of non-cash contributions or the reservation of special rights for promoters, the parties concerned may not vote. In both cases a majority of the remaining votes is sufficient to adopt decisions.
- (ii) The formation programme may not be amended except in a unanimous vote of all attending subscribers (49 CEA).

(IV) THE FORMALISATION OF THE DEED OF INCORPORATION AND REGISTRATION WITH THE COMMERCIAL REGISTRY

The process of successive formation ends with the submission of the deed of incorporation to the Commercial Registry and the inscription of the Corporation in the Commercial Registry.

Article 51.1 of the CEA states that:

In the month following the date of the meeting, the persons appointed to this end shall formalise the company's deed of incorporation, subject to the decisions adopted by the meeting and all other substantiating documentation.

While 51.3 adds that:

The deed shall be submitted for registration with the Mercantile Registry serving the place where the company's registered office is located within two months of formalisation thereof.

(IV) THE FORMALISATION OF THE DEED OF INCORPORATION AND REGISTRATION WITH THE COMMERCIAL REGISTRY

If the obligation to Register the Joint Stock Company in the Commercial Register is not met within the legal time-limit, then Article 52 CE provides for the liability of the persons appointed to register the company:

In the event of delay in the formalisation of the deed of incorporation or its submission to the Mercantile Registry, the persons referred to in the preceding article shall be held jointly and severally liable for any damages incurred.

(IV) THE FORMALISATION OF THE DEED OF INCORPORATION AND REGISTRATION WITH THE COMMERCIAL REGISTRY

However, article 55 CEA talks about the consequences of, not simply delay, but actual non-registration.

In any event, if the deed of incorporation is not registered within one year of the date of the deposit of the formation programme and prospectus in the Mercantile Registry, the subscribers may demand reimbursement of the contributions laid out plus any earnings accrued thereon.

This represents the failure of successive formation, and as we have already seen it is a cause for nullity.

THE RIGHTS, OBLIGATIONS, RESPONSIBILITIES, ADVANTAGES AND REMUNERATIONS OF THE PROMOTERS

As in the case of the joint stock company that is constituted by contract alone, the law establishes the rights and obligations of the promoters of the joint stock company constituted according to the rules of successive formation.

- a) The promoters have the responsibility to draft the formation programme (42 CEA)
- b) Deposit the formation programme with the National Securities Market Commission (43 CEA)
- c) Deposit the formation programme with the Commercial Registry (43 CEA)
- d) Convene the incorporation meeting (47.1 CEA)
- e) Chair the incorporation meeting - this function corresponds to the promotor whose name appears first on the formation programme (48.1 CEA)

THE RIGHTS, OBLIGATIONS, RESPONSIBILITIES, ADVANTAGES AND REMUNERATIONS OF THE PROMOTERS

As we have seen, the law also configures the regime of responsibility that is applied to the founding partners:

They are jointly and severally responsible, both to the Corporation and to third parties for:

- (a) The accuracy of the subscription list
- (b) The adequate use of initial payments
- (c) The truth of all statements made in the formation programme and the prospectus
- (d) The accuracy of the evaluations of non-cash contributions
- (e) The obligations made with third-parties in order to constitute the **joint-stock company**

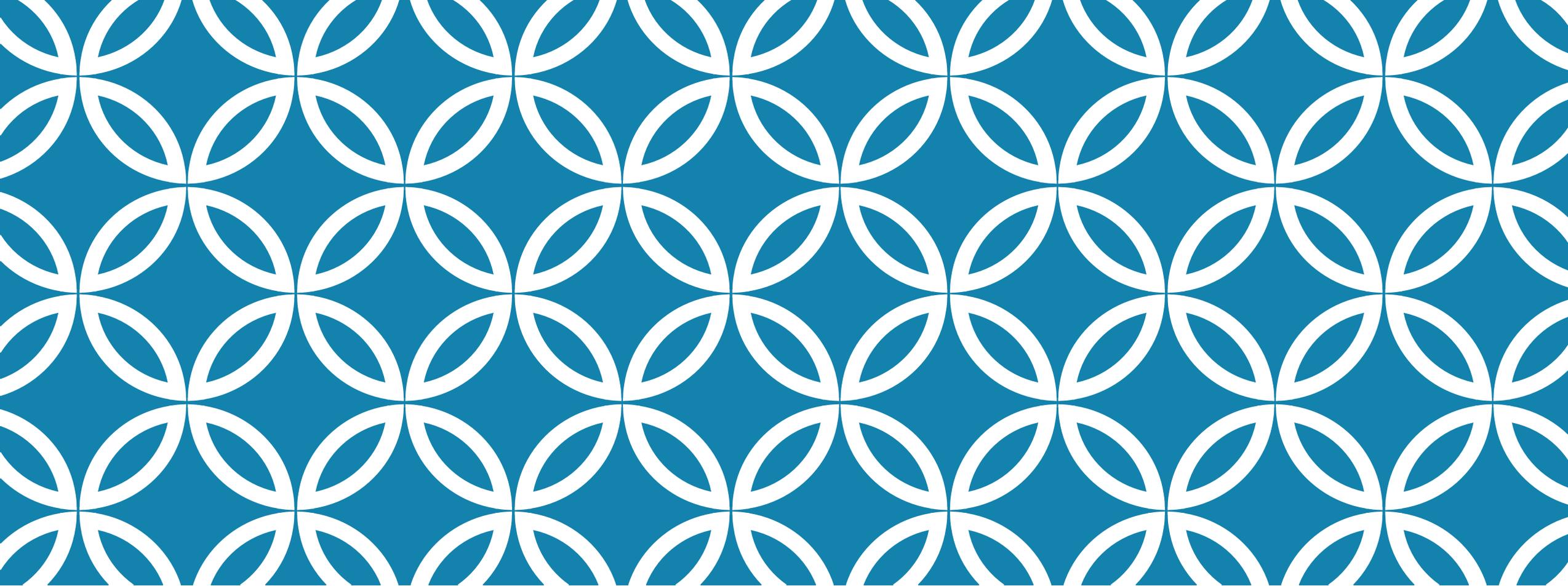
THE RIGHTS, OBLIGATIONS, RESPONSIBILITIES, ADVANTAGES AND REMUNERATIONS OF THE PROMOTERS

Once the joint-stock company has been registered in the Commercial Registry, then it (the company) will assume the obligations legally contracted by the promoters and will reimburse them for any expenses they may have laid out, providing of course that this is approved by the board of the partners and that the expenses are deemed to be necessary.

(Article 53 CEA)

THE RIGHTS, OBLIGATIONS, RESPONSIBILITIES, ADVANTAGES AND REMUNERATIONS OF THE PROMOTERS

As seen earlier, Article 27 CEA allows for the creation of certain economic privileges for the promoters. For the creation of these privileges to be valid they must be contained in the company by-laws (which form part of the formation programme).



THE NULLITY OF CORPORATIONS

THE NULLITY OF CORPORATIONS

The causes of nullity of Corporations are contained in Article 56 of the CEA.

Once the company has been registered, it may only be declared null and void on the following grounds:

- a) *Non-concurrence during the formalisation of company formation by at least two founding partners or shareholders, where there are several, or by the founding partner or shareholder in single member companies.*
- b) *Incapacity of all founding partners or shareholders.*
- c) *Failure to include partners' or shareholders' contributions in the deed of incorporation.*
- d) *Failure to include the company name in the deed of incorporation.*
- e) *Failure to include the corporate purpose in the by-laws, or the inclusion of a purpose that is unlawful or incompatible with law and order.*
- f) *Failure to include the amount of the share capital in the by-laws.*
- g) *In limited liability companies, failure to pay up the capital in full; and in joint stock companies, failure to lay out the legal minimum (currently 25% of the share price).*

THE NULLITY OF CORPORATIONS

So once the Corporation has been registered in the Commercial Registry and therefore legally constituted, it can only be declared null by a judge given one of the circumstances collected in Article 56 CEA, unless of course the whole purpose of the society can be deemed illegal in character or contrary to public order (due for example to a change in the law, which converts a licit objective into an illicit one).

THE NULLITY OF CORPORATIONS

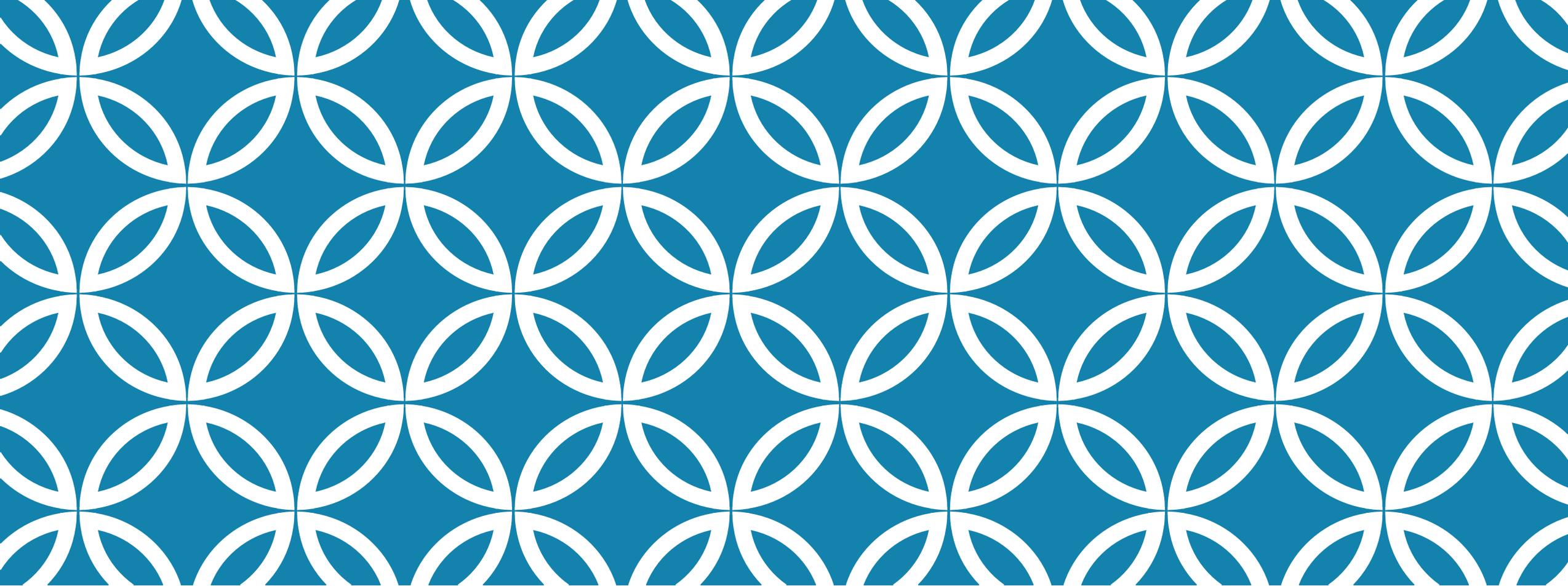
However, in practice the chances of a corporation being registered and then declared null are quite low because of the double filter of both a Notary and a Registrar intervening in the process of constitution of the Corporation. This article of the CEA is a direct transcription of a European Directive (some European countries do not have the same guarantees as Spain) that was placed unaltered in the CEA.

THE CONSEQUENCES OF THE DECLARATION OF NULLITY

The consequences of the declaration of nullity are established in Article 57 CEA. It produces a similar effect to the dissolution of the Corporation.

- (i) It causes the opening of liquidation proceedings.
- (ii) The nullity does not affect the obligations/debts owed by or to the company.
- (iii) It entails certain payments/repayments. In a limited company if the reason for the declaration of nullity was due to the failure to pay up the capital in full, the partners are obliged to pay up the outstanding capital.

In joint stock companies the shareholders are obliged to pay up any sums outstanding if required to do so in order to honour obligations with third parties.



LESSON 5: THE FINANCE OF CORPORATIONS

CAPITAL AND FINANCE

All corporations require recourse to finance in order to operate. One can distinguish between two main sources of finance.

- (i) The capital of the corporation itself
- (ii) Finance from an exterior source

The capital of the corporation refers to the money or goods furnished by the members of the corporation as risk capital, that is the capital contributed to the Corporation either in the moment of its constitution or later on.

In corporations in which the responsibility/liability of the members/partners is limited, the risk is limited to the value of the contribution made.

CAPITAL AND FINANCE

Outside finance is normally obtained from banks, however the partners can become creditors of the corporation (by lending it money).

THE CAPITAL OF THE CORPORATION

The capital is a figure entered in the accounting balance of the Corporation as part of the net patrimony. The amount of capital should coincide with the contributions made by the partners (paid out), and in the case of joint-stock companies with the sum of the quantities paid out and those the partners have undertaken to contribute (not paid out), this in turn ought to coincide with the sum of the nominal value of the shares or participations/stakes of the corporation.

ACTIVE AND PASSIVE PATRIMONY

Patrimony (active and passive) is the group of rights and obligations of a corporation in a given moment, so that while capital and patrimony coincide in the moment of the constitution of the corporation, after that the patrimony will almost certainly be lesser or greater than the capital (depending on whether the corporation has been operating at a profit or a loss).

So, while the patrimony of the corporation fluctuates, the capital of the corporation remains invariable unless the partners or shareholders take the decision to increase or reduce the amount of capital by following the procedures laid out in the law.

CAPITAL

From a legal perspective, capital operates as a type of financial valve.

Article 273.2 of the CEA states that:

Dividends may only be drawn on the year's profits or freely available reserves after meeting the requirements laid down by law and in the by-laws, and if the value of the corporate equity is not, or as a result of such distribution would not be, less than the company's capital. For these purposes, any profit directly allocated to total equity may not be distributed either directly or indirectly.

CAPITAL

The corporation therefore cannot distribute benefits if the patrimony of the corporation is less than the corporate capital.

Traditionally, capital has been seen as playing an important role in guaranteeing the economic rights of third parties. In the joint stock company it is the only guarantee in principle, as the partners do not respond personally for the debts of the Corporation.

RESERVES

From a purely economic perspective, reserves are patrimony obtained by the corporation that have not been distributed to the partners or shareholders, but are accumulated to form a fund to provide for future needs, that may well be very diverse in nature.

Reserves, from an accounting perspective are funds of the corporation that are included in the net patrimony in the corporation's balance. They receive a treatment similar to the capital of the corporation. Article 273.2 CEA states that:

Profit distribution shall likewise be prohibited if the amount of the distributable reserves comes to less than the sum of the research and development expenses shown as assets on the balance sheet.

RESERVES

The origin of reserves is generally benefits obtained by the Corporation and not distributed to the partners/shareholders.

Reserves can be of several different classes:

a) **Common legal reserves** – Article 274 CEA states that: *An amount equal to 10% of the profit for the year shall in any event be earmarked for the legal reserve until such reserve represents at least 20% of the capital.*

These common legal reserves are established by the law to consolidate the economic situation of all corporations. The law requires that before dividends are distributed the sum of 10% of the annual profit of the corporation is reserved until the legal reserves reach a total of 20% of the corporation's capital.

RESERVES

Furthermore, Article 273.4 CEA configures a conditional legal reserve consisting of 5% of its annual profits and equivalent to a goodwill fund.

Goodwill is an intangible asset that arises as a result of the **acquisition of one company by another for a premium value**. The value of a company's brand name, solid customer base, good customer relations, good employee relations and any patents or proprietary technology represent goodwill. Goodwill is considered an intangible asset because it is not a physical asset like buildings or equipment. The goodwill account can be found in the assets portion of a company's balance sheet.

Article 39.4 of the Code of Commerce only allows the inclusion of goodwill in the assets of the balance sheet when it has been acquired by a purchase, i.e. the corporation has acquired another company and has paid for this goodwill.

RESERVES

b) Special Legal Reserves

Are established outside of the CEA by special regulations that apply to particular industries, for example the insurance and finance industries. Banks and insurance companies have to keep a certain amount of money in reserve in order to meet their financial commitments.

c) Reserves contained in the by-laws of the corporation

Article 273.2 CEA declares that:

Dividends may only be drawn on the year's profits or freely available reserves after meeting the requirements laid down by law and in the by-laws (...).

RESERVES

d) Voluntary reserves

Exist when a decision is taken in the general meeting to create a reserve fund that is not mandatory or contained in the by-laws of the corporation. This decision may be made by a simple majority.

e) Tacit or hidden reserves

These may arise from appreciation of the assets of the corporation, or valuation of the assets that is below their real market value, or an overestimation of the debts of the Corporation, and are not revealed by examining the accounts of the corporation.

THE CONTRIBUTIONS OF THE PARTNERS/SHAREHOLDERS

The partners of a corporation make contributions when a corporation is constituted or when a corporation decides to increase its capital.

This capital may be contributed in cash or by way of a non-cash contribution such as goods or rights. The cash or non-cash contributions are reflected in the figure recorded in the by-laws of the corporation.

The payment or the assumption of the obligation to make a future payment is a necessary condition to becoming a partner.

CLASSES OF CONTRIBUTIONS

Article 58 of the CEA states that:

- 1. Contributions to corporate enterprises may comprise only goods or rights liable to economic appraisal.*
- 2. Work performed or services rendered shall under no circumstances comprise contributions to company capital.*

Article 61 states that:

- 1. Cash contributions shall be denominated in euros.*
- 2. If the contribution is made in any other currency, its equivalent value in euros shall be calculated as stipulated by law.*

CLASSES OF CONTRIBUTIONS

Article 86.1 CEA further states that:

- 1. The by-laws of corporate enterprises may include stipulations on ancillary commitments in addition to contributions, describing the specific content thereof and establishing whether they are to be provided cost-free or remunerated, as well as any penalty clauses for non-compliance.*
- 2. Under no circumstances shall ancillary commitments form part of the capital.*
- 3. The by-laws may make such commitments mandatory for all or some of the partners or shareholders, or the ownership of one or several specific stakes or shares contingent upon provision thereof.*

CLASSES OF CONTRIBUTIONS

Article 60 CEA declares that:

Unless explicitly stipulated otherwise, all contributions shall be understood to be held as possessions.

From the joint study of the articles mentioned we can say that there are two general classes of contributions: cash and non-cash contributions.

A) Cash contributions – The law requires that cash contributions be accredited by certification of their deposit in a financial institution in the name of the corporation or by handing over the quantity in question.

CLASSES OF CONTRIBUTIONS

Article 62.1 CEA states that:

Cash contributions must be substantiated before the public notary legalising the deed of incorporation or instrument on capital increase, or in joint stock companies, the instruments formalised on the occasion of successive payments. Such substantiation, which shall consist of a document certifying the deposit of the respective funds in the company's favour at a financial institution, shall be attached by the public notary to the deed or instrument.

CLASSES OF CONTRIBUTIONS

The joint stock companies formed by successive formation are excepted from this general rule regarding cash contributions according to Article 4.3 bis CEA, which states that:

No material proof of the monetary contributions made by shareholders founding a successive formation company shall be required. The founders and any other parties acquiring shares at the time of formation shall be severally liable to the company and its creditors for the existence of such contributions.

CLASSES OF CONTRIBUTIONS

B) Non – cash contributions.

These can come in a variety of forms, movable goods (such as cars or machinery, or non-movable goods such as a warehouse). In fact, any goods distinct from cash that can be valued in money for a fixed amount. These non-cash contributions are subject to a number of rules:

a) Valuation – Article 63 LSC states that:

Non-cash contributions must be described in the deed of incorporation or instrument on capital increase, including registry data as appropriate, the value thereof in euros and the numbers of the shares or stakes attributed thereto.

The worth of the non-cash contribution will therefore be included in the accountancy of the Corporation as forming part of the **capital** of the Corporation.

CLASSES OF CONTRIBUTIONS

The resulting valuation can lead to one of three situations:

- A) The valuation may be perfectly fair, reasonable and accurate
- B) The valuation is for less than the market price of the goods
- C) The valuation is superior to the price of the goods

A and B do not really concern the legislator given that they do not affect the integrity of the capital of the corporation and so do not threaten the position of third party creditors.

What is of real concern to the legislator is the third of these situations.

CLASSES OF CONTRIBUTIONS

In this case, the real patrimony of the corporation will be less than that indicated as the corporation's capital, and this obviously negatively affects the partners, shareholders and the corporation's creditors, the sole beneficiary being the partner or shareholder who has received more shares or participations in the corporation than he or she should have done.

In order to ensure that the valuation is carried out correctly, Articles 67ff of the CEA establish a series of rules for joint-stock companies and limited liability companies.

THE RULES FOR THE VALUATION OF NON-CASH CONTRIBUTIONS

A) The rules for joint stock companies –

Article 67.1 CEA declares that:

Non-cash contributions, irrespective of the nature thereof, made on the occasion of joint stock company formation or capital increases subsequent thereto shall constitute the object of a report prepared by one or several independent professionals. Such experts must be duly qualified and appointed to this end pursuant to the applicable regulations by the mercantile registrar serving the place where the company's registered office is located.

THE RULES FOR THE VALUATION OF NON-CASH CONTRIBUTIONS

Article 67.2 CEA goes on to state that:

The report shall contain a description of the contribution, registry data as appropriate, the valuation of the contribution and whether it concurs with the par value and, if applicable, the value of the issue premium of the shares issued in exchange therefore.

While 67.3 CEA declares that:

The value attributed to the contribution in the deed of incorporation shall not be higher than the value estimated by the experts.

to back up these three rules the Regulation of the Commercial Registry, Royal Decree 1784/1996, Article 133.2 stipulates that:

The Registrar will refuse to inscribe the value attributed to the goods if the value to be inscribed is greater than the value estimated by the expert by a margin of more than 20%.

THE RULES FOR THE VALUATION OF NON-CASH CONTRIBUTIONS

According to article 71.1 CEA:

An authenticated copy of the expert's or, as appropriate, the directors' report, must be deposited with the Mercantile Registry within one month of the actual date of contribution.

The expert can be held responsible for her valuation if it is not performed with due diligence. Article 68 CEA declares that:

1. Experts shall be held liable by the company, its shareholders and creditors for any damages resulting from the valuation but shall be exonerated therefrom if they can provide evidence of having acted with due diligence and pursuant to the standards associated with the task entrusted thereto.

2. The right to file claims in this regard shall lapse after four years of the date of the report.

NON-REQUIREMENT OF A REPORT BY EXPERTS APPOINTED BY THE COMMERCIAL REGISTRY

However, **joint stock companies** are not obliged to submit a report by an independent expert when there is a clear point of reference for the valuation of the joint non-cash contribution. Article 69 CEA gives a list of these points of reference:

- (a) Money market instruments listed on an official secondary market (or other regulated market).
- (b) Goods (other than of the type listed in (a)), whose value was determined within six months of the contribution by an independent professional not appointed by the contributor of the corporation.
- (c) When a new company is formed by way of a merger or a spin-off, and an independent report has been drafted by an independent expert on the proposed merger or spin-off.

NON-REQUIREMENT OF A REPORT BY EXPERTS APPOINTED BY THE COMMERCIAL REGISTRY

(d) When the share capital is increased to issue new shares or stakes to the partners or shareholders of the corporation taken over or spun-off subsequent to the formulation of an independent expert report on the proposed merger or spin-off.

(e) When the share capital is increased to issue new shares to the shareholders of the company that is the object of a takeover bid.

NON-REQUIREMENT OF A REPORT BY EXPERTS APPOINTED BY THE COMMERCIAL REGISTRY

In the absence of a report on non-cash contributions prepared by experts appointed by the Commercial Registry, the company directors shall draft one containing:

- (a) A description of the contribution
- (b) The value of the contribution, the source of the valuation and the method of calculation used
- (c) A statement specifying whether the calculated value is equal to the par value of the shares issued in exchange
- (d) A statement indicating that no new circumstances have arisen that might affect the initial valuation

THE RULES FOR NON-CASH CONTRIBUTIONS IN LIMITED LIABILITY COMPANIES

(B) In the case of **limited liability companies** the law does not require the intervention of independent experts when the corporation is founded with non-cash contributions.

What the law does instead is to determine the responsibility for those who contribute non-cash contributions, and for the founders and stake holders of the corporation itself.

Article 73.1 CEA declares that:

The founders, the shareholders at the time a capital increase is approved and anyone acquiring a holding paid in the form of a non-cash contribution, shall be held jointly and severally liable to the company and company creditors for such contributions and the value attributed thereto in the respective instrument.

Founder liability shall extend to the persons on whose behalf they may have acted.

THE RULES FOR NON-CASH CONTRIBUTIONS IN LIMITED LIABILITY COMPANIES

Article 73.2 makes an exception to this regime of joint and several liability:

If a contribution is made in exchange for a capital increase, shareholders recording their objection to the decision or to the valuation of the contribution in the minutes shall be exempt from such liability.

As does article 76 CEA

Partners whose non-cash contributions undergo expert valuation in accordance with the provisions for joint stock companies shall be excluded from the joint and several liability referred to in the preceding articles.

While 73.3 CEA extends this system of liability:

In the event of a capital increase charged to non-cash contributions, in addition to the persons mentioned in paragraph one above, the directors shall also be held jointly and severally liable for any difference between the valuation provided and the true value of the contributions.

THE LEGAL ACTION FOR LIABILITY

Article 74 CEA determines who has legal capacity to bring the action for liability:

(i) Action for liability shall be brought by company directors or liquidators. No prior company decision is required to bring such action.

(ii) Action for liability may also be brought by any partner or shareholder voting against the decision, provided he or she holds at least 5% of the capital, or by any creditor in the event of company insolvency.

THE LEGAL ACTION FOR LIABILITY

Article 75 CEA establishes the limitation of the action:

The liability to the company and company creditors referred to in this section shall lapse five years after the date when the contribution was made.

THE PAYMENT OF SHARES

As we have already seen, Article 79 CEA in reference to the joint stock company determines that;

The shares into which the share capital of joint stock companies is divided shall be fully subscribed by the shareholders and at least one-fourth of the par value of each share shall be paid up by the date of formalisation of the company's deed of incorporation or instrument on capital increase.

If the shareholders have chosen this option then the corporation becomes the creditor of the shareholders.

The by-laws of the company must specify the proportion of the par value outstanding, and the method of payment proposed and the deadline to make such payment (23 (d) CEA).

THE PAYMENT OF SHARES

Article 81.1 CEA reiterates this obligation:

In joint stock companies, shareholders must pay the portion of outstanding capital into the company in the manner and within the deadline stipulated in the by-laws.

In the case of joint-stock companies, there are special rules for non-cash contributions, Article 80.1 CEA determines that:

In the event of partial payment of subscribed shares in joint stock companies, the instrument must specify whether the future payments shall be made in cash or as non-cash contributions. In the latter case, the nature, value and content of such contributions, as well as the means and procedure of payment, shall be determined in the instrument, which shall also contain explicit mention of the payment deadlines.

THE PAYMENT OF SHARES

Article 80.2 CEA determines the maximum deadline for payment of non-cash contributions:

The deadline for payment of non-cash contributions shall not extend beyond five years of the date of company formation or its decision to increase its capital.

When there are outstanding payments to be made then Article 81.2 describes the procedure for claiming payment:

Notice of the sums payable shall be served upon the shareholders concerned or an announcement to that effect shall be published in the Official Journal of the Mercantile Registry. Notices or announcements must be issued at least one month in advance of the payment deadline.

SHAREHOLDERS IN ARREARS

Once the deadline for payment has passed, shareholders who have not made the corresponding payment in full are said to be in arrears. Article 83 CEA establishes a series of consequences for those shareholders who are in arrears:

- 1. Shareholders in arrears of payment of sums outstanding may not vote. The value of the respective shares shall be deducted from the share capital when calculating a quorum.*
- 2. Shareholders in arrears shall also be deprived of their right to dividends as well as their pre-emptive right to subscribe new shares or convertible bonds.*

After paying the sums owed, together with the interest accruing, shareholders may demand payment of any unexpired dividends, but not pre-emptive rights if the deadline for their exercise has lapsed.

CORPORATION CLAIM FOR PAYMENT

Article 84 CEA determines the procedures for claiming payment from those shareholders who are in arrears:

1. When shareholders are in arrears, depending on the circumstances and nature of the contribution outstanding, the company may demand payment, including any legal interest accruing and damages incurred by reason of the arrears, or convey share ownership for and at the risk of the shareholders in arrears.

2. When shares must be sold, the sale shall be substantiated either by a member of the official secondary market on which the shares are traded or by a notary public, and, as appropriate, shall entail the replacement of the original share certificate by a duplicate thereof.

If no sale materialises, the shares shall be redeemed and the share capital reduced accordingly, and any sums laid out shall be retained by the company.

ANCILLARY COMMITMENTS

Article 86.1 CEA allows for the inclusion of ancillary commitments in the by-laws of the company in addition to the contributions made. The same article (86.2 CEA) states that ancillary commitments cannot form part of the capital of the corporation.

These ancillary commitments may consist in giving something to the corporation (such as supplying raw materials), doing something for the corporation (such as some type of technical work), or not doing something (such as not competing with the business activity of the corporation in a certain area or within a certain market).

ANCILLARY COMMITMENTS

Article 86.3 CEA states that:

The by-laws may make such commitments mandatory for all or some of the partners or shareholders, or the ownership of one or several specific stakes or shares contingent upon provision thereof.

Article 87 contains provisions on remunerated ancillary commitments:

- 1. Where ancillary commitments are to be remunerated, the by-laws shall determine the sums to be received by the shareholders concerned.*
- 2. The amount of the remuneration shall under no circumstances exceed the value of support furnished.*

ANCILLARY COMMITMENTS

As the stakes or shares of those partners with ancillary commitments may themselves contain the obligation to carry out the ancillary commitment the CEA restricts their transfer (given that the corporation may not wish the shares to be transferred to a subject that is incapable of carrying out the ancillary commitment).

Article 88.1 CEA states that:

The voluntary inter vivos transfer of stakes or shares owned by a partner or shareholder who is personally bound by ancillary commitments, as well as the transfer of specific stakes or shares so conditioned, shall be subject to company authorisation.

Unless otherwise indicated in the by-laws, in limited liability companies such authorisation shall be granted by the general meeting, and in joint stock companies by the directors.

In any event, if the company fails to reply to a request for authorisation within two months of the date thereof, authorisation shall be deemed to be granted.

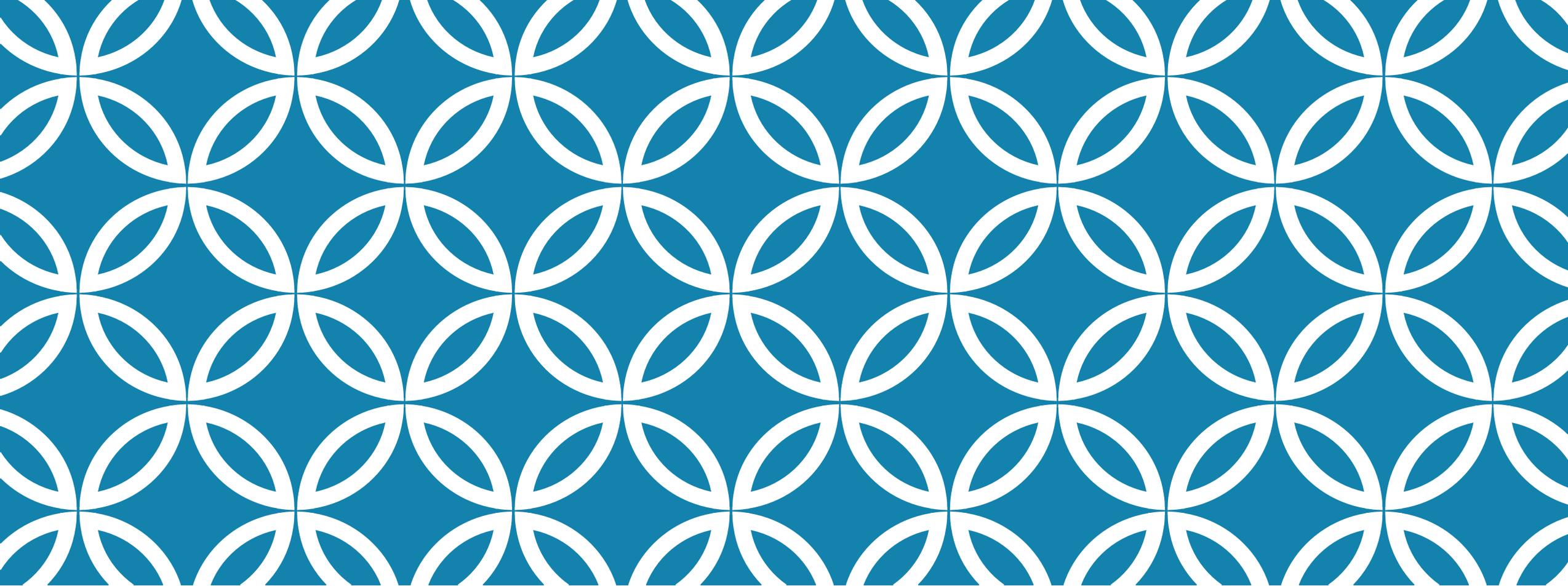
EXTERNAL FINANCE

Forms of external finance will not be studied in this Commercial Law I, so I will simply mention three forms of external finance.

1) External finance may take the form of a loan from a bank. Something which will be covered in detail in the subject Commercial Law II.

2) It may also take the form of a loan from the partners of the corporation.

3) Or risk capital, such as the emission of company bonds.



LESSON 6 - SHARES AND CORPORATE STAKES

SHARES AND CORPORATE STAKES

Article 90 of the Corporate Enterprises Act tells us the following about stakes and shares:

Stakes in limited liability companies and shares in joint stock companies constitute aliquot, indivisible and cumulative parts of the capital.

SHARES AND CORPORATE STAKES

Article 92 introduces one of the fundamental differences between stakes and shares:

*Shares may be represented by certificates of title or book entries. In both instances they shall be regarded to **be transferable securities**.*

A security is a fungible, negotiable financial instrument that represents some type of financial value.

Stakes in limited liability companies may not be represented by certificates or book entries, nor be called shares, and under no circumstances shall be regarded to be securities.

SHARES AND CORPORATE STAKES

While shares are generally relatively easy to transfer, **stakes are restricted in their transmission.**

Article 108.1 of the CEA states that:

Clauses in the by-laws allowing voluntary inter vivos transfer of stakes to be transacted virtually freely shall be null and void.

Although the possibility of totally closing the corporation from new stakeholders is also prevented by law:

108.4 CEA declares that:

Notwithstanding the provisions of the foregoing paragraph, the by-laws may prevent the voluntary inter vivos transfer of stakes or the exercise of exit rights for no longer than five years from the date of company formation, or in respect of stakes resulting from a capital increase, five years from the date of formalisation of the respective public instrument.

SHARES AND CORPORATE STAKES

The stake or share has various basic functions:

- (a) It is an instrument designed to capture capital.
- (b) It is a necessary title for the share or stakeholders to exercise their corporate rights.
- (c) It allows for the transfer, with greater or fewer restrictions, of the economic participation in a corporation.

THE STAKE OR SHARE AS PART OF THE CAPITAL OF THE CORPORATION

The capital of the Limited Liability Company is divided into stakes:

Article 1.2 of the CEA declares that:

*The capital in limited liability companies, which shall be divided into stakes, shall comprise the contributions made by all partners, **who shall not be held personally liable for company debt.***

The capital of the joint-stock company is divided into shares, as 1.3 of the CEA declares that:

*The capital in joint stock companies, which shall be divided into shares, shall comprise the contributions made by all shareholders, **who shall not be held personally liable for company debt.***

THE STAKE OR SHARE AS PART OF THE CAPITAL OF THE CORPORATION

In both cases, the stake or share represents a proportion of the capital of the corporation.

Stakes in limited liability companies and shares in joint stock companies constitute aliquot, indivisible and cumulative parts of the capital.

The stake or share is therefore an instrument used by the corporation to generate contributions of capital.

THE STAKE OR SHARE AS PART OF THE CAPITAL OF THE CORPORATION

In the joint-stock company the share is a title that represents the extent to which the partner has contributed to the company. The greater the contribution of the partner the more shares **she** receives and the greater **her** voting rights within the Corporation.

Article 96.2 CEA states that:

The issue of shares that may either directly or indirectly alter the proportionality between par value and voting or pre-emptive rights shall not be allowed.

This rule guarantees the existence of the **proportionality between capital and voting rights.**

THE STAKE OR SHARE AS PART OF THE CAPITAL OF THE CORPORATION

In the limited liability company, however, the rights of the partners depend to a lesser extent on the amount of capital that the stakeholders have contributed.

Although 96.2 CEA states that:

The creation of stakes that either directly or indirectly alter the proportionality between par value and voting or pre-emptive rights shall not be allowed.

In limited liability companies this strict alignment between capital and voting rights is not required by law because

Article 188.1 CEA decrees that:

In limited liability companies, unless specified otherwise in the corporate by-laws, each stake entitles its holder to the right to cast one vote.

Which of course means that the by-laws may specify something different.

This means that while the proportions established cannot be altered by the creation of stakes, the greater freedom to establish the rules over voting rights allows the corporation to instigate a system that does not follow the strict proportionality between capital and voting rights. So, for example, the corporation might establish a system of votes per head.

Article 275.1 goes on to say that:

In limited liability companies, unless specified otherwise in the by-laws, the dividends shall be distributed to the partners in proportion to their stakes in the company capital.

Which of course allows the by-laws to propose a non-proportional form of distribution.

THE VALUE OF THE STAKE OR PARTICIPATION

Shares or stakes possess a nominal value that is fixed and determined but at the same time they possess a fluctuating value that depends on the financial situation of the corporation at any given time.

The nominal value has to be stated in the by-laws of the corporation.

The law pays particular attention to the nominal value of stakes and participations.

The nominal value of the shares must be expressed directly by a concrete sum (for example 10 Euros each) and not indirectly (for example as a fraction of the total capital).

THE VALUE OF THE STAKE OR PARTICIPATION

Shares and stakes may be grouped in different classes, and within each class of shares or stakes there may be different series.

The shares and stakes that form part of the same series must each have the same nominal value.

The second paragraph of Article 94.1 CEA determines that:

Stakes and shares may afford different rights to their holders. Shares associated with the same rights form part of the same class. When a class is divided into several series, all shares in any given series shall have the same par value.

THE VALUE OF THE STAKE OR PARTICIPATION

The legislator tries to ensure that in the moment of constitution there is an effective equivalence between the nominal value of the shares and participations and the value of the contribution made or pledged to the corporation, and that therefore there is a direct correspondence between the capital of the corporation and the value of its patrimony in the moment of constitution.

For that reason, Article 59.2 CEA determines that:

No stakes may be created or shares issued for a sum lower than their par value.

And that following 59.1:

Stakes created or shares issued but not backed by a valid contribution to company equity shall be null and void.

THE EMISSION OF SHARES OR PARTICIPATIONS WITH A PREMIUM

The exception between this equivalence is given in Article 298.1 CEA which allows for the issue of shares with a premium:

In capital increases, stakes may be created and shares issued with a premium.

This special form of emission of shares or participations takes place when the partner (following a decision of the general meeting) makes a contribution that is superior to the nominal value of the shares or stakes acquired.

This may take place either at the moment of constitution of the corporation or at a later date when the corporation decides to increase its capital.

According to article 298.2 CEA:

The premium must be fully paid up when the new stakes are taken or new shares are subscribed.

THE EMISSION OF SHARES OR PARTICIPATIONS WITH A PREMIUM

The objective of this premium may be two-fold:

- (a) The partners may wish to strengthen the patrimony of the Corporation
- (b) The partners may wish to avoid the situation in which incoming partners would benefit unfairly from a corporation that has a patrimony that far exceeds its capital, and who only have to contribute the nominal value of the shares or stakes.

THE SHARE OR PARTICIPATION AS AN EXPRESSION OF THE CONDITION AS PARTNER

The ownership of a share or participation confers the condition of partner upon its owner.

We have already seen in the case of shares that they are transferable securities. As a general rule shares may be transferred fairly easily without the consent of the corporation, or the inscription of this transmission in the Commercial Registry.

The transmission of stakes **is subject to a set of much stricter rules.**

THE RIGHTS OF PARTNERS AND SHAREHOLDERS

A) Rights that integrate the condition of partner: Individual rights.

Article 93 CEA contains a minimum (and therefore not exhaustive) list of the rights of partners and shareholders:

Pursuant to the terms of this act, subject to the exceptions provided for hereunder, partners or shareholders shall be entitled to the following rights:

- a) To take part in the distribution of company earnings and in the equity resulting from liquidation.
- b) To acquire new stakes or subscribe new shares or convertible bonds under preferred conditions.
- c) To attend and vote at general meetings and challenge company agreements.
- d) To be duly informed.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

It is possible to distinguish between the abstract right to take part in the distribution of company earnings and the concrete right to a dividend.

While the general meeting cannot deprive a partner of her abstract right to participate in the profits of the corporation, it is possible and licit that they agree by a majority decision not to distribute dividends.

Even when the corporation records profits they may decide to add them to the corporation's reserves or to put them to other uses.

Article 273.1 CEA states that:

The general meeting shall decide on the distribution of the earnings for the financial year as shown on the approved balance sheet.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

However, this freedom to place the earnings of the corporation in reserve rather than distributing dividends cannot be considered absolute.

In particular, it cannot serve to justify the abuse by the majority, a situation that may come about when majority shareholders occupy important positions within the direction of the corporation and so channel the earnings of the company into their own salaries.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

Article 348 bis CEA determines that:

- 1. Beginning in the fifth financial year counting from the entry of the corporate enterprise in the Mercantile Registry, partners or shareholders voting in favour of distributing dividends shall be entitled to exit the company if the ordinary general meeting decides not to distribute a dividend of at least one third of the legally distributable profit earned in the preceding year in pursuit of the corporate purpose.*
- 2. The time-limit for exercising this right shall be one month from the date on which the ordinary general meeting was held.*
- 3. The provisions of this article shall not apply to listed companies.*

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

Once the general meeting has taken the decision to distribute earnings through a specific dividend, the partners acquire a right of credit against the corporation. They are then in a position analogous to that of any third party creditor, and have a five year period in which they can exercise the right to claim that amount, following Article 947.3 of the Commercial Code that states:

The right to receive dividends or payments agreed and accruing from securities or capital on part of the shares to which each partner is entitled in the corporate assets shall also prescribe after five years, as from the day set for their collection.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

The general meeting cannot then revoke or choose to ignore a previous decision to distribute a specific dividend to its partners.

The dividend corresponds to:

- a) Part of the profits obtained
- b) Part of the freely available reserves

That the general meeting has decided to distribute to each partner.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

In the case of the joint stock company, the dividend has to be distributed in proportion to the capital that the partner has paid for each of the *ordinary shares*. Article 275.2 CEA dictates that:

In joint stock companies, the dividends shall be distributed to the ordinary shareholders in proportion to the capital paid up.

Although the corporation may create privileged shares which will be grouped in a different class.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

It is important to remember that dividends can only be distributed when the net value of the patrimony of the corporation is greater than the social capital.

273.2 CEA:

Dividends may only be drawn on the year's profits or freely available reserves after meeting the requirements laid down by law and in the by-laws, and if the value of the corporate equity is not, or as a result of such distribution would not be, less than the company's capital. For these purposes, any profit directly allocated to total equity may not be distributed either directly or indirectly.

In the event of losses in preceding years that reduce corporate equity to less than the company's capital, profits shall be used to offset such losses.

THE RIGHT TO TAKE PART IN COMPANY EARNINGS

And that a further brake on the distribution of profits is applied by Article 273.3 CEA:

Profit distribution shall likewise be prohibited if the amount of the distributable reserves comes to less than the sum of the research and development expenses shown as assets on the balance sheet.

THE RIGHT TO TAKE PART IN EQUITY RESULTING FROM LIQUIDATION

The second part of Article 93 (a) CEA declares that:

Partners or shareholders shall be entitled to:

(a) (...) the equity resulting from liquidation

This means that, once dissolved and in a period of liquidation, each of the partners has a right to recover a part of the patrimony left over once all the creditors of the corporation have been paid. The part that they receive will be proportional to their effective participation in the capital of the corporation, unless the by-laws of the corporation allow for a different arrangement:

Article 392.1 CEA declares that:

Unless otherwise provided in the corporate by-laws, partners' or shareholders' liquidation dividends shall be proportional to their participation in company capital.

THE RIGHT TO TAKE PART IN EQUITY RESULTING FROM LIQUIDATION

The right to equity resulting from liquidation is a right that can be renounced, but that cannot be taken away from the partners by an agreement taken in the general meeting (see the judgement of the Spanish Supreme Court of the 1st of March 1983).

THE RIGHT TO ACQUIRE NEW SHARES OR CONVERTIBLE BONDS UNDER PREFERRED CONDITIONS

Article 304 CEA declares that:

In capital increases involving the issue of new ordinary or preference stakes or shares, posted against cash contributions, partners or shareholders shall be entitled to take or subscribe a number of stakes or shares in proportion to the par value of their holdings prior to the increase.

Article 305 CEA states that:

In limited liability companies, pre-emptive rights shall be exercised within the term specified in the respective decision (to increase capital). In joint stock companies, pre-emptive rights shall be exercised within the term established by the directors.

The preferential right to subscription has to be exercised by the partners within the time limit set by the directors of the joint stock company or the time limit fixed by the limited liability company for the increase in the capital of the corporation.

I HAVE ADDED THE WORDS IN RED

THE RIGHT TO ACQUIRE NEW SHARES OR CONVERTIBLE BONDS UNDER PREFERRED CONDITIONS

This right may be renounced by the partners or the shareholders. It is also transferable. Furthermore under certain circumstances this right does not exist:

304.2 CEA determines that:

Pre-emptive rights shall not be in order when the capital increase is the result of the takeover of another company or of all or part of the equity divested by another company or the conversion of bonds into shares.

THE RIGHT TO ACQUIRE NEW SHARES OR CONVERTIBLE BONDS UNDER PREFERRED CONDITIONS

Article 93 (b) establishes a right in favour of the partners to acquire new shares or new stakes or convertible bonds.

While article 416 CEA determines that:

Company shareholders shall have a pre-emptive right to subscribe convertible bonds.

A convertible bond is a bond that can be converted into a predetermined amount of the company's equity at certain times during its life, usually at the discretion of the bondholder.

This does not apply to limited liability companies as Article 402 CEA states that:

Limited liability companies may not issue bonds or other negotiable securities grouped by issues nor secure such operations.

THE RIGHT TO ATTEND GENERAL MEETINGS, TO VOTE AND TO BE DULY INFORMED

Article 93 CEA c) gives all partners and shareholders the right to attend and vote at general meetings and to be duly informed.

The right to vote is one of the principal rights of the partners and is the manner in which the corporation chooses who represents and manages it.

Article 159 CEA states that:

The partners or shareholders, assembled in an annual general meeting, shall adopt decisions on the matters whose competence is reserved to the general meeting by majority vote as defined by law or in the by-laws.

The decisions taken at the general meeting are binding, Article 159.2 CEA declares that:

All partners or shareholders, including any dissenting and any not attending the meeting, are bound by general meeting decisions.

THE RIGHT TO ATTEND GENERAL MEETINGS, TO VOTE AND TO BE DULY INFORMED

Obviously, in order for the decisions taken at the general meeting to be binding, it is necessary that they comply with certain requisites, (for example, that they relate to issues over which the general meeting has competence, that they form part of the agenda for the meeting or that they satisfy the necessary quorum).

Normally, all partners and shareholders can vote, however small their part of the capital of the corporation may be.

THE RIGHT TO ATTEND GENERAL MEETINGS, TO VOTE AND TO BE DULY INFORMED

In joint stock companies, the weight of the vote is determined by the proportion of the corporation's capital the shares represent. As we have seen, Article 188.2 CEA prohibits this direct proportionality from being disrupted. As does Article 96.2 CEA which declares that:

The issue of shares that may either directly or indirectly alter the proportionality between par value and voting or pre-emptive rights shall not be allowed.

THE RIGHT TO ATTEND GENERAL MEETINGS, TO VOTE AND TO BE DULY INFORMED

The Spanish Supreme Court has interpreted this right as referring to subscribed shares and not fully paid up shares (the judgement of the Spanish Supreme Court of the 27th of September 1973).

In limited liability companies this strict alignment between capital and voting rights is not required by law.

Article 188.1 CEA decrees that:

In limited liability companies, unless specified otherwise in the corporate by-laws, each stake entitles its holder to the right to cast one vote.

THE RIGHT TO ATTEND GENERAL MEETINGS, TO VOTE AND TO BE DULY INFORMED

The right to vote is personal and cannot be transferred independently of the transmission of the condition of partner. For that reason, if the shares or stakes are seized by a court for non-payment of creditors, the sequestrator does not have the right to vote, but it is retained by the proprietor.

The right to vote is an individual right that is essential to the condition of partner, which means that it cannot be rescinded by the by-laws or by a decision taken in the general meeting.

It can be exercised either by the partner herself or by someone who legally represents **her**.

RESTRICTIONS ON THE RIGHT TO ATTEND GENERAL MEETINGS AND THE RIGHT TO VOTE

In limited liability companies the right to attend general meetings and the right to vote **cannot** be restricted. Article 179.1 CEA states that:

In limited liability companies, all partners are entitled to attend the general meeting. The by-laws may not make attendance at general meetings contingent upon ownership of a minimum number of stakes.

However, for joint stock companies the right of attendance may be restricted. 179.2 CEA declares that:

In joint stock companies, the by-laws may subject eligibility to attend the general meeting to ownership of a minimum number of shares, irrespective of class or series. Under no circumstances, however, may the number required be greater than one-thousandth of the share capital.

RESTRICTIONS ON THE RIGHT TO ATTEND GENERAL MEETINGS AND THE RIGHT TO VOTE

This limitation on attendance does not deprive the shareholder of her right to vote, and Article 189.1 CEA states that:

Shares may be grouped for the purposes of exercising the right of attendance at general meetings and voting rights.

This means that once the group has reached the minimum requirement for attendance a representative of this group may attend and exercise the voting rights of the group in representation of their interests.

RESTRICTIONS ON THE RIGHT TO ATTEND GENERAL MEETINGS AND THE RIGHT TO VOTE

Joint stock companies may also put a cap on the voting rights of a single shareholder.

Article 188.3 CEA declares that:

Joint stock company by-laws may establish a general ceiling on the number of votes that may be cast by the same shareholder, companies belonging to the same group or anyone acting in conjunction therewith, without prejudice to the provisions of Article 527, applicable to listed companies.

RESTRICTIONS ON THE RIGHT TO ATTEND GENERAL MEETINGS AND THE RIGHT TO VOTE

This article obviously has to be put in conjunction with Article 527 CEA which states that:

Clauses in the by-laws of listed joint stock companies that directly or indirectly establish a general ceiling on the number of votes that can be cast by a single shareholder or companies belonging to the same group or anyone acting in conjunction therewith shall be null and void when, after a takeover bid, the bidder holds 70% or more of the voting share capital, unless such bidder is not bound by an equivalent break-through rule or fails to invoke it.

RESTRICTIONS ON THE RIGHT TO ATTEND GENERAL MEETINGS AND THE RIGHT TO VOTE

There are also certain cases in which the right to vote cannot be exercised.

(i) As we have already seen, in the case of shareholders in arrears Article 83.1 states that:

Shareholders in arrears of payment of sums outstanding may not vote. The value of the respective shares shall be deducted from the share capital when calculating a quorum.

(ii) Article 148 suspends voting rights when the company acquires its own shares/stakes or the shares/stakes of a parent company.

(iii) When capital is reduced to redeem shares and founders' bonds are issued to replace them (which do not carry voting rights according to Article 341.2 CEA).

THE RIGHT TO INFORMATION – LIMITED LIABILITY COMPANIES AND JOINT STOCK COMPANIES

In order for the partners to be able to vote with any criteria, they have to be informed about the issues to be put to the vote in the general meeting. This right to information is generally satisfied in two ways:

- (a) The partners may request in writing, before the general meeting, or verbally while the meeting is being held, the reports or clarifications that they believe to be necessary relating to the issues on the agenda.**

Article 196.1 CEA states that:

*The partners of **limited liability companies** may request in writing prior to the general meeting, or verbally during the meeting, any reports or clarification that they deem necessary in connection with items on the agenda.*

THE RIGHT TO INFORMATION LIMITED LIABILITY COMPANIES

The governing body shall be bound to provide such reports or clarification either verbally or in writing, depending on when and what kind of information is requested, except where, in the governing body's opinion, disclosing such information may be detrimental to the company's interests.

*Information may not be withheld when requested by partners representing at least **25%** of the capital.*

THE RIGHT TO INFORMATION — JOINT STOCK COMPANIES

With regard to **joint-stock companies**, Article 197 CEA states the following:

Shareholders may ask the directors to provide any information or clarification that they deem necessary about the items on the agenda, or pose any questions they deem appropriate, in writing up until the seventh day before the date on which the meeting is scheduled to be held.

The directors shall be bound to furnish the information in writing by the date of the general meeting.

THE RIGHT TO INFORMATION

During the general meeting, the company's shareholders may verbally request any information or explanations that they deem necessary with respect to the items on the agenda, and whenever their queries cannot be immediately answered, the directors shall be obliged to provide the information in writing no more than seven days after the general meeting.

The directors shall be bound to furnish the information requested pursuant to the provisions of the two preceding paragraphs except in cases where, in the chairperson's opinion, disclosing the information requested may be detrimental to the company's interests.

Information requested by shareholders representing at least 25% of the share capital may not be withheld. Smaller percentages, necessarily in excess of 5% of the share capital, may be stipulated in the by-laws.

THE RIGHT TO INFORMATION

(b) The second way in which the duty to inform shareholders or stakeholders is complied with concerns the financial statements of the Corporation. Article 272.2 CEA states that:

After the general meeting has been convened, any shareholder may apply to the company to obtain, immediately and cost-free, the documents that have to be submitted to the general meeting for approval, and, as appropriate, the management and auditor's reports.

Mention of this right shall be included in the notice of the meeting.

THE VIOLATION OF THE RIGHT TO INFORMATION

The infringement of the right to information generally permits the agreements taken at the general meeting to be challenged. However, the right to challenge the decision is limited. Article 204.3 (b) CEA states that there will be no right to challenge the decisions of the general meeting based on:

*The inaccuracy or insufficiency of the information provided by the corporation in response to the exercise of the right of information before the general meeting, **unless**, the information that is incorrect or lacking was essential to the reasonable exercise of the right to vote of the shareholder or partner (...).*

THE VIOLATION OF THE RIGHT TO INFORMATION

Furthermore, Article 197.5 CEA in relation to the joint stock company determines that:

The violation of the right to information (during the celebration of the general meeting) will only entitle the shareholder to request that this obligation be complied with and to be reimbursed for any damages resulting from the violation, but it will not entitle her to challenge the agreements of the general meeting.

OTHER RIGHTS OF SHAREHOLDERS AND STAKEHOLDERS

The partners, considered individually have a number of other rights:

- (a) They may challenge the agreements made at the general meeting (but only when they are contrary to public order, if they wish to challenge agreements for other reasons they must have a minimum of 1% of the capital of the corporation).
- (b) They have the right to exit from the corporation (346 CEA ff)
- (c) In the joint stock company they have the right to transfer their shares. In limited liability companies this right is far more limited, remember that 108.1 CEA states that:

Clauses in the by-laws allowing voluntary inter vivos transfer of stakes to be transacted virtually freely shall be null and void.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

There are a number of rights which are granted to minority shareholders or stakeholders.

- 1) The right to convene a general meeting** - *The directors must convene a general meeting when so requested by one or several partners or shareholders representing at least 5% of the capital, who must specify the matters to be addressed in the request.*

In joint stock companies this right is complemented by article 172 CEA which states that:

In joint stock companies, shareholders representing at least 5% of the share capital may request the publication of a supplementary notice of a general meeting which shall include one or more additional agenda items.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

2) The examination of company accounts -

Article 272.3 CEA - Unless specified otherwise in the by-laws, during that same period of time, any partner or partners of limited liability companies representing at least 5% of the capital, may alone or in the company of an expert accountant visit the registered office to examine the documents substantiating the financial statements and used as a basis for their formulation.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

3) The right to challenge the agreements of the general meeting –

As mentioned before, this right requires the individual partner or group of partners to have at least 1 % of the total capital of the corporation, unless the by-laws stipulate that a lower percentage is possible.

206.1 CEA states that:

Decisions taken in the general meeting may be challenged by any of the directors, third parties who prove that they have a legitimate interest, and those partners who had acquired the condition of partner before the decision had been taken, providing that they represent, either individually or collectively at least 1 % of the capital of the corporation.

The by-laws can reduce the percentages indicated, and, in all cases, the partners who do not meet the required level of capital will have the right to be indemnified if the agreement in question has provoked damages.

However, agreements which affect public order can be challenged without the requirement of meeting this level of capital.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

4) The right to challenge the decisions of the board of directors –

Article 251 CEA states that:

*Directors may challenge null and annulable decisions adopted by the board of directors or any other governing body within thirty days of their adoption. Similarly, such decisions may be challenged by partners or shareholders representing **5% of the capital** no more than thirty days after they became aware thereof and provided less than one year has elapsed since their adoption.*

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

5 Appointing members of the board by proportional representation –

Joint stock companies may decide to appoint their directors by proportional representation. This prevents the monopolisation of the board by the majority shareholders. Article 243 of the Corporate Enterprises Act declares that:

In joint stock companies, 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, rounding any fractions.

The Law **does not grant the same right to limited liability companies.**

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

6. The right to claim responsibility against the directors of the corporation

The minority have the right to convene a general meeting in order to bring an action for liability against the directors of the corporation.

Article 239 CEA states that:

- 1. Partners or shareholders representing at least 5% of the capital may request a general meeting to decide whether to bring action for liability.*
- 2. They may also jointly bring action for liability to defend the corporate interest when the directors fail to convene the general meeting requested, when the company fails to bring such action within one month of the date of adoption of the respective decision, or when the meeting decides not to claim liability.*

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

The minority which has at least 5% of the capital may also initiate the action directly, without first convening a general meeting when it is grounded in an infraction of the director's duty of loyalty to the corporate interest.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

The corporate action for liability may be proposed in an ordinary general meeting, but the decision to waive the action for liability may be challenged by the minority shareholders:

Article 238 CEA states that:

1. Action to demand director liability shall be brought by the company pursuant to a general meeting decision, which may be adopted at the behest of any shareholder even where not included on the agenda. The by-laws may not require a qualified majority for the adoption of such decisions.

2. The general meeting may reach a settlement in or waive such action at any time, unless an objection is raised thereto by partners or shareholders representing 5% of the capital.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

7. The right to request the appointment of an auditor

Article 265.2 CEA states that:

In companies that are not bound to have their financial statements audited, shareholders representing at least 5% of the share capital may apply to the mercantile registrar serving the place where the registered office is located to appoint an auditor to, at the company's expense, audit the financial statements for a given financial year within the three months following the end of such financial year.

THE RIGHTS OF MINORITY SHAREHOLDERS AND STAKEHOLDERS

8. The right to request the presence of a notary at the general meeting

Article 203 states that:

The directors may ask a notary public to attend the general meeting and take the minutes and shall be obliged to do so when requested by shareholders representing at least 1% of the company's capital, in joint stock companies, or 5% in limited liability companies. Such requests must be lodged five days before the date scheduled for the meeting. In the event, decisions shall only be effective if recorded in the notary public's minutes.

PRIVILEGED RIGHTS CONTAINED IN STAKES AND SHARES

Article 94 CEA allows for some stakes and shares to contain privileged rights. The text states that:

Stakes and shares may afford different rights to their holders. Shares associated with the same rights form part of the same class. When a class is divided into several series, all shares in any given series shall have the same par value.

The creation of stakes and issue of shares attributing privileges over ordinary stakes and shares shall be subject to the procedures laid down to amend the by-laws.

PRIVILEGED RIGHTS CONTAINED IN STAKES AND SHARES

Ordinary shares or stakes are those that attribute to the partner or shareholder the general rights that accompany the condition of shareholder, whilst privileged stakes and shares concede certain advantages to their holders.

These advantages may be of different types, such as a greater dividend or a greater share in the case of the liquidation of the corporation.

PRIVILEGED RIGHTS CONTAINED IN STAKES AND SHARES

Article 96 contains a list of prohibitions in matters of privilege. The article states that:

1. The creation of stakes or the issue of shares entitled to collect interest shall not be valid, irrespective of the manner in which it is determined.
2. The issue of shares that may either directly or indirectly alter the proportionality between par value and voting or pre-emptive rights shall not be allowed.
3. The creation of stakes that either directly or indirectly alter the proportionality between par value and voting or pre-emptive rights shall not be allowed.

Although in the limited liability company it should be remembered that Article 188 CEA declares that:

In limited liability companies, unless specified otherwise in the corporate by-laws, each stake entitles its holder to the right to cast one vote.

Which of course means that the by-laws may establish a different order of things.

NON VOTING SHARES AND STAKES

Article 99 of the Corporate Enterprises Act allows for the creation of non-voting stakes and shares in joint stock companies and limited liability companies:

Limited liability companies may create non-voting stakes up to a par value of less than half of the capital and joint stock companies may issue non-voting shares up to a par value of under half of the paid up share capital.

NON VOTING SHARES AND STAKES

Non-voting stakes and shares do not allow their holders to vote at the general meeting, however they may be considered as a class of preferential participations as they provide shareholders or stakeholders with what is known as the minimum yearly dividend, which other shareholders or stakeholders are not entitled to.

Article 99 CEA establishes the following:

Holders of non-voting stakes or shares shall be entitled to receive the minimum yearly dividend, whether fixed or variable, established in the by-laws. Once the minimum dividend has been approved, the holders of non-voting stakes or shares shall be entitled to the same dividend as paid for ordinary stakes or shares.

NON VOTING SHARES AND STAKES

The minimum yearly dividend must be distributed to the non-voting stakeholders or shareholders whenever distributable profits are earned. Article 99.2 of the CEA declares that:

Where distributable profits are earned, the company shall be bound to approve the distribution of the above mentioned minimum dividend.

NON VOTING SHARES AND STAKES

Article 99.3 explains what happens if distributable profits are not earned:

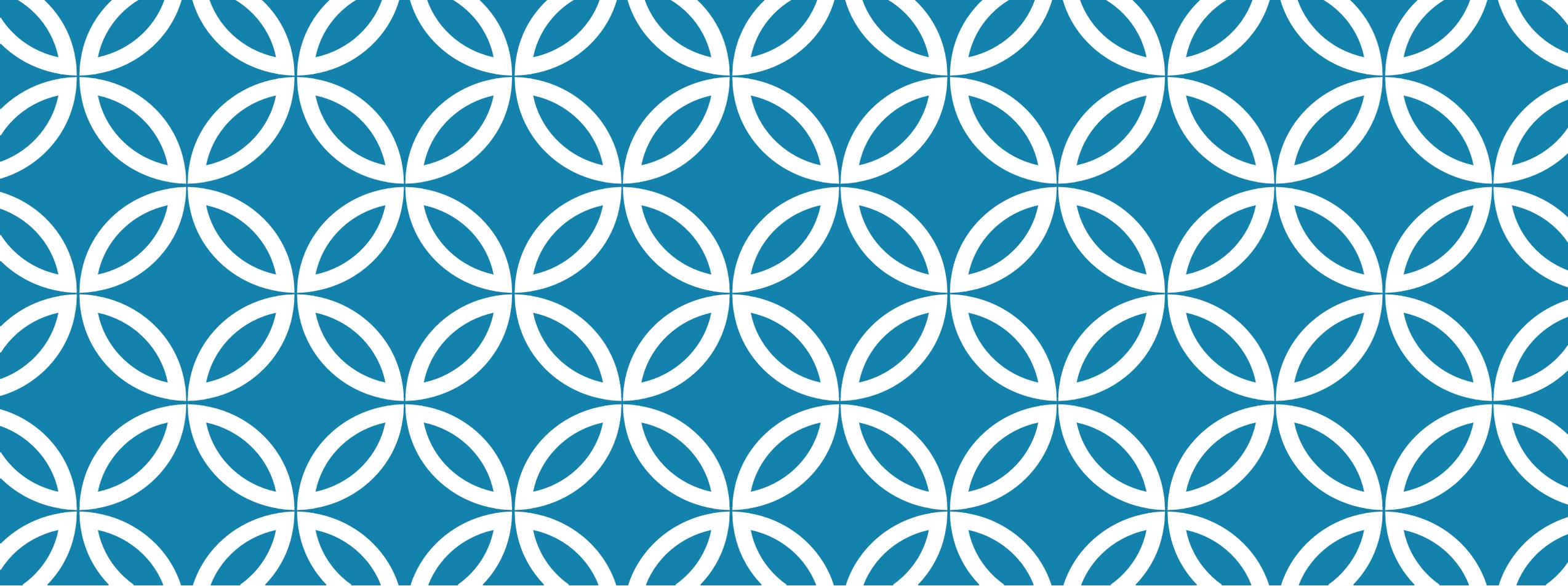
Where distributable profits are not earned or are insufficient for distribution, the portion of the unpaid minimum dividend must be paid within the following five financial years. Until such minimum dividend is paid up, the non-voting stocks and shares shall be entitled to this right under the same terms and conditions as ordinary shares and maintain their financial privileges.

This means that until the non-distributable profits are paid up then the holders of non-voting stakes or shares have the right to vote.

OTHER ECONOMIC PRIVILEGES

Besides their right to receive the minimum dividend, holders of non-voting stakes and shares have a number of other economic privileges:

1. They are unaffected by capital reductions to reflect losses unless the reduction exceeds the par value of the remaining stakes or shares. (Article 100)
2. In the event of company liquidation they are entitled to reimbursement prior to the distribution of any amount to the remaining stakeholders. In joint stock companies this amount is limited to the amount paid up in non-voting shares. (Article 101)



PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

EXIT

Article 346 contains some of the legal causes which entitle a partner or shareholder to exit the company. The article states that:

Partners or shareholders not voting in favour of the respective decision, including non-voting partners or shareholders, shall be entitled to exit the company in any of the following circumstances:

- a) Supersession or amendment of the corporate purpose
 - b) Extension of company term
 - c) Company reactivation
 - d) Creation, amendment or early cancellation of ancillary commitments, unless otherwise provided in the by-laws.
- 2.** In limited liability companies, partners not voting in favour of amendment of the arrangements for the transfer of stakes shall also be entitled to exit the company.
- 3.** In company conversions and relocations of the registered office abroad, partners or shareholders shall be entitled to exit rights in the terms laid down in **Act 3/2009 of 3 April** on structural changes in trading companies.

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

Shareholders of non-listed joint stock companies and stake holders of limited liability companies can also request to exit the company when the general meeting has decided not to distribute dividends, in the terms described by Article 348 bis of the CEA:

Beginning in the fifth financial year counting from entry of the corporate enterprise in the Mercantile Registry, partners or shareholders voting in favour of distributing dividends shall be entitled to exit the company if the ordinary general meeting decides not to distribute a dividend of at least one third of the legally distributable profit earned in the preceding year in pursuit of the corporate purpose.

The provisions of the article and not applicable to listed companies.

However, the application of this article has been suspended until the 31st of December 2016.

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

The company by-laws can also establish causes for a partner or shareholder exiting the company.

Article 347.1 of the CEA determines that:

The by-laws may establish causes for exit other than provided in this act. In such event, they shall determine the procedure for accrediting existence of the cause and for exercising exit rights as well as the term for doing so.

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

The decisions of the general meeting which give rise to exit rights must be published in the Official Journal of the Commercial Registry. In limited liability companies and joint stock companies with registered shares only, instead of publication, the directors may serve notice on all partners or shareholders not voting in favour of the decision.

All rights must be exercised in writing within one month of the publication of the decision or receipt of notification. (Article 384 CEA)

If there is no agreement between the company and the partner or shareholder concerning the fair value of the stakes or shares, then there will be a valuation procedure, which will follow the rules laid down in Article 353 of the CEA. This procedure is common to both the exit and the exclusion of partners and shareholders.

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

The exclusion of partners and shareholders is a mechanism for the resolution of conflicts. Normally the decision to exclude is taken by the directors of the corporation. The Corporate Enterprises Act only stipulates causes for exclusion in the case of limited liability companies.

Article 350 CEA declares that:

Limited liability companies may exclude partners who voluntarily fail to honour their ancillary commitments, or managing partners who breach the prohibition on competition or are ordered in an unappealable court ruling to indemnify the company for damages deriving from acts that run counter to this act or the by-laws or from the absence of due diligence.

PARTNER OR SHAREHOLDER EXIT AND EXCLUSION

However, corporations may include specific causes for exclusion in their by-laws.
(Article 351 CEA)

ASPECTS COMMON TO BOTH THE EXIT AND THE EXCLUSION OF PARTNERS AND SHAREHOLDERS

When a partner or shareholder exits or is excluded from a company they must be reimbursed for the contribution that they made. The valuation of their stakes or shares will be carried out by the company's auditor.

However, if the parties do not come to an agreement about the value of the stakes or shares (or the company does not have an auditor as it is not legally obliged to have one), then the procedure detailed in Article 353 CEA will be followed.

ASPECTS COMMON TO BOTH THE EXIT AND THE EXCLUSION OF PARTNERS AND SHAREHOLDERS

Article 353 CEA states the following:

In the absence of an agreement between the company and the partner or shareholder on the fair value of stakes or shares, the identity of their appraisers, or the procedure to be followed for their valuation, these holdings shall be valued by an auditor other than the company's auditor. Such expert shall be designated by the mercantile registrar serving the place where the company's registered office is located, at the behest of the company or of any of the partners or shareholders owning the stakes or shares to be appraised.

ASPECTS COMMON TO BOTH THE EXIT AND THE EXCLUSION OF PARTNERS AND SHAREHOLDERS

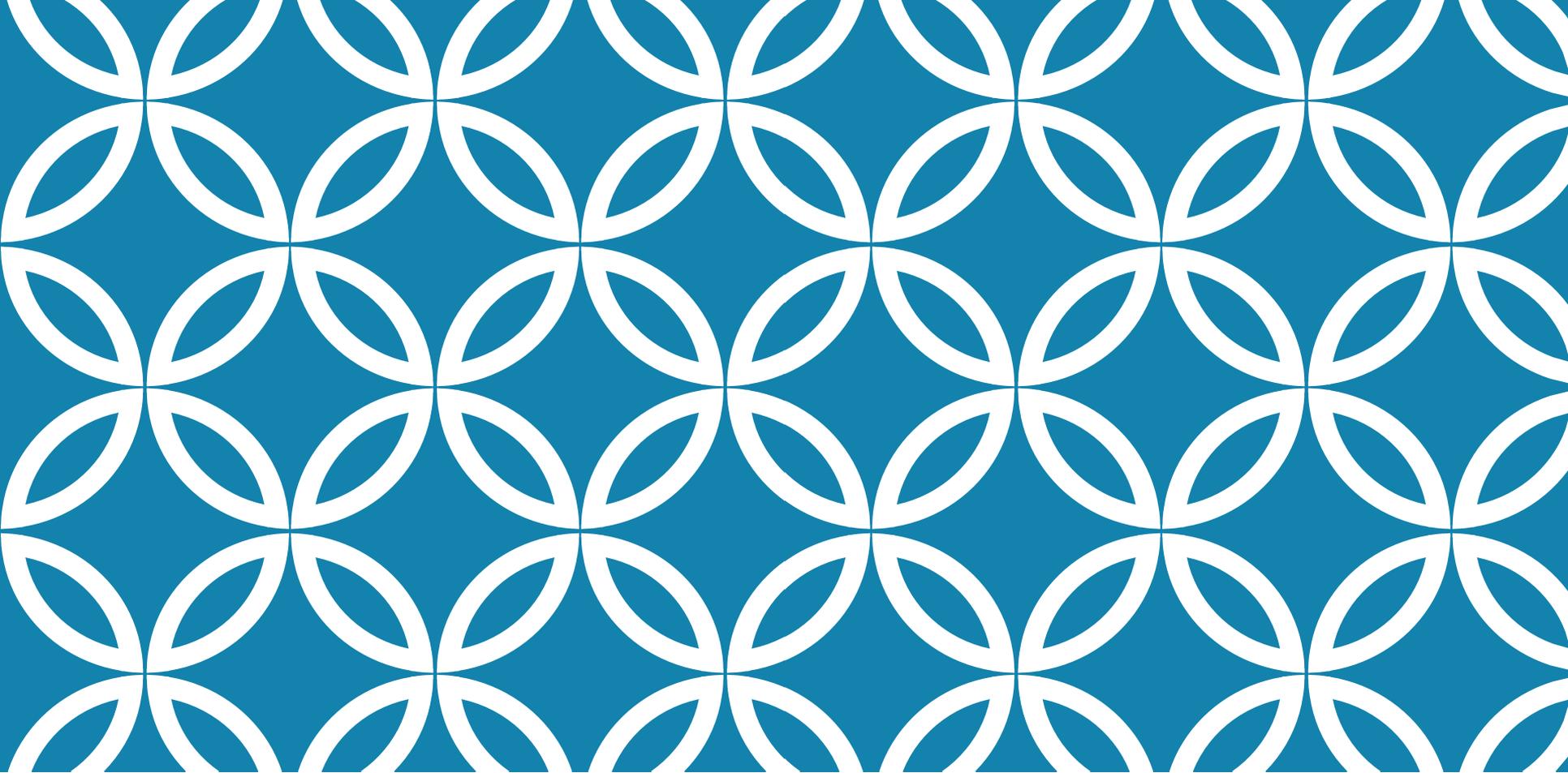
The auditor's remuneration will be paid for by the company.

However, when shares are listed on an official secondary market the value shall be the average quotation price for the last quarter.

ASPECTS COMMON TO BOTH THE EXIT AND THE EXCLUSION OF PARTNERS AND SHAREHOLDERS

When a partner leaves a corporation (either because she exits or is excluded), the basic effect that it produces is the reduction of the capital of the Corporation.

In the case of limited liability companies, the partners whose redeemed stakes are reimbursed are subject to the provisions on liability for corporate debt established for capital reductions via the refund of contributions (something we will see in a future lesson).



LESSON 7.
**THE TRANSMISSION OF STAKES AND SHARES AND
TREASURY SHARES**

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

The ability to transmit shares is essential to the nature of the joint stock company. It is one of the key features behind the success of joint stock companies. The condition of partner is transferred with the transmission of the share.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

Shares are value titles, and with them comes the group of rights that are associated with being a shareholder.

Shares may be nominative or registered shares (they name the person who owns them in the share document) or made out to the bearer (bearer shares), although in some cases they must be registered shares.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

Article 113.1 of the CEA states that:

Shares represented by certificates may be registered or bearer shares. They shall necessarily be registered until the amount thereof is fully paid up if transferability is subject to restrictions or the shares to ancillary commitments, or where special provisions so stipulate.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

Registered shares have the following characteristics:

- a) The owner of the shares has to be registered in a book which lists all the registered shares.
- b) If a registered share is transmitted, then this transmission must be reflected in the share document and the new holder entered into the book of registered shares.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

Bearer shares have the following characteristics:

- a) The exhibition of the share document or the certificate issued by an authorized depository is sufficient proof of the condition of shareholder.
- b) The transmission of the share can be effected by the sales contract and the mere handing over of the documentation.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

Electronic book entry –

The book entry system means that the transmission of shares is entered on an electronic registry. This electronic book keeping is managed by a specialized firm or financial entity with which the corporation maintains a contractual relationship.

THE TRANSMISSION OF STAKES AND SHARES AND TREASURY SHARES

- a) Proof of ownership is established by inscription in the electronic registry and a certificate issued showing the entry made in favour of the shareholder.
- b) The transmission of the shares is carried out by electronic registration.

Corporations are only admitted to the stock exchange when they operate a system of electronic registration.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

Share transfer may be limited as the joint stock company may have been constituted in the first instance by a group of partners with a certain skill set (engineers, biologists and software writers), members of the same family or any other special link. In this case, it might well be in the interest of the partners to restrict the entry into the corporation of new partners who do not share the group's characteristics. Entry may therefore be restricted by the by-laws of the corporation.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

While the by-laws may restrict the transfer of shares, they cannot make them impossible to transmit.

Article 123.2 CEA is very clear about this:

Clauses in the by-laws that render shares non-transferable in practice shall be null and void.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

The restrictions that the by-laws can place on the transmission of shares are themselves subject therefore to a series of limitations:

- a) As we have just seen, a total ban on transfer would be declared void.
- b) Also, any restriction in the statutes which is formally and externally valid but which due to its content or function in practice results in a *de facto* ban on the transfer of shares will also be declared void.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

c) Any by-law that obliges the share-holder who wishes to transmit a number of shares to only transmit a limited number cannot be inscribed in the Commercial Registry. The effect of this non-inscription is that such a by-law would be void (Article 123.5 of the Regulation of the Commercial Registry).

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

d) The same impossibility of registration applies to by-laws that would prevent the share-holder from obtaining the real value of the shares he or she wishes to sell (Article 123.6 of the Regulation of the Commercial Registry).

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

e) The limitations placed on the transmission of shares that are not contained in the by-laws of the corporation will not be void, but they cannot be used in court by or against the corporation.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

Article 123.1 CEA states that:

Restrictions on or requisites for the free transfer of shares shall only be valid when applied to registered shares and explicitly stipulated in the by-laws.

When limitations are established by amendment to the by-laws, shareholders who are affected but voted against such amendment shall not be subject thereto for three months from the publication of the decision in the Official Journal of the Mercantile Registry.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

Classes of restrictions in the by-laws

1) Pre-emption clauses – these clauses grant to shareholders the preferential right to acquire the shares that another shareholder wishes to transmit. This means that the shareholder who wishes to transmit her shares cannot do so without previously offering her shares to the other pre-existing shareholders first. Only when no other shareholder wishes to acquire them may she proceed to transmit them to a third party.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

2) Authorising clauses –

These clauses condition the transmission of shares to the authorisation of the corporation.

These clauses are only valid when the by-laws mention precisely the causes that permit the corporation to refuse to authorise the transmission.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

Article 123.3 CEA states that:

Share transferability may only be subject to prior company authorisation if the by-laws list the reasons for withholding such authorisation.

Unless otherwise provided in the by-laws, it shall be incumbent upon company directors to grant or deny authorisation.

In any event, if the company fails to reply to a request for authorisation within two months of the date of submission, the authorisation shall be regarded to have been granted.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

3) The moment in which the restriction may be created

The restrictions are normally introduced into the by-laws of the corporation when the corporation is constituted. However, Article 123 CEA allows for amendments to the by-laws to be introduced (although these have to follow the procedure for amendments to the by-laws contained in Articles 285ff CEA). As we have seen those shareholders who voted against the amendment will not be affected by the restriction for a period of three-months from the publication of the decision in the Official Journal of the Commercial Registry.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

4) Restrictions placed on the transmission of registered shares-

Only registered shares may have restrictions placed on their transmission.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

5) The transmission *mortis causa* and by forced sale

The CEA considers both these cases. Article 124.1 CEA declares that:

Restrictions in the by-laws on share transfers shall only be applicable to acquisitions on the occasion of death when explicitly stipulated in the by-laws themselves.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

In the event of transmission *mortis causa* the transmission to the heirs of the deceased can only be prevented if the corporation provides the heir with a buyer or offers to purchase the shares itself at their fair value (CEA 124.2).

The meaning of fair value is given in the text of the law which goes on to state that:

Fair value shall be understood to be the value determined by an auditor other than the company's auditor, appointed for this purpose by the company's directors at the behest of any party concerned.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

In the case of mandatory transfers or forced sales Article 125
CEA stipulates that:

*The provisions of the preceding article shall apply when the shares are
acquired as a result of court or administrative foreclosure proceedings.*

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

6) The transmission of shares with ancillary commitments:

When shares contain ancillary commitments it's obvious that the corporation has a direct interest in making sure that the shareholders fulfil these commitments, and does not want the shares to be passed on to somebody who cannot fulfil them.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

Article 88 CEA declares that:

The voluntary inter vivos transfer of stakes or shares owned by a partner or shareholder who is personally bound by ancillary commitments, as well as the transfer of specific stakes or shares so conditioned, shall be subject to company authorisation.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

*Unless otherwise indicated in the by-laws, in limited liability companies such authorisation shall be granted by the **general meeting**, and in joint stock companies by **the directors**.*

In any event, if the company fails to reply to a request for authorisation within two months of the date thereof, authorisation shall be deemed to be granted.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

7) The effects of the violation of the restrictions

When the restriction violated is not a by-law but only an agreement among the partners then the transmission will be valid both from the perspective of the corporation and the shareholders who decide to transmit their shares. However, the shareholder who made the transmission will incur responsibility with respect to the other parties to the agreement.

LIMITATIONS PLACED ON THE TRANSMISSION OF STOCKS AND SHARES

If, however, the restriction violated is a **by-law**, then the effect will be that the corporation refuses to inscribe the **new** shareholder in the registry of registered shares, with the consequence that she will not be able to exercise her rights as a shareholder.

It is also possible that the by-laws of the corporation declare such a transmission to be void, and the corporation does not recognise the shareholder as a partner (i.e. does not pay out dividends).

THE TRANSMISSION OF STAKES

The treatment that stakes receive in the law is primarily concerned with their transmission.

a) Transmission *inter vivos* –

(i) As we saw earlier, Article 108.1 CEA states that:

Clauses in the by-laws allowing voluntary inter vivos transfer of stakes to be transacted virtually freely shall be null and void.

THE TRANSMISSION OF STAKES

Also, as declared in Article 108.2 CEA:

Clauses in the by-laws by which the partner offering all or part of his stakes is bound to transfer a number other than offered shall be null and void.

This is the same as we saw earlier in relation to shares, it means that the corporation cannot have a by-law which would prevent the stakeholder from transmitting the number which he or she intends to transmit, as such a by-law would be null and void.

THE TRANSMISSION OF STAKES

A total ban on the transmission of stakes is possible, but only under the condition stipulated in Article 108.3 CEA:

Clauses forbidding the inter vivos voluntary transfer of stakes shall only be valid if the by-laws acknowledge the partners' right to exit the company at any time. The inclusion of such clauses in the company by-laws shall be subject to the consent of all partners.

THE TRANSMISSION OF STAKES

However, the exception to the previous rule is provided in Article 108.4 CEA which declares that:

*Notwithstanding the provisions of the foregoing paragraph, the by-laws may prevent the voluntary inter vivos transfer of stakes or the exercise of exit rights for **no longer than five years** from the date of company formation, or in respect of stakes resulting from a capital increase, five years from the date of formalisation of the respective public instrument.*

THE TRANSMISSION OF STAKES

The transmission of stakes between partners is free from restrictions, unless the company by-laws place a restriction on this form of transmission.

Also the transmission between family members is free from restrictions, according to Article 107.1 CEA which declares that:

Unless otherwise indicated in the by-laws, voluntary inter vivos transfers of stakes may be freely transacted among partners or in favour of partners' spouses, ascendants or descendants or companies belonging to the same group as the transferor. In all other cases, transfers shall be subject to the rules and limitations established in the by-laws or, wanting that, in this act.

THE TRANSMISSION OF STAKES

The law has limited itself to establishing the cases in which transmission of stakes may be freely transacted unless the by-laws of the company establish that these cases are subject to limitations. The freedom to place limitations may even lead to these cases of free transmission being eliminated entirely.

THE TRANSMISSION OF STAKES

Outside of these cases of free transmission, the transmission of stakes is subject to the restrictions placed upon transmission by the by-laws.

However, if the by-laws do not regulate the restrictions placed on transmissions then the provisions of Article 107.2 CEA come into play.

THE TRANSMISSION OF STAKES

A) Any partner wishing to transfer his or her stake or stakes must inform the directors in writing, specifying the number and characteristics of the stakes involved, of the identity of the transferee and other terms and conditions of transfer.

THE TRANSMISSION OF STAKES

B) The transfer shall be subject to company authorisation, granted under a decision of the annual general meeting adopted by ordinary majority vote as established by law, provided the item is included on the agenda.

THE TRANSMISSION OF STAKES

C) The company may only withhold its consent if it serves a notarised notice upon the transferor, specifying the identity of one or several partners or third parties interested in acquiring all the stakes for sale. No notice need to be served upon the transferor if he or she attended the annual general meeting where such arrangements were approved.

THE TRANSMISSION OF STAKES

Partners attending the general meeting shall have purchase priority. If several attendees express an interest in the stakes in question, they shall be distributed among them all in proportion to their existing stakes in the company capital.

THE TRANSMISSION OF STAKES

D) If one or several partners or third party purchasers of all the shares cannot be identified, the general meeting may decide that the company itself should acquire the shares that are not acquired by any partner or third party accepted by the meeting, pursuant to the provisions of Article 140.

THE TRANSMISSION OF THE STAKES

E) The price of the stakes, the payment method and other terms and conditions of the transaction shall be as agreed to by the transferor and disclosed to the company. If the payment of all or part of the price is deferred in the proposed transfer, payment of the amount deferred must be guaranteed by a financial institution prior to the purchase of the stakes.

THE TRANSMISSION OF STAKES

F) The public instrument on transfer must be formalised within one month of the date of disclosure by the company of the identity of the purchasing party or parties.

MANDATORY TRANSFER

Article 109 CEA states that:

The seizure of stakes in the company on the occasion of proceedings for collection must be immediately reported to the company by the judge or authority ordering such attachment, identifying the lienor and the stakes subject to lien. The company shall record the seizure in the stakeholders' ledger and immediately forward a copy of the notice received to all partners.

MANDATORY TRANSFER

Lien - The legal right of a creditor to sell the collateral property of a debtor who fails to meet the obligations of a loan contract. A lien exists, for example, when an individual takes out a loan to buy a car. The lien holder is the bank that grants the loan, and the lien is released when the loan is paid in full.

MANDATORY TRANSFER

The judge or administrative authority shall forward a literal transcript of the auction or adjudication to the company, along with the adjudication requested by the creditor. The company shall send copies of such transcripts to all partners within five days of receipt thereof.

MANDATORY TRANSFER

Before the decision on the sale or award of the stakes is final, the partners or, lacking that if the by-laws establish a right of pre-emption in its name, the company, may be subrogated to the rights of the awardee or creditor, providing they or it explicitly accept all the terms of the auction and full appropriation of the sum involved or, as appropriate, of the adjudication to the creditor and all expenses incurred. If several partners undertake subrogation, the stakes shall be distributed in proportion to the holding of each in company capital.

TRANSFERS *MORTIS CAUSA*

Article 110 CEA deals with transfers *mortis causa*:

It establishes that:

Acquisition of a stake through hereditary succession confers partnership status on the inheritor or legatee.

TRANSFERS *MORTIS CAUSA*

Notwithstanding the foregoing, the by-laws may grant the surviving partners or, in the absence thereof, the company, the right to purchase the deceased partner's stakes at their fair value on the date of the partner's death. The valuation shall be as specified in this act for the terms governing partner exit and the right of purchase must be exercised no more than three months after the date the company is notified of the bequest.

TREASURY SHARES

The concept of the Treasury share is that the corporation purchases its own shares.

There are certain dangers to the corporation purchasing its own shares:

- a) It can weaken the patrimony of the company.
- b) This in turn poses a threat to third party creditors.

TREASURY SHARES

The law distinguishes between original acquisition and derivative acquisition of shares.

1) Original acquisition of shares means that the company issues shares which it then subscribes to and purchases itself. This poses two significant dangers:

TREASURY SHARES

- a) The money for the purchase of freshly issued shares would come from the company itself, and so there would be no incoming funds – thus weakening the financial position of the company.
- b) The shares would be owned by the corporation, meaning that the directors of the company would control the voting rights that accompanied these shares, and could therefore use them to strengthen their position within the company.

TREASURY SHARES

Article 134 CEA establishes a ban on the original acquisition of shares:

Under no circumstance may corporate enterprises acquire or subscribe their own stakes or shares or any created or issued by the parent company.

TREASURY SHARES

This ban on original acquisition is complete in the case of limited liability companies:

Article 135 states the following with regard to limited liability companies:

Original acquisitions of their own stakes or parent company stakes or shares by limited liability companies shall be null and void.

TREASURY SHARES

The prohibition is not complete in the case of joint stock companies, and the law does not establish the nullity of the acquisition as the result of infringement but rather determines a series of other consequences:

Article 136 CEA states that:

Shares subscribed in violation of the prohibition contained in Article 134 shall be owned by the subscribing joint stock company.

In the event of subscription of the company's own shares, the founding partners or shareholders or promoters and, in the event of a capital increase, the directors, shall be jointly and severally liable to pay for the shares involved.

The shares, therefore, have to be paid for by the founder partners or promoters at the moment of the foundation of the joint stock company, or the directors in the event of a capital increase.

TREASURY SHARES

In the case of parent company stakes or shares the laws determines that:

Where parent company stakes or shares are taken or subscribed, the directors of the purchasing and parent companies shall be jointly and severally liable to pay for the stakes or shares in question.

TREASURY SHARES

Further consequences of the infringement of the prohibition of original acquisition are contained in Article 139 CEA:

Shares acquired by joint stock companies in breach of the provisions of Article 134 must be alienated within one year of the date of first purchase.

This means that they must be sold off within a year of purchase, the corporation cannot keep hold of them.

TREASURY SHARES

If the shares are not sold off within the deadline, then the capital of the corporation will have to be reduced:

If alienation is not forthcoming by the aforementioned deadline, the directors shall immediately proceed to convene a general meeting to agree on the redemption of treasury shares and the concomitant reduction in share capital.

TREASURY SHARES

If this reduction in capital is not forthcoming, then this entitles interested parties (for example creditors or guarantors) to request the court to instruct the corporation to reduce its capital:

If the company fails to reduce the share capital within two months of the end of the alienation deadline, any party concerned may ask the commercial court with jurisdiction in the place where the registered office is located to reduce company capital. If the meeting decides not to reduce the company's share capital or where such reduction cannot be attained, the directors shall be bound to apply for a court ruling in this regard.

With the consequence that:

Shares in the parent company shall be alienated by court order at the behest of any party concerned.

TREASURY SHARES

B) Derivative acquisitions mean that the shares were initially purchased by another party (not the corporation itself), and then subsequently obtained by the corporation.

This is permitted in both joint stock companies and limited liability companies but is subject to certain restrictions.

UNRESTRICTED ACQUISITION

Article 144 permits the unrestricted acquisition of their own shares by joint stock companies under the following circumstances:

- a) When a company's own shares are acquired in implementation of a capital reduction agreement reached by the company's general meeting.
- b) When the shares or stocks are part of an estate acquired in whole.
- c) When fully paid up stakes or shares are acquired at no cost.
- d) When fully paid up stakes or shares are acquired as a result of a court adjudication in settlement of a company loan held against the owner.

TREASURY SHARES

The stakes and shares acquired:

- i) When the shares or stakes are part of an estate acquired in whole
- ii) When fully paid up stakes and shares are acquired at no cost.

They must be alienated within three years of the date acquisition, unless they are redeemed prior to that date by a reduction in share capital.

TREASURY SHARES

In all other circumstances, the terms of Article 146 CEA apply:

Joint stock companies may also acquire their own shares created or issued by their parent company, providing the conditions set out below are met.

TREASURY SHARES

1) The acquisition has to be authorised by the general meeting, this authorisation must cover the maximum number of shares to be purchased, the maximum and minimum price in onerous acquisitions and the term of authorisation, which cannot exceed five years.

TREASURY SHARES

- 2) The acquisition shall not reduce equity (the difference between assets and liabilities) to below the sum of the share capital plus the restricted reserves established by law or the by-laws.
- 3) The par value of the shares directly or indirectly acquired by the company, taken together with any shares already owned by it and its subsidiaries and, as appropriate, the parent company and its subsidiaries, shall not exceed 20% of the total.
- 4) Company acquisition of its own shares when only partly paid up or subject to ancillary commitments, shall be null and void, unless the acquisition is cost-free.

DERIVATIVE ACQUISITIONS BY JOINT STOCK COMPANIES

Article 140 states the derivative acquisitions allowed to be made by limited liability companies, these include:

- a) When they form part of an estate acquired as a whole or are acquired at no cost, or as a result of a court award in payment of debt held by the company against their owner.
- b) When the company's own stakes are acquired through a capital reduction decision adopted by the general meeting.
- c) When they are acquired as a result of the pre-emption rights contained in the by-laws for the cases of mandatory transfer contained in Article 109 CEA.
- d) When the acquisition is authorised by the general meeting, charged to profits or reserves freely available for distribution and involves the stakes of a partner who has exited or been excluded from the company; stakes acquired as a result of the application of transfer restrictions; or stakes transferred *mortis causa*.

DERIVATIVE ACQUISITIONS BY JOINT STOCK COMPANIES

Outside of these cases, acquisitions shall be null and void.

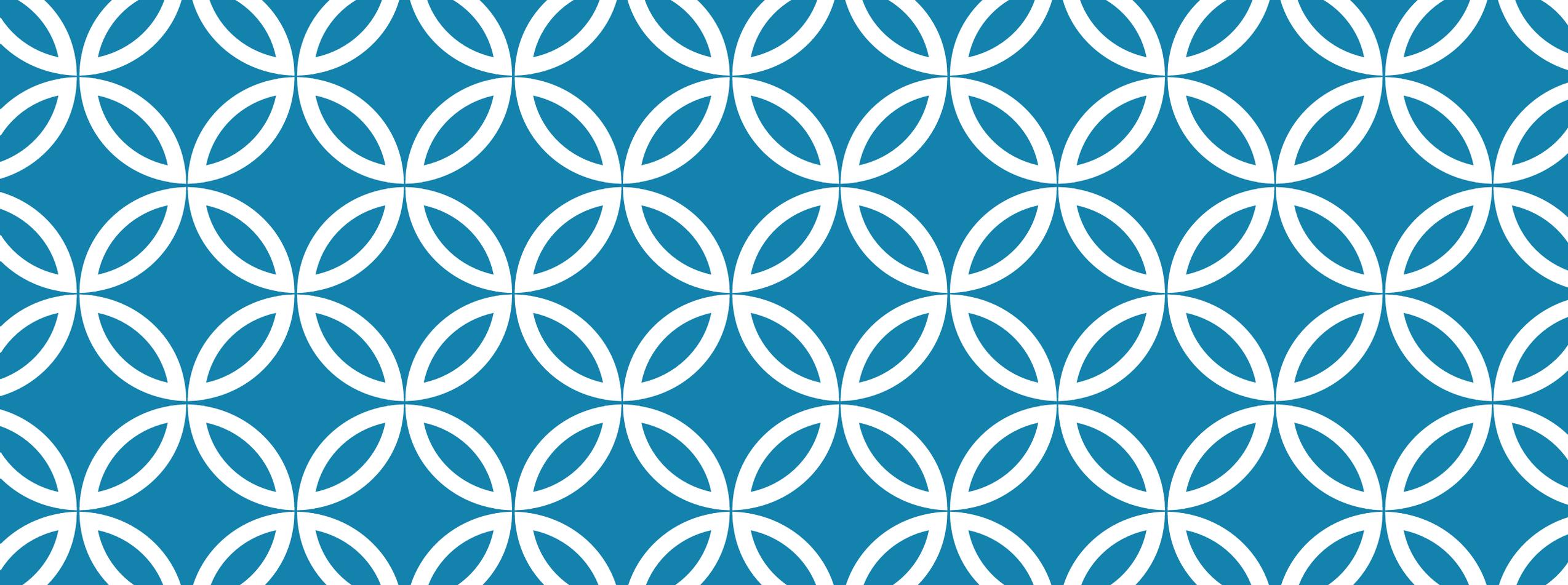
Furthermore, they are subject to the rules regarding amortisation or alienation contained in Article 141 CEA.

AMORTISATION OR ALIENATION

Stakes in their own capital acquired by limited liability companies must be amortised or alienated, abiding in this case by the stipulations on transfers set out in the laws and by-laws, within three years.

AMORTISATION OR ALIENATION

If the stakes are not alienated within the established period, the company shall immediately approve their redemption and capital reduction. Should the company fail to take such steps, any party concerned may apply to the judicial authority to do so. The directors of the purchasing company shall be bound to ask the court to adopt such measures when, for whatsoever reason, no decision on redemption and capital reduction can be adopted.



LESSON 8: THE GENERAL MEETING AND THE DIRECTORS

INTRODUCTION – THE GENERAL MEETING

Corporations are legal persons that have to operate through corporate bodies. These bodies operate according to the competences granted to them either by the law or through the by-laws of the corporation itself.

The two most important corporate bodies that act in the joint stock company and the limited liability company are:

- a) The general meeting
- b) The directors/ The Board of Directors

THE GENERAL MEETING - DEFINITION

The general meeting is a meeting of partners that is called to decide over specific matters concerning the running of the corporation in which it has been attributed competence to make decisions.

Article 159 CEA declares that:

The partners or shareholders, assembled in an annual general meeting, shall adopt decisions on the matters whose competence is reserved to the general meeting by majority vote as defined by law or in the by-laws.

In order for the decisions taken at the general meeting to be valid, it is not necessary that all the partners are present, and the statutes cannot oblige partners to attend the general meeting.

THE GENERAL MEETING - TYPES

There are three types of general meeting:

- 1) Ordinary general meetings
- 2) Extraordinary general meetings
- 3) The Universal Shareholders' Meetings

TYPES OF GENERAL MEETING:

A) The Ordinary general meeting:

This is the meeting, that, convened in accordance with the law, must be held within the first six months of each financial year in order to approve the management of the corporation and the accounts and make decisions regarding the results/profits of the previous year.

TYPES OF GENERAL MEETING

B) The extraordinary general meeting.

This is a meeting called for purposes others than those contained in Article 165 CEA.

C) The universal general meeting. This is the meeting at which all of the capital of the corporation is represented. It does not need to be convened and the partners are free to discuss and decide upon any matter they chose to.

THE UNIVERSAL SHAREHOLDER'S MEETING

According to Article 178 CEA:

The general meeting shall be deemed validly constituted to discuss any matter, with no need for advance notice, when all the capital is present or represented and the attendees unanimously consent to hold the meeting.

THE GENERAL MEETING

THE ORDINARY MEETING

Ordinary general meetings:

As just mentioned, the ordinary general meeting must be duly convened and meet within the six first months of each financial year to approve corporate governance in, and the financial statements for, the preceding financial year, as appropriate in both cases, and determine the distribution of earnings.

Ordinary general meetings shall be valid even when convened or held after the six-month deadline.

THE REQUISITES FOR THE VALID CONSTITUTION OF THE GENERAL MEETING

- 1) The general meeting must be convened by the company directors.
- 2) It must be convened at the place where the company has its registered office.
- 3) In joint stock companies it must meet the quorum established by law in order to be held validly. The law establishes a minimum quorum that can be increased by the by-laws of the company. There is a stricter quorum in operation for those cases that the law establishes. The quorum is also less stringent when the general meeting is held at the second calling.

THE REQUISITES FOR THE VALID CONSTITUTION OF THE GENERAL MEETING

4) In limited liability companies the law does not differentiate between the first and the second calling, and it does not require a quorum of assistance at the general meeting in order for the meeting to be valid. The quorum is only required for the adoption of decisions (Articles 198 and 199 CEA).

THE GENERAL MEETING: THE COMPETENCE TO CALL A GENERAL MEETING

The general meeting must be convened by the directors of the corporation (or the liquidators). The directors may convene the general meeting whenever they consider it necessary or convenient to do so in the interests of the corporation, when the law determines the general meeting must be convened, or when requested to do so by partners representing at least 5 % of the capital of the corporation.

THE GENERAL MEETING – COMPETENCE TO CALL IT – THE COMPANY DIRECTORS

Article 166 CEA declares that:

The annual general meeting shall be convened by company directors or liquidators, as appropriate.

THE GENERAL MEETING — THE COMPETENCE TO CALL A GENERAL MEETING

While Article 167 CEA declares that:

The directors shall convene a general meeting whenever they deem it in the company interest to do so and, in any event, on the dates or within the terms established by law and the by-laws.

THE GENERAL MEETING — CONVENED BY MINORITY SHAREHOLDERS

However, as we have seen previously it is also possible that a minority of the shareholders request a general meeting. Article 168 CEA states that:

The directors must convene a general meeting when so requested by one or several partners or shareholders representing at least 5% of the capital, who must specify the matters to be addressed in the request.

In this case, the general meeting must be convened in time to be held within two months of the date on which the directors receive the notarised request to that effect, and the agenda must include the matters specified therein.

THE GENERAL MEETING:

If the general meeting is not convened within the stipulated time limit, then any of the partners may legitimately request a Commercial Law Court, after meeting with the directors of the company, to order that the meeting be convened.

THE GENERAL MEETING — CONVENED BY A COURT

If general meetings or Extraordinary Meetings are not convened when stipulated by the law or by the by-laws of the corporation then the partners are entitled to request the Commercial Court to order that the meeting be held, as explained in Article 169 CEA:

If the ordinary general meeting or any others provided in the by-laws are not convened within the term stipulated by law or the by-laws, they may be convened, at the behest of any partner, by the judge of the Commercial Court with jurisdiction where the registered office is located, who shall hear the directors before passing a ruling.

If the directors fail to respond in time to a minority request to convene a general meeting, the meeting may be convened by the judge of the commercial court with jurisdiction in the place where the registered office is located, who shall hear the directors before passing a ruling.

THE GENERAL MEETING - PLACE

Unless specified otherwise in the by-laws, the general meeting shall be held in the municipal district where the company has its registered office. If no meeting place is specified, the meeting shall be understood to be convened at the registered office.

THE GENERAL MEETING - TIME

In joint stock companies, general meetings must be convened at least one month in advance of the date they are to be held, and fifteen days in advance in limited liability companies

The notification of the general meeting issued by the joint stock company may contain the date for the second calling of the general meeting if the first cannot be celebrated or is not celebrated validly.

THE GENERAL MEETING:

The by-laws of the company may stipulate that the calling of the general meeting can be carried out by any form of personal written communication that assures that the notification will reach all the partners.

If the by-laws do not stipulate the form of notification, then the notification of the general meeting may be carried out via a public notice placed on the website of the corporation, as long as it complies with the formal requirements of Article 11 bis (that lists the requisites for corporate websites).

THE GENERAL MEETING - ANNOUNCEMENT

The general meeting shall be convened by an announcement published on the company's website, if created, registered and publicly announced as stipulated in Article 11 bis. When the company has no website or if the site has not yet been duly registered and publicly announced, the meeting shall be convened by announcement in the Official Journal of the Mercantile Registry and in one of the daily newspapers most widely circulated in the province where the registered office is located.

THE GENERAL MEETING - ANNOUNCEMENT

Instead of the procedure just explained the by-laws may provide for convening general meetings by any written, individually addressed notice forwarded in a manner that guarantees receipt by all the partners or shareholders.

The by-laws may envisage mechanisms for public disclosure other than those provided for by law and require the company to establish an automatic system to alert partners or shareholders to the publication of meeting notices on the company's website.

THE GENERAL MEETING:

If not then, the law determines that the notification of the general meeting must be published in the Official Bulletin of the Commercial Registry and in one of the newspapers with a large circulation in the province where the corporation has its registered office.

The by-laws may establish other mechanisms of publicity than those determined by the law.

THE GENERAL MEETING - NOTICE

Notices of meetings shall specify the company name, date and time of the meeting, and contain the agenda with a list of the items to be discussed and the name of the person or persons convening the meeting.

THE GENERAL MEETING — SECOND CALL

If the first general meeting convened cannot be celebrated (or cannot be validly celebrated), then it will be necessary to convene a second general meeting. Article 177 CEA describes the procedure for the second call:

- 1. Notices of the general meetings of joint stock companies may also specify the date of the second call, if necessary.*
- 2. At least twenty-four hours must elapse between the first and second call.*
- 3. If a duly convened general meeting, regardless of type, is not held on the first call, and no date for the second is specified in the notice thereof, the second call must be announced, subject to the same public notice-related requirements as the first, within fifteen days of the date of the meeting not held and at least ten days prior to the date of the second call.*

THE GENERAL MEETING: REQUISITES FOR NOTIFICATION

The requisites of the notification are that:

- (a) It should express the name of the corporation.
- (b) It should express the date and time of the meeting.
- (c) It should express the names of the person or persons that convene the meeting.

If the place where the meeting is to be held is not mentioned in the notification, then it will be assumed that the general meeting will be convened at the registered office of the corporation.

THE GENERAL MEETING — ATTENDANCE NOT OBLIGATORY

In order for the decisions taken at the general meeting to be valid it is not necessary that all the partners are present, and the statutes cannot oblige partners to attend the general meeting.

THE GENERAL MEETING — RIGHT OF ATTENDANCE

Article 179 CEA governs the right of attendance.

For limited liability companies the following rules apply:

*In limited liability companies, all partners are entitled to attend the **general meeting**. The by-laws may not make attendance at general meetings contingent upon ownership of a minimum number of stakes.*

THE GENERAL MEETING — RIGHT OF ATTENDANCE

Whereas in joint stock companies the law states that:

In joint stock companies, the by-laws may subject eligibility to attend the general meeting to ownership of a minimum number of shares, irrespective of class or series. Under no circumstances, however, may the number required be greater than one-thousandth of the share capital.

THE GENERAL MEETING — VIRTUAL ATTENDANCE

In joint stock companies virtual attendance of the general meeting is possible if permitted by the by-laws as stated by Article 182 CEA:

If joint stock company by-laws allow remote attendance at general meetings by electronic methods that duly guarantee the shareholder's identity, the notice of the meeting shall describe the time frame, ways and means provided by the directors to allow shareholders to exercise such rights and ensure the meeting is conducted in an orderly fashion. Specifically, the directors may require the shareholders attending the meeting via electronic means pursuant to this act to send the opinions and proposals they plan to raise to the company prior to the meeting date. Replies to shareholders exercising their right to information during the meeting shall be forwarded in writing within seven days after the general meeting.

VOLUNTARY ATTENDANCE AT THE GENERAL MEETINGS OF LIMITED LIABILITY COMPANIES

Partners may only be represented at general meetings by:

- A) Their spouses
- B) Ascendants or descendants
- C) Another partner
- D) By a person holding a general power of attorney by virtue of a public document vesting him or her with powers to administer all the assets that the principal owns on Spanish soil.

Representation by other persons may be authorised in the by-laws.

VOLUNTARY REPRESENTATION AT GENERAL MEETINGS OF JOINT STOCK COMPANIES

The representation of shareholders of joint-stock companies is regulated by Article 184 CEA:

Any shareholder entitled to attend may be represented at the general meeting by a proxy, who need not be a shareholder. This right may be limited in the by-laws.

THE RIGHT TO VOTE

The right to vote is subject to the provisions of Article 188 CEA:

- a) In limited liability companies, unless specified otherwise in the corporate by-laws, each stake entitles its holder to the right to cast one vote.
- b) Joint stock companies shall not be entitled to create shares that directly or indirectly alter the proportionality between the par value of each share and voting rights.

THE GENERAL MEETING - QUORUMS

The Law tries to ensure that the decisions adopted at the general meeting are supported by a sufficiently high percentage of the capital of the Corporation.

The quorums necessary for the general meeting in joint stock companies are referred to in Articles 193 and 194.

THE GENERAL MEETING - QUORUMS

Article 193.1 CEA states that:

In joint stock companies, the general meeting shall be deemed to reach a quorum in the first call when the shareholders present or represented own at least 25% of the subscribed capital with voting rights. The by-laws may establish a higher quorum.

THE GENERAL MEETING - QUORUMS

Article 193.1 CEA states that:

In the second call, a quorum shall be deemed to be reached regardless of the amount of share capital present or represented, unless the by-laws establish a quorum, which must be less than the quorum established or required by law for the first call. Therefore, it must be less than 25% of the capital that has voting rights.

THE GENERAL MEETING - QUORUMS

Article 194 CEA establishes a stricter quorum for special cases:

In joint stock companies, shareholders holding at least 50% of the subscribed capital with voting rights must be present or represented in the first call for the general meeting or extraordinary general meeting to validly adopt decisions regarding:

- a) An increase or reduction of the company share capital or any other amendment to the by-laws
- b) The issue of bonds or debentures
- c) The cancellation or restriction of the pre-emptive rights to acquire new shares
- d) The conversion, merger, spin-off or global assignment of assets and liabilities;
- e) The transfer of the registered office abroad.

THE GENERAL MEETING - QUORUMS

However:

- 1) 25% of the share capital present or represented shall suffice in the second call.
- 2) The by-laws may call for larger majorities than stipulated in the preceding articles.

THE GENERAL MEETING — THE ADOPTION OF DECISIONS

In limited liability companies Articles 198 and 199 CEA govern the quorums necessary:

In limited liability companies, corporate resolutions shall be adopted by a plurality of valid votes cast, provided they represent at least one-third of the votes pertaining to the stakes into which the capital is divided. Blank ballots shall not be counted.

THE GENERAL MEETING – THE ADOPTION OF DECISIONS - EXCEPTIONS IN LIMITED LIABILITY COMPANIES

However, there are exceptions to these general provisions which are contained in Article 199 CEA:

Exceptions to the provisions of the preceding article are listed below.

- a) Increases or reductions in capital and amendments to the by-laws shall require a yes vote from over half of the votes associated with the stakes into which the capital is divided.
- b) A majority of at least two-thirds of the votes associated with the stakes into which the capital is divided shall be required to:
 - i) Authorise directors to engage in an activity that is the same as or similar or complementary to the company's corporate purpose.
 - ii) Cancel or limit pre-emptive rights in capital increases.
 - iii) Convert, merge, spin off or globally assign assets and liabilities.
 - iv) Transfer the registered office abroad.
 - v) Exclude partners.

THE GENERAL MEETING — THE ADOPTION OF DECISIONS — EXCEPTIONS IN LIMITED LIABILITY COMPANIES

For all or some items, the by-laws may require a higher percentage of yes votes than established by law, but not unanimity.

In addition to the proportion of votes established by law or the by-laws, the latter may demand that yes votes be cast by a certain number of partners.

VOTING IN JOINT STOCK COMPANIES

In joint stock companies, corporate decisions shall be adopted by a majority of the votes of the shareholders present in person or by proxy.

Adoption of the decisions shall require a two-thirds majority of the share capital present or represented at the meeting when, **at second call**, at least twenty-five but less than 50% of the subscribed capital with voting rights is in attendance.

The by-laws may call for larger majorities.

THE GENERAL MEETING - COMPETENCES

The powers reserved to the general meeting are contained in Article 160 CEA:

The general meeting is vested with the power to discuss and decide on the following matters:

a) Approval of the financial statements, the distribution of earnings and the approval of corporate governance.

THE GENERAL MEETING - COMPETENCES

- b) Appointment and dismissal of directors, liquidators and, where necessary, auditors, and the institution of liability action against any of these persons.
- c) Amendment of the by-laws.
- d) Capital increase and reduction.
- e) Removal or limitation of the pre-emptive rights to take stakes or subscribe shares.
- f) The acquisition, sale or the contribution to another corporation of essential assets. The essential character of assets will be presumed when the value of the operation is greater than 25% of the assets that figure in the last approved balance sheet.
- g) Conversion, merger, spin off or global assignment of assets and liabilities and the transfer of the registered office abroad.

THE GENERAL MEETING - COMPETENCES

- h) Company dissolution.
- i) Approval of the final liquidation balance sheet.
- j) Any other matters stipulated by law or the by-laws.

THE GENERAL MEETING — COMPETENCES

There are other competences of the general meeting dispersed throughout the text of the Corporate Enterprises Act:

1) The authorisation of directors who wish to engage in a business that is the same or analogous or supplementary to the business constituting the corporate purpose (Article 230 CEA).

THE GENERAL MEETING COMPETENCES

Article 511 bis of the CEA contemplates some additional competences for the general meeting:

In listed companies (joint stock companies whose shares are listed on the stock exchange) competence over the following matters is reserved to the general meeting in addition to those mentioned in Article 160 CEA:

a) The transfer to dependant companies of essential activities that had until that moment been carried out by the corporation itself, even when the corporation retains full ownership of these dependant companies.

THE GENERAL MEETING COMPETENCES

- b) Any operation whose effect is the same as the liquidation of the corporation.
- c) The remuneration policy of the directors in the terms established by the law.

The essential character of operations and activities will be presumed when their volume is greater than 25% of the total assets on the balance sheet.

THE GENERAL MEETING - COMPETENCES

The general meeting cannot manage and direct the company as these competences are reserved to the governing body according to Article 209 CEA.

However, Article 161 CEA allows for the intervention of the general meeting in the management affairs of limited liability companies as long as the by-laws allow it:

Unless specified otherwise in the by-laws, in limited liability companies the general meeting may issue instructions to the governing body or make the adoption of decisions by the governing body regarding certain management affairs contingent upon its authorisation, subject to the provisions of Article 234.

COMPETENCES OF THE GENERAL MEETING

According to article 162 CEA:

In limited liability companies, the general meeting may, on a case-by-case basis, advance funds, grant loans or furnish security or financial assistance in favour of its partners and directors.

No general meeting decision shall be required to perform the aforementioned actions in favour of another company.

CHALLENGING THE AGREEMENTS OF THE GENERAL MEETING

Article 204.1 CEA details the decisions that are subject to legal challenge:

Corporate decisions that are contrary to the law or the by-laws or detrimental to corporate interests to the benefit of one or various partners or shareholders or of third parties shall be subject to challenge.

CHALLENGING THE AGREEMENTS OF THE GENERAL MEETING

There is a difference between decisions taken which are against the law and those which are not:

Decisions that are contrary to law shall be null and void. The other decisions referred to in the preceding paragraph shall be annulable.

CHALLENGING THE AGREEMENTS OF THE GENERAL MEETING

The law states that damage to corporate interest is also caused when the agreement, without causing damage to corporate assets, is imposed in an abusive manner by the majority. An agreement is understood to have been imposed in an abusive manner when, rather than responding reasonably to a corporate need, the majority adopts the agreement in its own interests and to the unjustifiable detriment of the other partners.

REASONS WHICH ARE NOT SUFFICIENT TO CHALLENGE AN AGREEMENT

The law provides a list of reasons which it considers to be insufficient to form the basis of a challenge.

a) The infringement of procedural requirements to call or establish the general meeting, unless these relate to the form and the place of the calling, the majorities needed to adopt decisions and the basic regulations for the establishment of the general meeting.

REASONS WHICH ARE NOT SUFFICIENT TO CHALLENGE AN AGREEMENT

- b) Inaccurate or insufficient information supplied by the company in response to exercising the right to prior information for the general meeting, unless the incorrect or missing information would have been essential for the reasonable exercise of the shareholder or partner's right to vote.
- c) Non-authorized persons participating in the meeting, unless their participation was a determining factor in constituting the general meeting.
- d) The invalidity of one or various votes, or the calculation error of any issued, unless the invalid vote or calculation error, may have been a determining factor in the achievement of the necessary majority.

EXPIRATION OF THE RIGHT TO CHALLENGE

According to A 205 CEA, the action to challenge corporate decisions must be lodged within one year, unless the subject of the action is any agreement that by its circumstances purpose or content runs contrary to public order, in which case the action shall not have a validity period, nor shall it expire.

The validity period shall be calculated from the date of the agreement adoption if it was adopted in a members' general meeting or board of directors' meeting and from the date of receipt of copy of the act if the agreement was adopted in writing, the validity period shall be calculated from the date of the enforceability of the entry.

THE LEGAL CAPACITY TO CHALLENGE

Article 206 CEA states that any director, any third party that accredits a legitimate interest and any partner that acquired the condition of partner before the agreement was made, providing that this partner represents, either individually or jointly, at least 1% of share capital, has the legal capacity to challenge.

The by-laws may reduce the percentages of share capital indicated and in all cases partners will have the legal right to seek redress for any damages caused to them personally by the challengeable decision.

THE LEGAL CAPACITY TO CHALLENGE

Any partner, even if she acquired this position after the agreement, as well as any director or third party shall be capacitated to challenge agreements that are contrary to public order.

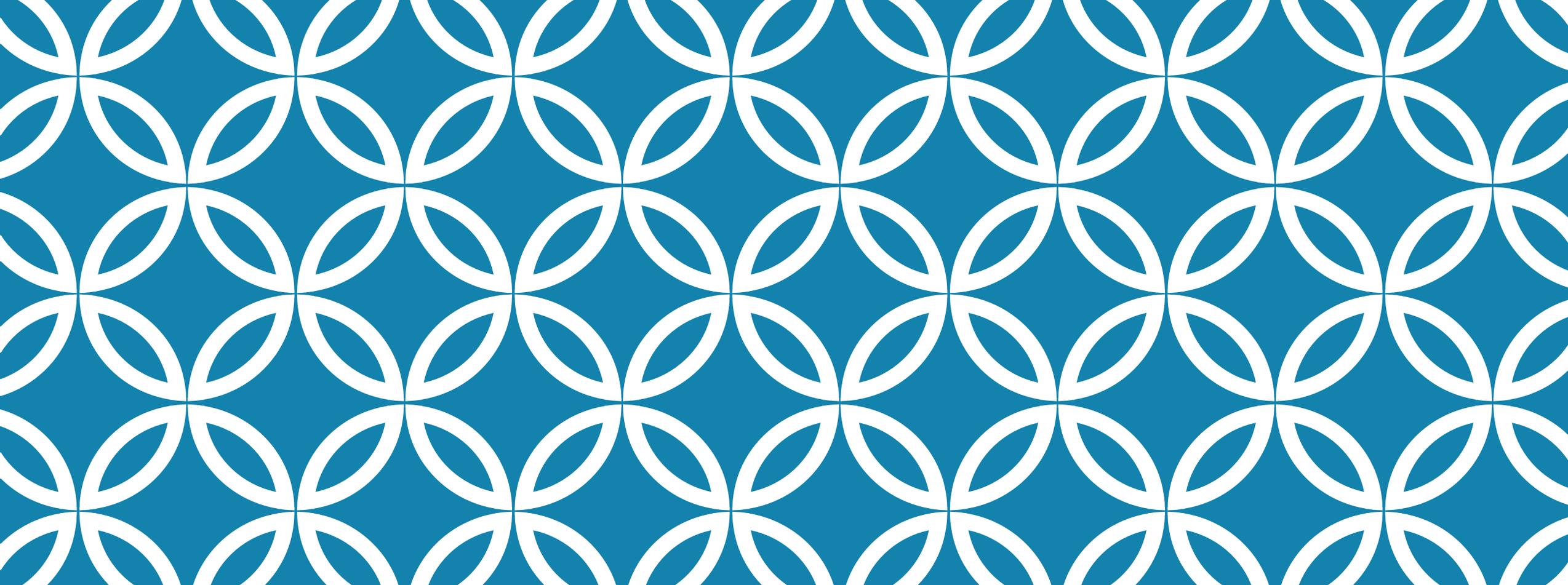
Actions for challenge shall be brought against the company. When the claimant holds exclusive powers to represent the company and the general meeting has no other designated person to represent them, the judge hearing the challenge shall appoint a representative from among the partners who voted in favour of the challenged agreement.

RULINGS IN FAVOUR OF THE CHALLENGER

The text of Article 208 states that:

Final rulings declaring a decision subject to registration to be null and void shall themselves be registered in the Mercantile Registry and published in the Official Journal of the Mercantile Registry.

If the decision challenged was registered in the Mercantile Registry, the ruling shall order the cancellation of the respective entry, as well as any of the subsequent contradictory entries.



CORPORATE GOVERNANCE

CORPORATE GOVERNANCE

The governing bodies of corporations operate under the control and supervision of the general meeting. However, this control, especially in large joint stock companies has been undermined by the power of the directors who have steadily increased their control over corporations over the last few decades.

This increase in the power of directors can be explained by the following factors:

CORPORATE GOVERNANCE

- 1) It is the directors who manage the company.
- 2) The complexity of managing the company means that most shareholders lack the information and technical skills to properly assess the performance of the directors.
- 3) Most shareholders in large companies are often minority shareholders and, knowing that their individual votes cannot influence managerial decisions, they often abstain from attending the general meeting.

GENERAL PROVISIONS REGARDING CORPORATE GOVERNANCE

Article 210 of the CEA stipulates that Company Administration may be entrusted to:

- a) A sole Director - The sole director means that the management and representation of the corporation is entrusted to a single individual
- b) Several directors acting jointly
- c) A board of directors

GENERAL PROVISIONS REGARDING CORPORATE GOVERNANCE

In **joint stock companies** when administration is entrusted to two directors they shall act jointly, and when entrusted to more than two directors they shall form a board of directors.

GENERAL PROVISIONS REGARDING CORPORATE GOVERNANCE

In limited liability companies the by-laws may envisage several organisational schemes, vesting the general meeting with the authority to opt for any one of these alternatives with no need to amend the by-laws.

GENERAL PROVISIONS REGARDING CORPORATE GOVERNANCE

However, any decision that alters the arrangements for corporate governance, whether or not it entails amending the by-laws, shall be recorded in a public instrument and registered in the Commercial Registry.

THE DETERMINATION OF THE NUMBER OF DIRECTORS

When the by-laws only specify a minimum and maximum number of directors, the general meeting shall determine the exact number, subject only to the limitations provided by law.

THE SUBJECTIVE REQUIREMENTS TO BE A DIRECTOR

Article 212 CEA lists the subjective requirements necessary to be a director.

- a) The directors of Corporate Enterprises may be physical persons or legal persons.
- b) Unless specified in the by-laws, company directors need not be partners or shareholders.

THE SUBJECTIVE REQUIREMENTS TO BE A DIRECTOR

If the director is a legal person, then that legal person has to designate someone to represent it. This physical person will exercise the functions of a director. The representative will have to meet the requirements that are established for directors, Article 236.5 states that:

The individual assigned to the permanent exercise of the duties of the role of incorporated entity director must meet the legal requirements established for directors and shall be subject to the same duties and shall respond jointly with the incorporated entity director.

That means that she will respond jointly and severally with the director of the corporation that appointed her.

THE FACULTIES OF THE DIRECTORS

The Law attributes two principal functions to the directors of the Corporation:

- a) The management of the company (Article 209 CEA)
- b) The representation of the company both in and out of court (Article 233 CEA).

THE FACULTIES OF THE DIRECTORS

The management of the company encompasses everything that affects its internal functioning or that is necessary or useful in order to fulfil its commercial objective, providing that it is not a function that corresponds to the general meeting.

The statutes of the company may limit the faculties of the directors, requiring that certain functions be performed exclusively by the general meeting.

THE DUTIES OF THE DIRECTORS

The directors have to carry out their tasks according to a code of conduct and the infraction of this code can lead to them incurring in responsibility.

Articles 225ff contain an extensive list of the duties of the directors.

Among these duties are the following:

THE DUTIES OF THE DIRECTORS

- a) **Due diligence** – directors must carry out their role and fulfil their tasks in accordance with the by-laws with the diligence of an orderly business person (Article 225 CEA). The standard of diligence expected from an orderly business person is understood to have been fulfilled when the director acts in good faith without any personal interest in the matter being decided, with sufficient information and organisation to be able to proceed to an appropriate decision.

THE DUTIES OF THE DIRECTORS

This means that the director does not respond personally for decisions taken in a disinterested manner after having informed herself adequately, even if that decision causes damage to the patrimony of the corporation.

If that were not the case then the obligations of the directors would be to achieve results, i.e., to guarantee the success of the corporation.

THE DUTIES OF THE DIRECTORS

b) The duty of loyalty

Directors must perform their roles as loyal representatives operating in good faith and in the best interest of the company.

Upon breach of loyalty the director shall be bound to compensate any damage caused to the company assets and to return to the company any unjust gains obtained.

THE DUTIES OF THE DIRECTORS

Article 228 of the CEA lists the basic obligations arising from the duty of loyalty. Among those listed are the following:

- a) Not to exercise their powers for any end other than that for which they were granted.
- b) Maintain the confidentiality of information or records to which they have access in the course of their role, including when that role has ceased, except when the law allows or requires disclosure.

THE DUTIES OF THE DIRECTORS

Article 228 of the CEA lists the basic obligations arising from the duty of loyalty:

- c) Refrain from participating in discussions and votes on agreements and decisions in which the director or a related person may have a direct or indirect conflict of interest.
- d) Adopt the necessary measures to avoid situations arising in which their interests, whether their own or of another party may enter into conflict with the company's interests and their duties to the company.

THE DUTIES OF THE DIRECTORS

Furthermore, Article 229 CEA concentrates specifically on the duty to avoid conflicts of interest. It contains a list of prohibitions, among which feature:

a) Completing transactions with the company, except when these are ordinary transactions made under the standard customer conditions and are of scarce relevance. Scarce relevance is understood to mean that no information of the company's assets or financial situation is required in order for the transaction to be made.

THE DUTIES OF THE DIRECTORS

- b) Using or invoking their position as director to unduly influence the completion of private transactions.
- c) Taking advantage of the company's business opportunities.
- d) Making use of company assets, including confidential company information for private ends.
- e) Performing activities on their own or others behalf that would entail a current or potential effective competition that would otherwise place them in situation of permanent conflict of interest with the company's wishes.

THE DUTY OF LOYALTY

The rules regarding the duty of loyalty and the responsibility borne for a breach of these rules are imperative. By-laws limiting or that are contrary to this system shall not be valid.

However the law allows for the company to exempt directors from this duty in exceptional circumstances, by authorising a director to complete a particular transaction with the company, use certain company assets, take advantage of a specific business opportunity or obtain an advantage or remuneration from a third party.

THE DUTY OF LOYALTY

When the release from this prohibition refers to obtaining a benefit or remuneration from third parties, or affects a transaction with a value exceeding 10 % of the corporate assets, the authorisation must be agreed on by the general meeting.

In limited liability companies the general meeting must also grant authorisation when it refers to the provision of any form of financial assistance, including guarantees from the company (i.e. providing the security for a personal loan), in the director's favour.

THE DUTY OF LOYALTY

The obligation not to compete with the company may only be subject to exemption in the event that no damages are expected to be suffered by the company or that the damages expected to be suffered shall be compensated by the benefits forecast to be gained by obtaining said exemption. The exemption has to be granted through the explicit separate agreement of the general meeting.

However, in all cases, at the request of any partner, the general meeting shall decide upon the severance of a director who performs competitive activities when the risk of damage to the company becomes relevant.

COMPANY REPRESENTATION

In corporate enterprises the company is represented both in and out of court by the directors in the manner provided for in the by-laws.

- a) Where the company has a sole director then that director shall necessarily be vested with representative powers.
- b) Where the company has joint and several directors, then all shall be vested with representative powers, without prejudice to the provisions of the by-laws or any decisions that may be adopted by the general meeting on the distribution of powers, whose scope shall be purely internal.

COMPANY REPRESENTATION

- c) In limited liability companies with more than two joint directors, at least two shall jointly exercise representative powers in the manner provided by the by-laws.
- d) In joint stock companies, representative powers shall be held jointly.
- e) In companies with a board of directors, representative powers shall be vested in the board itself, acting collegiately. The by-laws may nonetheless vest one or several members of the board with representative powers, individually or jointly. When the board delegates its power to an executive committee or one or several managing directors it shall delimit the scope of their action.

THE SCOPE OF REPRESENTATIVE POWERS

Company representation extends to all the acts included in the corporate purpose described in the by-laws. Any limitation to the directors' representative powers **even when** registered in the Commercial Registry are null and void in relation **to third parties**.

The company shall be bound to honour its commitments to third parties acting in good faith and not incurring negligence, even where, according to the by-laws registered in the Commercial Registry, the transaction may be inferred not to be included in the company's corporate purpose.

THE CAPACITY TO BE A DIRECTOR AND THE PROHIBITIONS AGAINST HOLDING THE POST

As seen previously, the Corporate Enterprises Act allows for the possibility of directors who are not share or stake holders, as long as the by-laws do not state otherwise (article 212.2 of the CEA).

Also, the law allows directors to be either physical or legal persons.

When a legal person is appointed director then the physical person has to be designated to represent the legal person and to fulfil its duties. This person will then be inscribed in the Commercial Register as a director.

THE CAPACITY TO BE A DIRECTOR AND THE PROHIBITIONS AGAINST HOLDING THE POST

Article 213 of the CEA contains a list of persons who are not eligible to be company directors:

- a) Non-emancipated minors (this modification of the previous legislation which did not permit emancipated minors to be company directors is controversial. Article 4 of the Code of Commerce, which has not been repealed, does not allow emancipated minors to carry out commercial activity under their own name).
- b) The legally incapacitated.
- c) Persons that have been disqualified from holding the position of director due to insolvency.
- d) Persons with criminal convictions for crimes affecting freedom, property, the socio-economic order, public safety or the administration of justice.

THE CAPACITY TO BE A DIRECTOR AND THE PROHIBITIONS AGAINST HOLDING THE POST

e) Public officials (such as judges) who are bound by legal incompatibility.

THE APPOINTMENT AND ACCEPTANCE OF THE POST OF DIRECTOR

- (a) The competence to appoint directors is held by the general meeting (although there are some legal exceptions to this).
- (b) The appointment of directors is effective upon their acceptance of the post.

THE REGISTRATION OF THE APPOINTMENT

Within ten days of the acceptance of the appointment as director application must be made for the entry of their appointment in the Commercial Registry. The application has to state the identity of the persons appointed, and, in relation with their powers of representation, whether they can act singly or are obliged to act jointly.

THE TERM OF OFFICE OF THE DIRECTORS

- (A) The directors of limited liability companies can hold their offices indefinitely unless the by-laws establish a specific term, in which event they may be re-elected on one or more occasions for terms of the same duration.
- (B) The directors of joint stock companies can hold their offices for the term established by the by-laws, which may not exceed six years and must be the same for all the directors.

THE DISMISSAL OF THE DIRECTORS

Directors may be dismissed at any time by the general meeting, even when the dismissal is not included on the meeting agenda.

In limited liability companies, the by-laws may require a qualified majority for dismissal, which may not be more than two thirds of the votes corresponding to the stakes into which the company capital is divided.

SPECIAL CASES FOR DISMISSAL IN JOINT STOCK COMPANIES

In joint stock companies directors subject to any legal prohibition will be dismissed immediately at the request of any shareholder.

Directors holding any interest that clashes with the company's interests shall be dismissed by a decision adopted by the general meeting at the request of any shareholder.

INSCRIPTION OF THE DISMISSAL OR CESSATION

When a person ceases to be a director for whatever reason this must be inscribed in the Commercial Registry. The director's functions will cease with respect to third parties when it is announced in the Bulletin of the Commercial Registry.

THE RESIGNATION OF THE DIRECTOR

The directors may present their resignation without the need to justify it. The resignation of a director must be submitted to the corporation in writing, and the cessation of the director in her post must be inscribed in the Commercial Registry.

The effects of the resignation regarding third parties will date from the moment of its publication in the Official Bulletin of the Commercial Registry.

THE REMUNERATION OF THE DIRECTORS

The role of director of a corporation is almost always a paid position.

However, the CEA states that:

The role of director is unpaid, unless the company by laws provide otherwise and establish a remuneration system.

The only exception to that rule is in listed companies, in which case Article 529 (sixteenth) states that:

Unless otherwise stipulated in the by-laws, the role of director in a listed company shall, by necessity, be remunerated.

THE REMUNERATION OF THE DIRECTORS

The system of remuneration that the corporation opts for must be included in the by-laws.

Among the types of remuneration possible are the following:

- a) A fixed salary
- b) Attendance fees
- c) Shares in the profits
- d) A variable system of payment with fixed indicators
- e) Remuneration in shares
- f) Compensation for dismissal, assuming the dismissal was not the result of failing to perform her duties

THE REMUNERATION OF THE DIRECTORS

The maximum amount of annual remuneration for directors must be approved by the general meeting, and this quantity will remain valid until an amendment is approved.

THE REMUNERATION OF THE DIRECTORS

The most common form of remunerating the directors in a company is through a share of the profits and Article 218 of the CEA sets out some general provisions regarding this.

- 1) When remuneration includes a share of the profits, the company by-laws have to determine the maximum share or percentage thereof.
- 2) In limited liability companies the maximum share percentage may not, under any circumstances, exceed 10% of the profits set aside for distribution among the partners.
- 3) In joint stock companies, the share may only be drawn from net earnings, and only after having provisioned the legal and statutory reserves and designated a 4% nominal dividend for the shareholders (or higher if the by-laws sets this figure higher).

REMUNERATION LINKED TO COMPANY SHARES

In joint stock companies, when the remuneration system for directors includes the awarding of shares, share options or remuneration linked to the value of shares the system must be explicitly mentioned in the company by-laws, and the application of the provision requires an agreement by the shareholders at the general meeting.

This agreement must include the maximum number of shares to be assigned during each financial year as part of this remuneration system, the strike price and the system used to calculate the strike price of the share options. The strike price is the price at which the director may purchase the shares at, the difference between the strike price and the current market price is the amount of profit that the director will gain from calling her option to buy.

THE LIABILITY OF THE DIRECTORS

The directors carry out a great number of acts and operations in the name of the company. In the course of carrying out their functions it is quite possible that they cause harm to the interests of the company. They may also harm the interests of other partners or third parties.

The Law provides for a system of civil liability of the directors (apart from the administrative and criminal responsibility they may incur).

THE LIABILITY OF THE DIRECTORS

Article 235 CEA states that directors shall answer to the company and its partners and creditors for any damage caused by their acts or omissions contrary to the law or the by-laws, or for having failed to complete any duties inherent to their roles, assuming that there has been misconduct or negligence.

When the act is contrary to the law or the company by-laws guilt will be presumed unless proven otherwise.

THE LIABILITY OF THE DIRECTORS

Under no circumstances shall the fact that the act or arrangement has been adopted, or authorised or ratified by the general meeting waive liability for the detrimental agreement.

The liability of the directors is extended equally to de facto directors, that is, those who perform the tasks and the role of a director without the title or with a null and void title or a another title.

THE LIABILITY OF THE DIRECTORS

When no permanent delegation powers of the board exist in one or more directors, then the law decides that all the provisions regarding the directors' duties and liabilities will be applied to the person, whatever their position, who has the highest management role in the company.

THE JOINT AND SEVERAL LIABILITY OF THE DIRECTORS

Article 237 of the CEA makes it clear that all members of the governing body that adopt a detrimental decision or that perform a detrimental act shall answer jointly and severally unless they are able to prove that they took no part in its adoption or implementation, they were unaware of its existence, or, being aware of it, took all reasonable measures to prevent the damage or at least voice their objection to it.

THE JOINT AND SEVERAL LIABILITY OF THE DIRECTORS

The possibilities of being exonerated therefore seem to be the following:

- a) If the director did not take any part in the meeting in which this decision was taken, it is also necessary that she had no part in the subsequent implementation of the decision (as to do so would be to ratify the decision made). Not only does the person in question need to prove that they knew nothing about the decision, but they would also have to show that this lack of awareness did not stem from negligence on their part.
- b) Knowing of the existence of the act the director concerned would have to show that she did everything in her power to prevent the damage.

THE JOINT AND SEVERAL LIABILITY OF THE DIRECTORS

- c) Alternatively, if the director attended the meeting then it is not enough that she abstained from the damaging vote in question, but rather she would have had to vote against it.

- d) As we have seen, the fact that the decision or act in question is later ratified by the general meeting does not exonerate the directors from their responsibility.

THE CORPORATE ACTION TO DEMAND LIABILITY

The action to demand director liability is brought by the company following a decision taken by the general meeting. This may be adopted at the request of any shareholder even when it is not included on the agenda.

The by-laws **may not** require a qualified majority for the adoption of such a decision, so the decision must therefore be reached by a simple majority vote in favour.

The decision to bring such an action (or reach a settlement) will automatically result in the dismissal of the director or directors concerned.

ACTION TAKEN BY A MINORITY

The law permits any partner or partners who, whether individually or jointly represent a share that permits them to request a general meeting, to bring an action for liability to defend corporate interests when the directors fails to call a general meeting requested for this purpose, or when the company does agree to bring the action but does not do so within one month of the agreement to take action, or when the meeting decides against the claim for liability.

THE CREDITORS' SUBSIDIARY CAPACITY TO BRING CORPORATE ACTION

The company's creditors may institute corporate action for liability against its directors when not brought by the company or its partners or shareholders if the company has insufficient assets to repay its loans.

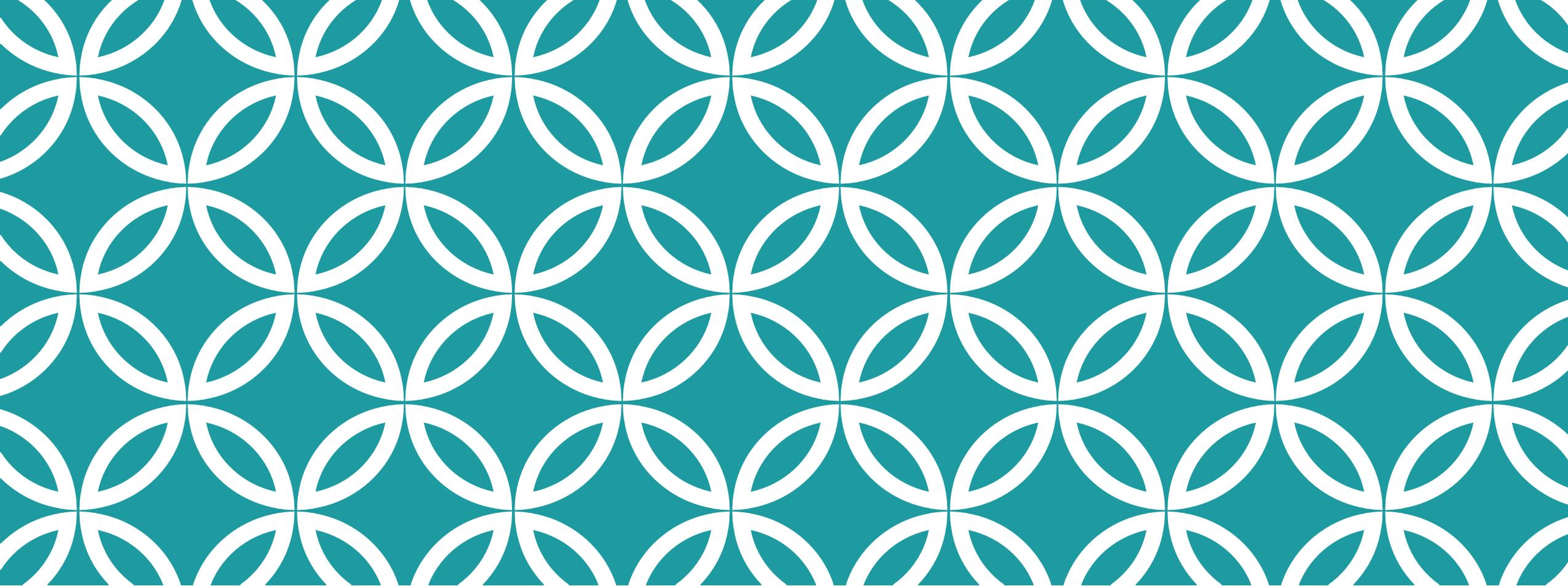
INDIVIDUAL ACTION FOR LIABILITY

The individual action for responsibility can be exercised by shareholders or stakeholders regardless of their participation in the capital of the corporation. It permits them to pursue the directors individually even when they are acting collectively for any action that is directly detrimental to their interests (basically their individual patrimony).

It also permits third parties to bring actions of individual responsibility against the directors, once again for any direct harm that their individual or collective actions have caused them.

PRESCRIPTION OF ACTIONS FOR LIABILITY

The action for liability against directors, whether corporate or individual expires four years from the day on which it could have first been exercised.



THE BOARD OF DIRECTORS

THE BOARD OF DIRECTORS

A board of directors must have at least three members. The by-laws may establish the exact number, or a maximum and minimum number (in which case the exact number will be determined by the general meeting).

In limited liability companies, the board of directors (if there is one) cannot have more than twelve members.

THE BOARD OF DIRECTORS

According to Article 245 of the CEA in limited liability companies the by-laws will establish the organisational arrangements and the mode of action of the board of directors. This will include as a minimum the rules on calling the meeting of the board and the quorum required for the meeting to be held validly. It will also include details on the majority needed to adopt decisions.

THE BOARD OF DIRECTORS

The same article determines that in joint stock companies, unless otherwise specified in the by-laws, the board of directors can designate its chairman and regulate its own form of operating. The board of directors decisions will be adopted by the majority vote of the directors attending. The quorum for the validity of the meeting will be the majority of its members (attending either in person or by proxy) (Articles 247 CEA and 248 CEA).

In both cases the board of directors must meet at least once every three months.

APPOINTMENT OF DIRECTORS

The competence to appoint directors lies with the general meeting, however in joint stock companies the law provides for two alternative manners of appointment.

- a) Proportional representation
- b) Cooptation

THE APPOINTMENT OF DIRECTORS BY PROPORTIONAL REPRESENTATION IN JOINT STOCK COMPANIES

- A) The appointment of directors by proportional representation seeks to avoid the situation by which the majority shareholders appoint all the directors.

The law allows shareholders to group together voluntarily and, if the share capital that they hold is equivalent to or greater than the number obtained by dividing the total share capital by the number of directors on the board, then they may appoint as many directors as their proportion of the capital entitles them to.

THE APPOINTMENT OF DIRECTORS BY PROPORTIONAL REPRESENTATION IN JOINT STOCK COMPANIES

For example, imagine a company with a share capital of 100,000 Euros, and this company has a board of directors that the by-laws state must have 10 members.

If a group of shareholders has a combined share capital of 10,000 Euros then they are entitled to appoint 1 director.

Although this system is a technical possibility, it is not often used in practice.

COOPTATION

B) Article 244 of the CEA declares that if vacancies should arise during the directors' term and no deputies have been appointed, then the board is permitted to designate from among the company shareholders the person or persons who are to fill such positions until the next general meeting is held.

This form of designation is only possible when the vacancy on the board of directors is produced before the natural term of the director or directors in question has expired, and it is only intended to fill a vacancy before the next general meeting when the new appointment has to be put to the vote.

THE POWERS OF THE BOARD OF DIRECTORS

The powers of the board of directors may be very broadly divided into:

- a) Non-delegable powers
- b) Delegable powers

THE NON-DELEGABLE POWERS OF THE BOARD OF DIRECTORS

Article 249 bis of the CEA gives a list of the powers of the board of directors that cannot be delegated:

Among these powers are the following:

- i) Preparing the annual statements and presenting them to the general meeting
- ii) Preparing any type of report required from the board by law when it concerns a function of the board that it cannot delegate
- iii) The policies relating to shares
- iv) Calling the shareholders' meeting and preparing the agenda and proposals for agreements
- v) Determining the companies general policies and strategies

THE POWERS OF THE BOARD OF DIRECTORS THAT CAN BE DELEGATED

Article 249 of the CEA permits the board of directors to delegate certain powers to particular directors, providing that this is not contrary to the law or the by-laws of the company.

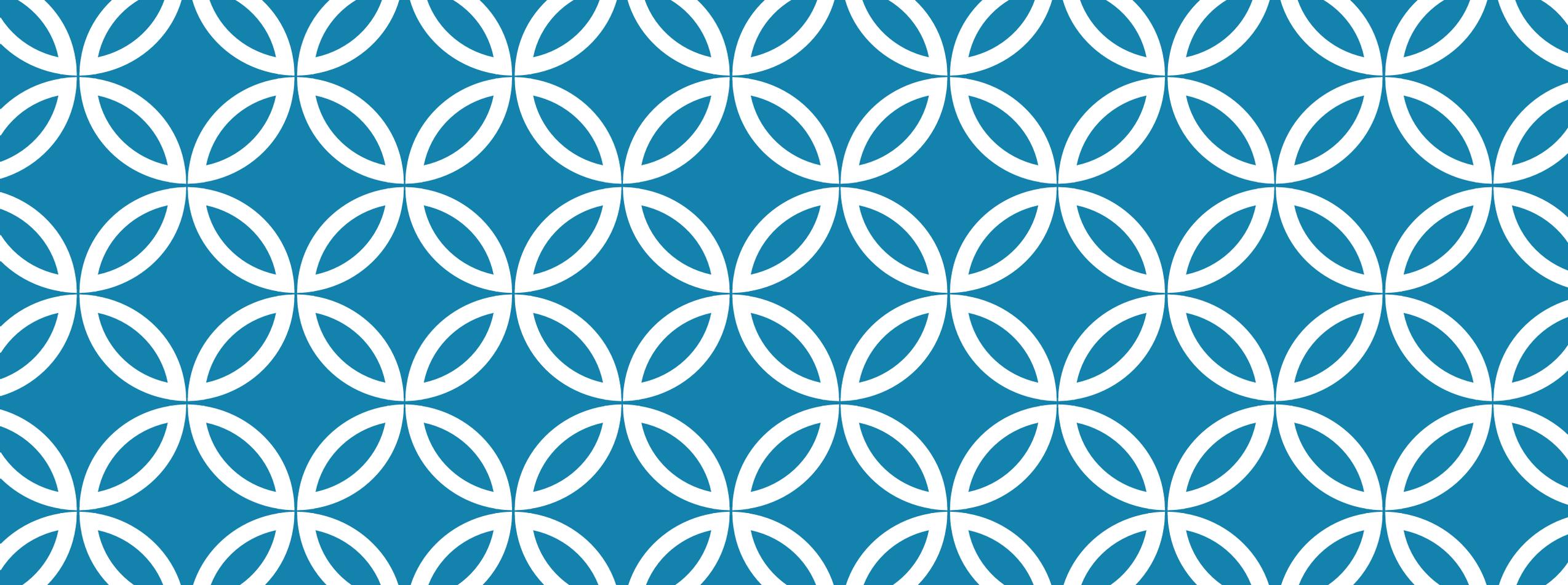
- 1) This delegation requires the favourable vote of two thirds of the board members (the person to be delegated these powers must refrain from voting).
- 2) It will not come into effect until it is registered in the Commercial Registry.
- 3) The content and limitations of the delegation must be specified and a contract between the delegated director and the company must be drawn up specifying the remuneration that the director will receive for performing these executive duties.

CHALLENGING THE AGREEMENTS OF THE BOARD OF DIRECTORS

Directors may challenge the agreements made by the board of directors within thirty days of their adoption.

Any partner or partners may also challenge the agreements made by the board of directors providing that they represent at least one percent of the corporate capital, in this case within thirty days of becoming aware of the existence of the agreement in question and providing that not more than one year has passed since its adoption.

The same general rules apply to the challenging of the agreements of the board of directors as those we saw for challenging the agreements of the general meeting.



LESSON 9

THE MODIFICATION
OF THE BY-LAWS

THE MODIFICATION OF THE BY-LAWS

As we have seen, the by-laws are the basic rules that govern the running of the corporation. However, once they have been drawn up, there is nothing to prevent them from being modified at a later date by an agreement made by the general meeting. In this way they can be altered in order to adapt to changes in the circumstances of the company.

THE MODIFICATION OF THE BY-LAWS

A modification of the by-laws takes place whenever the general meeting of a corporation decides to alter, add or suppress any of the rules contained in the by-laws.

Article 285 of the CEA determines that:

The by-laws may only be amended by the general meeting.

THE PROPOSAL TO AMEND THE BY-LAWS

1) The directors, or the partners or shareholders that author the proposal have to draft the wording of the proposed amendment in full.

In joint stock companies it is also necessary that they draft a written report justifying the proposal.

NOTICE OF THE GENERAL MEETING

2) Next, notice of the general meeting at which the proposal will be voted on has to be given. This notice needs to contain an explicit reference to the points to be amended. It must also inform the partners of their right to examine the full wording of the proposal at the registered office, and, in joint stock companies, their right to examine the report on the proposed amendments. They are also entitled to request free copies of these documents. (Article 287 CEA)

THE DECISION TO AMMEND THE BY-LAWS

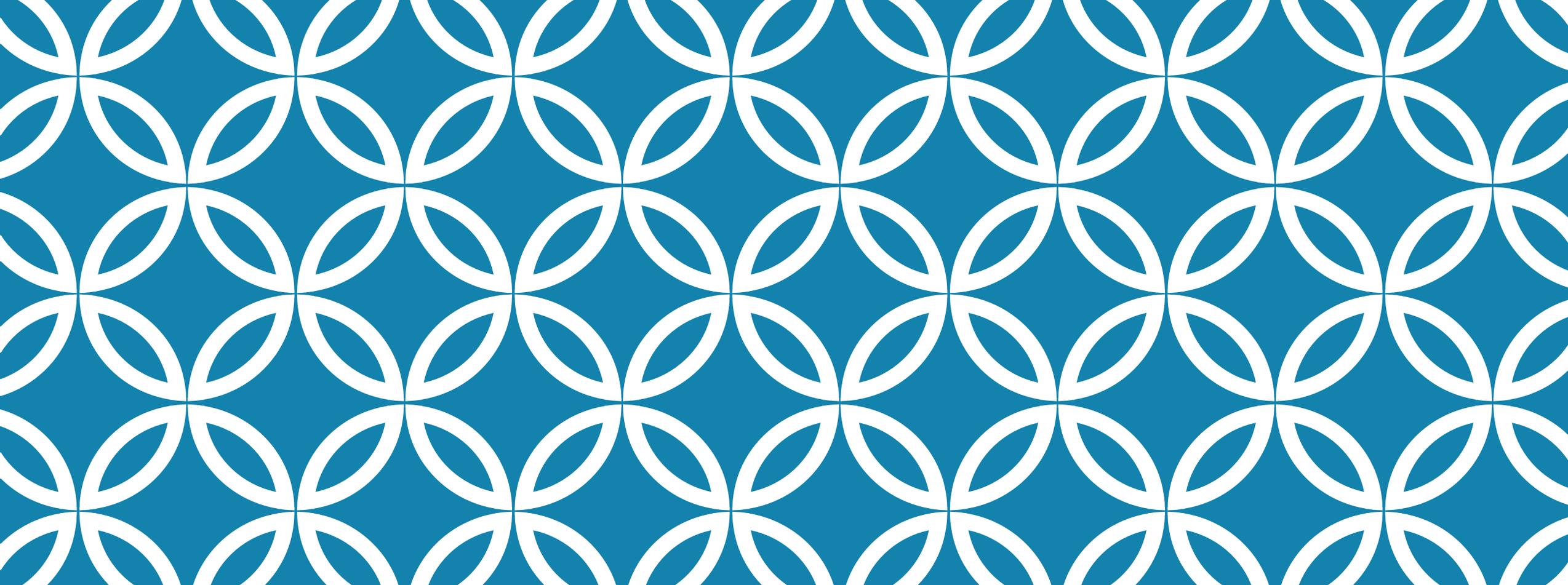
In **limited liability companies** the decision to amend the by-laws is subject to a qualified majority. This qualified majority is given by Article 199 of the CEA which requires that the decision to amend the by-laws receive a yes **vote from over half of the votes associated with the stakes** into which the company capital is divided.

In **joint stock companies** the decision to amend the by-laws must be passed by:

- a) A general meeting at which, in the first meeting, shareholders holding at least 50% of the subscribed capital with voting rights are present or represented.
- b) In the second call of the general meeting, this changes to 25% of the share capital present or represented.
- c) The majority required in order to pass the amendment to modify the by-laws is an absolute majority of over 50% of the present or proxy share capital. However, at the second call, this majority changes if less than 50 % of the subscribed share capital with voting rights is in attendance. A two thirds majority vote is needed (providing that at least 25% of the subscribed share capital with voting rights is in attendance but less than 50% is present). This means that at a second calling, the by-laws could theoretically be changed when 16.7% of the share capital with voting rights votes is in favour of the modification.

THE REGISTRATION OF THE AMENDMENT

The decision to amend the by-laws must be recorded in a public instrument (by a notary) and then registered in the Commercial Registry. It will subsequently be published in the Bulletin of the Commercial Registry.



SPECIAL RULES REGARDING THE MODIFICATION OF THE BY-LAWS

NEW OBLIGATIONS FOR PARTNERS OR SHAREHOLDERS AND THE AMENDMENT OF THE INDIVIDUAL RIGHTS OF PARTNERS

The basic obligation of the partners or shareholders to the Corporation is to make the economic contribution to it. The law protects them by stipulating that:

- a) When an amendment to the by-laws entails new obligations for partners or shareholders, its adoption must be contingent upon the consent of the parties concerned.
- b) When amendments refer to the individual rights of partners in limited liability companies, their adoption shall be contingent upon the consent of the parties concerned.

NEW OBLIGATIONS FOR PARTNERS OR SHAREHOLDERS AND THE AMENDMENT OF THE INDIVIDUAL RIGHTS OF PARTNERS

This means that the amendment of the by-laws cannot be imposed upon these parties by the majority vote of the general meeting, even when that vote is subject to a reinforced majority.

The same rule applies to the creation, modification and the premature extinction of ancillary commitments which, as Article 89.1 CEA tells us, must be done in accordance with the provisions on amendment of the by-laws and requires the individual consent of the parties bound by them.

PROTECTION OF THE RIGHTS OF SHAREHOLDERS IN JOINT STOCK COMPANIES

As we have already seen, the law allows for the creation of various classes of shares that attribute a different set of rights to their shareholders. In order to validly adopt an amendment to the by-laws that directly or indirectly affect these rights the following rules must be applied.

- 1) The amendment must first be approved by the general meeting.
- 2) The amendment must then be approved by the majority of the shareholders pertaining to the class in question.
- 3) The decision taken by the shareholders affected shall be subject to approval by the same majority (of the votes of that class) as is required for amending the by-laws and must be voted on either at the general meeting itself or at a special meeting.

THE MODIFICATION OF THE FREE TRANSMISSION OF REGISTERED SHARES

The transmission of registered shares can be restricted through a modification of the by-laws providing that the procedure for the modification of the by-laws just explained is followed.

However, the legislator, conscious of the seriousness of the agreement that alters the free transmission of shares (which affects a basic right of the shareholders) allows those shareholders who voted against the restriction to transmit their shares without this restriction for a period of three months dating from the publication of the amendment in the Official Bulletin of the Commercial Registry.

Those who voted in favour of the amendment do not benefit from this exception and are immediately bound by it.

MODIFICATION OF THE TRANSMISSION OF STAKES

When the by-laws are changed to alter the arrangements for the transmission of stakes in limited liability companies, the partners are entitled to leave the company (and have their capital returned to them).

MODIFICATION OF THE CORPORATE PURPOSE

Article 346.1 of the CEA states that partners or shareholders that did not vote in favour of the suppression or amendment of the corporate purpose have the right to exit the company.

If the shares of the company are traded on the stock exchange, then the price that the shareholder will receive for them is their average worth over the preceding three months.

In all other cases there will have to be an agreement between the corporation and the shareholders in question, and if no agreement is reached, then the value of the shares will be fixed by an auditor appointed by the Commercial Register, who must be different from the auditor that habitually does the accounts of the corporation.

CHANGE OF DOMICILE

According to Article 285.2 of the CEA the directing body of the corporation is competent to relocate the registered office within national territory.

However, if the corporation decides to move the registered office overseas then the previous agreement of the general meeting is necessary. Act 3/2009 on Structural Changes in Trading Companies states in Article 97 that:

Relocation of Registered Offices to another State must necessarily be approved by the general meeting, subject to the requirements and formalities laid down in legislation on the type of company concerned.

This agreement would be subject to the reinforced majorities of Articles 194.1 CEA and 201.2 (i.e. both for the validity of the meeting and the vote on the decision).

CHANGE OF DOMICILE ABROAD

A change of the registered domicile of a Spanish Corporation abroad also requires the permission of the law of the country to which it is transferring in order to retain its legal personality (Article 93 of the Law on Structural Changes in Trading Companies).

THE DECISION TO INCREASE COMPANY CAPITAL

A corporation may decide to increase its capital (among many other reasons) in order to strengthen its financial resources, to purchase goods (machinery, equipment, real-estate) or to make investments.

THE DECISION TO INCREASE COMPANY CAPITAL

The decision to increase the company capital has to be adopted by the general meeting and is subject to approval by the majority required for the amendment of the by-laws.

The decision to increase capital and its implementation must be entered simultaneously in the Commercial Register.

There are different methods by which the capital of the corporation can be increased.

a) If the decision to increase capital is by an increase in the par value of the stakes or shares, then this agreement will be contingent on the consent of all the partners (as they will be asked to make further contributions to the corporation), unless the balance is fully charged to profits or capital reserves.

THE DECISION TO INCREASE COMPANY CAPITAL

b) If new stakes or shares are emitted, requiring new cash contributions, then partners or shareholders shall be entitled to take or subscribe a number of stakes or shares in proportion to the par value of their holdings prior to the increase (this is known as a pre-emptive right). This right aims to give the stakeholder or shareholder the possibility of maintaining their proportional share of the corporation and thus retain the power of their political rights over the corporation.

Obviously, the exercise of this right is optional, as stakeholders and shareholders cannot be obliged to invest more of their money in the corporation.

EXCLUSION OF THE PRE-EMPTIVE RIGHT

However, the pre-emptive rights of the shareholders or stakeholders can be excluded if the general meeting, when approving the capital increase, decides it is in the Company's best interest to do so.

For the agreement regarding the exclusion of the pre-emptive rights the following is needed:

- A) The directors have to draft a report justifying the proposal and indicating the individuals that will receive the stocks and shares.
- B) Assurance has to be given that the nominal value of the new stocks or shares is the premium amount and that this corresponds to their real value.
- C) The partners or shareholders have the right to examine the directors' report and to request free copies of it.

INCREASED CAPITAL CHARGED TO CASH CONTRIBUTIONS

In joint stock companies (with the exception of insurance companies) capital increases booked against new cash contributions may not be made until all previously issued shares are paid up. The justification of the prohibition is reasonably clear, before asking for more money from shareholders for new shares, the old shares ought to be fully paid up first. This prohibition does not operate if the outstanding sum is less than 3% of the share capital.

INCREASES CHARGED TO NON-CASH CONTRIBUTIONS

Where the proposed increase is to come from non-cash contributions, along with the notice of the meeting, partners or shareholders must be provided with a directors' report containing a detailed description of the planned contributions, their valuation, the persons expected to make them, the number and par value of the stakes or shares to be created or issued, the amount of the capital increase and the security established to render the increase effective.

The notice of the general meeting shall inform all partners or shareholders of their right to examine the report at the registered office, as well as to request free copies of the document.

INCREASES CHARGED TO NON-CASH CONTRIBUTIONS

In joint stock companies this non-cash contribution must also be subject to a report made by one or several independent experts in accordance with Article 67 CEA. The report has to contain a detailed valuation of the contribution and whether it concurs with the par value of the shares to be issued.

INCREASES TO OFFSET LOANS

This is the situation in which a partner or a third party has a credit against the Corporation. In order to cancel this credit, the corporation increases its capital and pays its creditor with shares or participations in the company instead of in cash.

When the general meeting is convened, the partners or shareholders must be given access to a report at the registered office, prepared by the company's governing body on the nature and characteristics of the loans to be offset, the identity of the contributors, the number of stakes or shares to be created or issued and the amount of the increase.

INCREASES CHARGED TO RESERVES

This of course means that the corporation does not receive an input of money from outside of the corporation, but rather money that is already held in reserve by the corporation itself is used to increase capital.

The law establishes that the operation has to be based on a balance sheet approved by the general meeting no more than six months prior to the decision to increase capital and that this balance has to be verified by the company's auditor, or by an auditor appointed by the Commercial Register at the request of the directors (if the corporation is not obliged to have an auditor).

THE REDUCTION OF CAPITAL

Capital reductions may:

- a) Seek to re-establish the balance between the company's capital and its equity (which could have declined due to losses).
- b) Be the result of the decision to create or to provision for legal or voluntary reserves.
- c) To refund contributions.
- d) In joint stock companies to cancel the amounts due on outstanding contributions.

Decisions to reduce capital must be adopted by the general meeting and are subject to the qualified majority required for amending the by-laws.

THE REDUCTION OF CAPITAL

The general meeting's decision must specify the amount of the reduction, its purpose, how it will be implemented and the term for its implementation.

In joint stock companies the decision to reduce capital must be published in the Official Bulletin of the Commercial Register and a daily newspaper widely circulated in the province where the corporation has its registered office.

THE REDUCTION TO REFLECT LOSSES

When a reduction is made to re-establish the balance between a corporation's capital and its equity that has been adversely affected by losses, the reduction must affect all stakes or shares in equal proportion to their par value, and respect any special privileges in this regard granted to certain stakes or shares either by the law or by the by-laws.

Capital reductions resulting from losses must not entail refunds to partners or shareholders, or, in the case of joint-stock companies, the cancellation of sums owed on outstanding contributions.

THE REDUCTION TO REFLECT LOSSES

Capital reductions to reflect losses cannot be made in limited liability companies when they have reserves.

Joint Stock Companies cannot reduce their capital to reflect losses when the company has voluntary reserves or legal reserves which, after the reduction, would be greater than 10% of its capital.

THE REDUCTION TO REFUND CONTRIBUTIONS

When not all stakes or shares are equally impacted by the decision to reduce capital and its objective is to refund contributions then it is necessary to have:

- (a) In limited liability companies the individual consent of the stakeholders affected.
- (b) In joint stock companies the agreement of the majority of shareholders affected.

THE JOINT AND SEVERAL LIABILITY OF PARTNERS

Partners whose contributions have been refunded in full or in part shall be held jointly and severally liable to one another and the company for the payment of company debt acquired prior to the date on which the reduction became effective in respect of third parties.

The liability of each partner will be limited to the amount refunded to them (assuming they have no more financial interest in the corporation).

This liability will be limited to a period of 5 years from the time in which the reduction was made effective.

THE CREDITORS' RIGHT TO CHALLENGE REDUCTIONS IN LIMITED LIABILITY COMPANIES

In limited liability companies, the by-laws may provide that the implementation of the decision to reduce capital in order to refund partners' contributions is subject to a three-month delay in which time notice will be served individually on the creditors of the company.

During this delay the creditors may challenge the implementation of the decision if their debts are not honoured by the corporation, or if the company fails to provide security.

Refunds paid before the end of the three month period or despite challenges made in due time and manner by any creditor will be null and void.

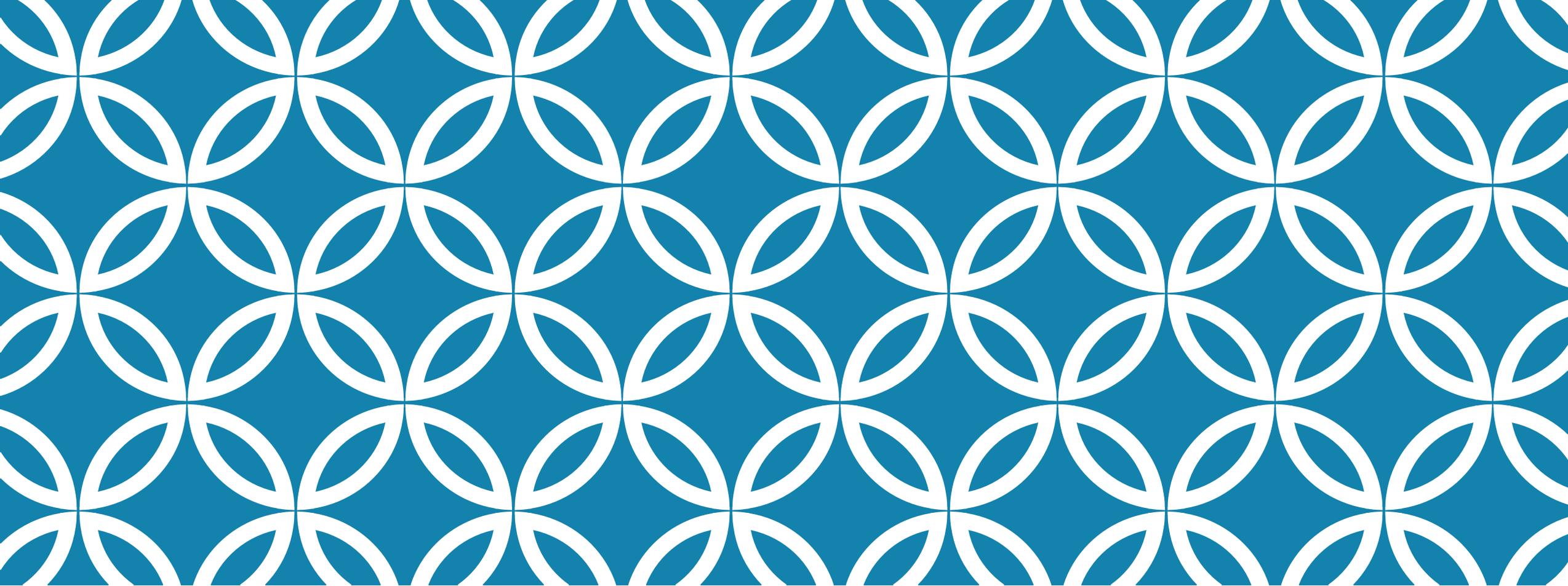
THE CREDITORS' RIGHT TO CHALLENGE THE REDUCTION IN JOINT STOCK COMPANIES

In joint stock companies creditors whose debts are dated prior to the announcement to reduce capital are entitled to challenge the reduction until their debts are paid or secured.

EXCEPTIONS TO THE RIGHT TO CHALLENGE REDUCTIONS

Creditors may not challenge capital reductions when:

- a) The sole aim of the capital reduction is to re-establish the balance between the company's capital and its equity, which is being reduced as a result of losses.
- b) When the reduction aims to create or provision the legal reserves.
- c) When the reduction is charged to unrestricted profits or reserves.



LESSON 10: DISSOLUTION AND LIQUIDATION

THE DISSOLUTION OF THE COMPANY VIA AN AGREEMENT OF THE GENERAL MEETING

The joint stock company may be dissolved at any moment, but in order to do so there must first be an agreement of the general meeting. Although the agreement to dissolve the corporation does not have to be unanimous, the quorums of Articles 193 and 201 do apply.

In the limited liability company the majority necessary is over half the votes associated with the stakes into which the capital is divided.

THE AUTOMATIC DISSOLUTION OF THE COMPANY FOR LEGAL REASONS

Article 360 of the CEA cites two legal causes of dissolution of corporations.

a) The expiry of the term of duration of the corporation as established in the by-laws. This term will apply unless it is explicitly renewed and the renewal is registered in the Commercial Registry prior to the expiry date.

THE AUTOMATIC DISSOLUTION OF THE COMPANY FOR LEGAL REASONS

b) A lapse of one year after the adoption of the decision to reduce capital to below the legal minimum, where no entry has been recorded in the Commercial Register on company conversion or dissolution or reflecting an increase in its capital to a sum greater than or equal to the legal minimum.

In the case that no entry is recorded in the Commercial Register on company conversion or dissolution, or of an increase in the capital within one year, the consequence is that the directors shall answer personally to one another and the company for corporate debts.

THE AUTOMATIC DISSOLUTION OF THE COMPANY FOR LEGAL REASONS

- c) A third legal cause is contained in Law 17/2001 on Trademarks which in its additional disposition 17 declares that when a judgement declares the violation of a trademark and imposes a change in the denomination of the company, and this change is not carried out within the term of one year then the corporation will be dissolved.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

However, on occasions the dissolution of the company is imposed by the law or the by-laws when certain conditions are met. In these cases, the corporation should be dissolved **by an agreement of the general meeting** in which the cause is stated.

These causes of dissolution are listed in Article 363 of the CEA.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

According to Article 363 CEA a corporate enterprise shall be dissolved:

- a) Upon interruption of the activity or activities that constitute its corporate purpose;** in particular inactivity for over one year will be deemed to constitute interruption.
- b) Upon termination of the corporate purpose** – For example, if the corporation was constituted to achieve a concrete objective (the construction of a dam or a motorway) then the corporation will be dissolved once this objective is achieved. This may be avoided by an extension or by the substitution of its corporate purpose (registered in the Commercial Registry).

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

- c) Where the achievement of the corporate purpose is manifestly impossible.** This impossibility of achieving the corporate purpose may be due to internal reasons (such as a lack of funds), or external reasons, such as an earthquake or a fire or a war.
- d) Due to the paralysation of the governing bodies of the corporation which make it impossible to conduct business.** This paralysation must be understood to be permanent, definitive and impossible to overcome. It should also be understood to refer to the general meeting, as any other blockage could be solved by the decision making capacities of the general meeting.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

e) Due to losses that reduce its equity to an amount lower than one half of the share capital, except where the capital is increased or decreased as required and application for insolvency is not warranted.

The meaning of equity should be taken to refer to the net assets mentioned in Article 36.1 c of the Code of Commerce, which according to the text are: *“the residual part of the company assets **once all the liabilities are deducted**. This includes the contributions made, either at the moment of its incorporation, or in other subsequent ones, by the partners or owners thereof, which shall not be considered liabilities, as well as the accumulated results or other variations that affect this”*.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

f) Due to a capital reduction to a sum that is below the legal minimum, except as in compliance with a legal provision.

This does not seem to be feasible in practice, as the only possibility of reducing the capital below the legal minimum is by simultaneously carrying out an increase in the capital of the Corporation which would set it above that minimum. This simultaneous reduction and increment of the capital of the corporation is known as the accordion effect. It consists in lowering the capital of the corporation down to virtually nothing (for example to one cent per share, so that the investors lose their investment) and then re-floating the corporation via new contributions by existing or new shareholders.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

Article 343 of the CEA states clearly that this is the only option when it determines that:

Decisions to reduce the share capital to zero or to below the legal minimum may only be adopted when a simultaneous decision is adopted to convert the company or increase its capital to an amount equal or above such minimum.

THE DISSOLUTION OF THE COMPANY AS IMPOSED BY THE LAW OR THE BY-LAWS OF THE COMPANY WHEN CERTAIN CONDITIONS ARE MET

- g) Because the par value of non-voting stakes or shares exceeds one half of the paid-up capital and the due proportion is not recovered within two years.**
- h) For any other cause established in the by-laws.**

THE SPECIAL CASE OF GOVERNMENT INTERVENTION IN JOINT STOCK COMPANIES

Article 373 CEA allows for the special case of government intervention to prevent the dissolution of a joint stock company by royal decree.

The article declares that:

When the government, at the behest either of shareholders representing at least one fifth of the share capital or of the company personnel, deems the continuation of the joint stock company to be in the interest of the national economy or socially beneficial, it may so rule by royal decree, specifying how the company is to subsist and the consideration payable to shareholders deprived of their right.

This is possible even when any of the causes of dissolution just mentioned are present.

THE FORMAL REQUISITES FOR DISSOLUTION

The causes of dissolution listed in Article 363.1 CEA do not operate automatically, rather they **require an agreement by the general meeting or a judicial judgement** so that the corporation is officially dissolved. The formal requisites for dissolution of the corporation are therefore:

- 1) The general meeting must be called by the directors. The agenda must mention the intended dissolution of the corporation.

THE FORMAL REQUISITES FOR DISSOLUTION

2) The general meeting may only meet the ordinary quorum (not the special reinforced quorum needed to amend the by-laws) specified in Article 193 of the CEA. In joint stock companies (which have a quorum for the valid holding of the meeting) this ordinary quorum is at least 25% of the subscribed capital with voting rights.

3) The general meeting will vote to recognise the existence of the cause of dissolution, the quorum for the valid recognition of the cause of dissolution is the ordinary majority contained in Articles 198 and 201.1 CEA. That is in joint stock companies a simple majority of the votes cast. In limited liability companies the majority vote is sufficient (more in favour than against) as long as at least **one third of the stakes into which the capital is divided are represented.**

THE FORMAL REQUISITES FOR DISSOLUTION

3) The agreement for the dissolution of the company must be written up in a public document (by a notary), registered in the Commercial Register and then published in the Official Bulletin of the Commercial Register.

Until the agreement for the dissolution of the corporation is inscribed in the Commercial Register then the corporation is not officially dissolved.

However, as we saw earlier, in certain cases the law itself establishes the automatic dissolution of the corporation.

THE FORMAL REQUISITES FOR DISSOLUTION

In the case of the expiry of the term of the corporation, the Registrar must place a note in the margin next to the last inscription made, indicating that the corporation has been dissolved.

The Registrar must do the same when a year has passed since the adoption of the agreement to reduce the capital of the corporation below the legal minimum without any of the following taken place:

- a) The transformation of the corporation into another type of corporation.
- b) An increase in the capital of the corporation to the legal minimum or above.
- c) An agreement to dissolve the corporation.

The Law of Trademarks (Law 17/2001) also provides for the Registrar to carry out the cancellation of the corporation when its name has not been duly changed.

THE DUTY OF THE DIRECTORS TO INITIATE THE PROCESS OF DISSOLUTION

The Law requires that the general meeting meets with the objective of agreeing on the dissolution of the corporation. In this sense it is possible to speak of the obligatory dissolution of the corporation.

Many of the causes of dissolution are necessary causes, and any partner or shareholder may call upon the directors to convene a general meeting if in her opinion a cause for dissolution exists or the company is insolvent.

THE DUTY OF THE DIRECTORS TO INITIATE THE PROCESS OF DISSOLUTION

However, it is the directors who are called upon in Article 365 to *“convene the general meeting within two months to adopt the decision on dissolution or, in the event of company insolvency, to institute insolvency proceedings”*.

This two month period begins, according to the case law of the Supreme Court: *“when the directors are aware of the existence of the cause of dissolution, or should have been aware of it had they conducted themselves in the manner of an orderly business person, among whose duties figures the obligation to inform oneself diligently of the state of the corporation”*.

(Judgement of the Supreme Court of 17th of March 2011).

THE JOINT LIABILITY OF THE DIRECTORS

Directors who fail to convene the mandatory general meeting within two months to adopt a decision on dissolution shall be jointly and severally accountable for corporate obligations incurred after the legal cause for dissolution is forthcoming.

Directors who fail to apply for a court ruling to dissolve the company, or as appropriate to institute insolvency proceedings within two months of the date scheduled for the meeting, if not held, or from the day of the meeting, if the dissolution proposal is defeated, shall be equally liable.

THE JOINT LIABILITY OF THE DIRECTORS

This responsibility only requires proof that the two months since the moment that the directors were aware of the cause of dissolution has passed without them having:

- a) Called the general meeting
- b) Initiated insolvency proceedings where appropriate

THE JOINT LIABILITY OF THE DIRECTORS

As we have just seen, the liability of the directors does not end with the mere calling of the meeting but continues if they do not apply for a court ruling to dissolve the Corporation or initiate insolvency proceedings when:

- a) The scheduled meeting is not held
- b) The motion to dissolve the Corporation is defeated.

The directors are obliged to apply to the court for company dissolution when the company decides against dissolution or its decision cannot be implemented. The application needs to be submitted within two months of the date scheduled for the general meeting if it was not held, or when the decision was against dissolution or no decision was adopted.

DISSOLUTION BY A COURT RULING

If the general meeting is not convened or not held or does not vote to dissolve the corporation (when such a cause exists), then any party concerned may apply to the judge of the Commercial Court with jurisdiction in the place where the company's registered office is located to dissolve the company.

THE REACTIVATION OF A DISSOLVED COMPANY

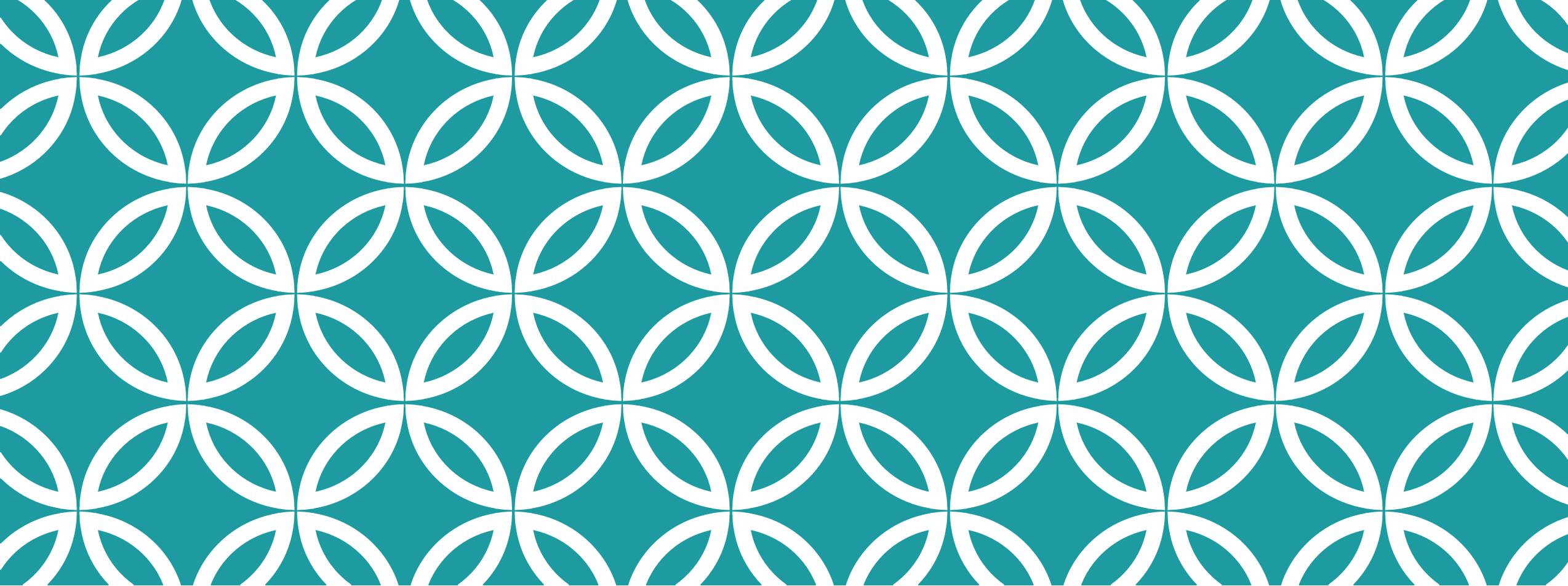
Once the decision to dissolve the company has been taken, Article 370 CEA allows for the reactivation of the dissolved company. The article states that the general meeting may agree to restore a dissolved company to active life once:

- a) the cause for which it was dissolved is remedied,
- b) book equity is not lower than company capital,
- c) no surplus after liquidation has been paid to partners or shareholders.

The partners or shareholders that do not vote to reactive the company are entitled to exit it.

Corporate creditors are entitled to challenge the decision to reactive the company under the same conditions that they are entitled to challenge capital reductions (see lesson 8).

Activation is not possible in the cases of the automatic dissolution of the company listed in Article 360 CEA.



THE LIQUIDATION OF THE CORPORATION

THE LIQUIDATION PERIOD

The dissolution of the corporation does not result in its automatic extinction but rather initiates the period of liquidation.

The period of liquidation comprises the series of acts that culminate in the total or partial payment of the corporation's debts, and, if possible, the partition of the remaining assets of the corporation among the partners according to the rules laid down in the by-laws, or, if the by-laws have no such provision, in proportion to their economic contributions to the corporation. Only after the process of liquidation has been carried out does the corporation become extinct.

THE PROCESS OF LIQUIDATION

We can therefore characterise liquidation as a process which begins with the inscription in the Commercial Register of the agreement to dissolve the corporation and which ends with the cancellation of the inscription of the corporation in the Commercial Registry.

Dissolved companies retain their legal personality during the liquidation proceedings but must add the expression “in liquidation” to their denomination throughout the period.

THE FIGURE AND THE FUNCTION OF THE LIQUIDATORS

According to Article 374, once the liquidation proceedings have been initiated, the directors are dismissed from their positions and their powers to represent the company are terminated.

The liquidators assume their legal duties (according to the text of the CEA) until the end of the liquidation process. However, Article 376 states that the liquidators shall be the company's directors at the time of the dissolution unless otherwise stipulated in the by-laws or liquidators are appointed by the general meeting adopting the decision to dissolve the company.

THE FIGURE AND THE FUNCTION OF THE LIQUIDATORS

The liquidators take care of the management and representation of the Corporation during the period of the liquidation procedure. They also have a number of specific duties to perform among the most important of which are:

- (i) They must prepare a company inventory and balance sheet within three months of the beginning of liquidation proceedings.
- (ii) They must keep the accounts of the corporation and keep custody of its accounting books, documentation and correspondence.
- (iii) They must dispose of corporate assets.
- (iv) They must receive and pay corporate debts.
- (v) They must receive any sums outstanding on shares in joint stock companies.

THE FIGURE AND THE FUNCTION OF THE LIQUIDATORS – DUTY TO INFORM

The liquidators also have the duty to periodically notify the partners or shareholders as well as the creditors of the progress of the process of liquidation, by the means regarded to be the most effective.

THE DISMISSAL OF THE LIQUIDATORS

The liquidators are appointed for an indefinite period, unless otherwise stipulated in the by-laws, and their term ends when the liquidation process is finalised.

However, they may be dismissed before liquidation is complete. Article 380 CEA determines that:

The dismissal of liquidators appointed by the general meeting may be agreed by the same, even when it does not appear on the agenda items.

If the liquidators were designated by the company by-laws the agreement (to dismiss them) must be adopted pursuant to the requirements of the majority vote, and, in the case of joint stock companies, the quorum established for the amendment of the by-laws.

THE DISMISSAL OF THE LIQUIDATORS

Joint stock company liquidators may also be dismissed by the decision of the clerk of the Commercial Court or the Registrar of the Commercial Registry in the location of the registered offices at the request of shareholders representing at least 5% of share capital, providing they can show just cause.

Dismissal of the liquidators appointed by the clerk of the commercial court or the registrar of the Commercial Registry may only be decided by the court who appointed them, at the request of any showing a legitimate interest, providing they can show just cause.

GENERAL MEETING DURING THE PERIOD OF LIQUIDATION

During the course of the liquidation proceedings, the corporation must observe the provisions in the by-laws regarding the holding of general meetings. In these meetings the liquidators will report to the shareholders/partners on the progress of the process in order to determine the most suitable action for the common interest.

CONTROLLERS

In the case of the liquidation of a joint-stock company, shareholders representing at least 5% may apply to the clerk of the Commercial Court or the Registrar of the Commercial Registry where the corporation is registered for the designation of a controller to supervise the liquidation process.

The function of the controller is to make sure that the liquidators carry out their functions correctly.

LIQUIDATION PROCEEDINGS

Liquidation includes a series of phases that lead to the extinction of the corporation.

- 1) The confection of the balance and inventory
- 2) The sale of the assets of the corporation
- 3) The payment of corporate debts
- 4) The distribution of any surplus assets resulting from the liquidation to the partners (the liquidation dividend)

THE FINAL LIQUIDATION BALANCE SHEET

Upon completion of the liquidation proceedings, the liquidators submit a final balance sheet, a complete report on the operations performed, and a proposal for distribution of the remaining assets among partners or shareholders to the general meeting for approval.

The decision approving the balance sheet may be challenged by the partners or shareholders not voting in favour within two months of the date of its adoption.

THE DISTRIBUTION OF CORPORATE EQUITY

The distribution of the remaining assets can only take place once the time period for challenging the proposal for distribution has expired or a judgement has resolved the challenge.

This distribution will be done according to the rules established by the by-laws, but if the by-laws do not establish any order for the distribution, then the partition will be carried out in proportion to the contributions of each partner or shareholder.

THE DISTRIBUTION OF CORPORATE EQUITY

Article 391.2 CEA states that:

The liquidators shall not pay the partners or shareholders their liquidation dividend until all creditors have been paid or the sum of the company debts is deposited at a financial institution in the place where the registered office is located.

THE DISTRIBUTION OF CORPORATE EQUITY

In the case of joint stock companies, if all the shares were not paid up in the same proportion, shareholders who paid up the highest amounts shall first be paid the surplus over the contribution on which they paid up the least, after which the remainder shall be distributed among partners or shareholders in proportion to the par value of their shares.

THE EFFECTS OF THE LIQUIDATION

The liquidators must formalise the termination of the corporation in a public instrument (through a notary). This formal instrument will include a statement on:

- a) The deadline for challenging the resolution of the approval of the final balance sheet has expired and that no challenge has been made to it or it has been dismissed by a judgement.
- b) That the creditors have been paid or the amounts owed to them have been deposited.
- c) The partners or shareholders have been paid their liquidation dividend or the amount has been deposited.

THE EFFECTS OF THE LIQUIDATION

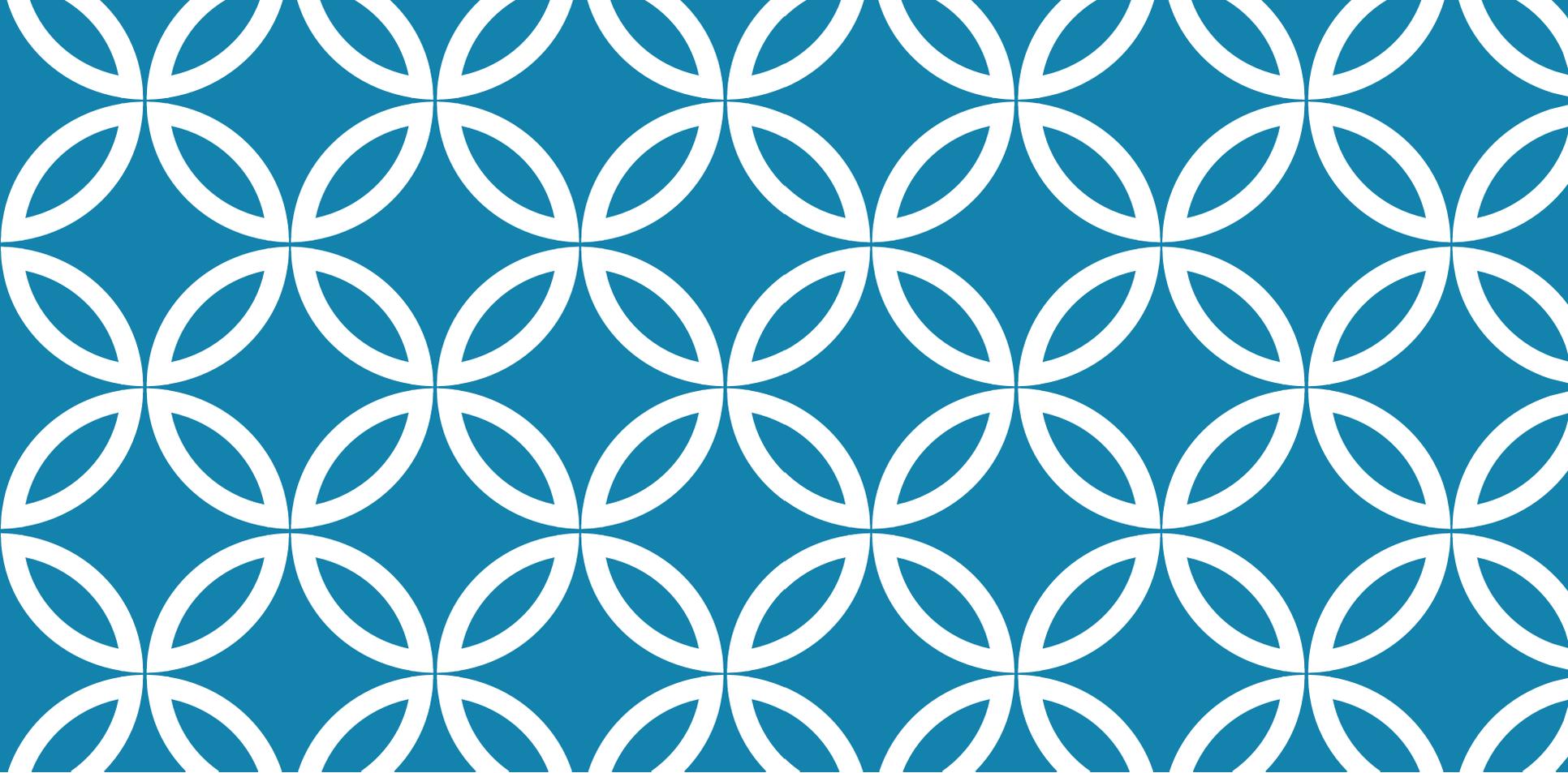
The public instrument on termination will be registered in the Commercial Registry

Once the cancellation of the registration of the corporation in the Commercial Registry has been carried out then the extinction of the corporation is complete.

The liquidators have to deposit all the terminated company's books and documents in the Commercial Registry.

THE LIQUIDATORS LIABILITY

The liquidators are liable to partners and creditors for any damages incurred due to misconduct or negligence in the performance of the liquidators' duties.



LESSON 11: INSOLVENCY

PART 1 OF THE
INSOLVENCY PROCEDURE

PATRIMONIAL RESPONSIBILITY

The law authorises the creditors of businesses to demand payment through court action. When the creditor requests that a judgement for payment be enforced, the patrimony of the debtor guarantees the satisfaction of the creditor.

PATRIMONIAL RESPONSIBILITY

Article 1911 of the Civil Code states that:

The debtor is liable for the performance of his obligations with all present and future property.

ENFORCEMENT

Enforcement action must be grounded on a title involving enforcement in accordance with Article 517 of the Civil Procedure Act.

Enforcement actions may be singular or collective.

In a singular enforcement action a single creditor demands, in his or her name and for his or her benefit, satisfaction of the outstanding debt by the court seizing and selling the patrimony of the debtor.

ENFORCEMENT

As stated in Article 517 of the Civil Procedure Act, enforcement must be grounded in a legal title such as:

- a) A court judgement
- b) An arbitration award
- c) A security instrument
- d) A Commercial agreement signed by the parties and a notary.

ENFORCEMENT

This legal title permits the creditor to request that the court seizes the property of the debtor and sells it so that the proceeds are used to satisfy the debt. If the debtor has a number of creditors then each one is entitled to request the seizure of goods belonging to her so that they may receive the money owed to them.

If the debtor is solvent, then her patrimony will be sufficient to cover all the debts owed. As a general rule, the first creditors to exercise their right to enforcement will be paid first.

INSOLVENCY

This situation changes radically when the debtor has a number of creditors and her patrimony is insufficient to cover all her debts.

As Article 2.2 of the Insolvency Act states:

A debtor who cannot duly fulfil the obligations he may be required to is in a state of insolvency.

INSOLVENCY

In this situation if the general “first come, first served” rule were to be applied, it would lead to the unjust situation of only a few creditors being able to get their money back. In order to avoid this, when the debtor does not have sufficient patrimony to cover the debts owed to a plurality of creditors, the ordinary system of enforcement is substituted for insolvency proceedings.

INSOLVENCY

In the case of the insolvency of a common debtor it is necessary to establish a system of collective enforcement (although as we shall see certain creditors are more privileged than others), which means that all of them must suffer collectively to some extent the insolvency of their common debtor.

INSOLVENCY

There are other advantages to this collective enforcement procedure:

- a) A collective enforcement makes the procedure of enforcement far easier than it would be if each creditor had to file their claims separately.
- b) The collective procedure is public and therefore gives public notice of the insolvency of the debtor, thus giving notice to other creditors and third parties who might be affected by this situation.

THE SUBJECTIVE PREMISE FOR INSOLVENCY

- 1) Insolvency proceedings may apply to any debtor, whether they are a natural or a legal person.
- 2) Insolvency proceedings may be opened with respect to an inheritance, provided it has not been accepted unconditionally (in which case the insolvency proceedings would be applied to the heir or heirs if they could not meet the debts of the creditors).
- 3) Insolvency proceedings may not be opened with respect to entities that form the territorial organisation of the State, public bodies and other Public Law entities.

THE OBJECTIVE PREMISE FOR INSOLVENCY

Clearly the objective premise for insolvency is not the same as the mere failure to comply with an obligation. As we have already seen, insolvency means that the debtor cannot satisfy her debts in the moment that her creditors are legally entitled to claim and enforce them.

THE OBJECTIVE PREMISE FOR INSOLVENCY

Precisely because of this, when the patrimony of the debtor is sufficient to cover the money owed to her creditors then the debtor is not insolvent.

The law only allows insolvency proceedings when the insolvency of the debtor becomes manifest, that is, when the situation of insolvency becomes public. If this were not the case, then businesses would have to accept an intolerable intrusion into their operations to discover if at any given moment they were effectively in a state of insolvency.

THE OBJECTIVE PREMISE FOR INSOLVENCY

The principle way in which the insolvency of the debtor is made public is when a general suspension of the payment of the debtor's obligations takes place. It is logical to assume that if the company in question is not meeting their general obligations it is because they do not have sufficient patrimony to cover them.

THE OBJECTIVE PREMISE FOR INSOLVENCY

According to Article 2.3, the petition for a declaration opening the insolvency proceedings may be submitted by a debtor. If that is the case, then she must justify her indebtedness and state of insolvency. This state of insolvency may be either current or imminent (which means she foresees that she will not be able to comply with her obligations).

THE OBJECTIVE PREMISE FOR INSOLVENCY

The petition for a declaration of insolvency proceedings may also be submitted by a creditor. It must in this case be based either:

a) On a title by virtue of which enforcement proceedings have been dispatched without the seizure of goods discovering sufficient free assets to cover the payment of the outstanding sums – or:

THE OBJECTIVE PREMISE FOR INSOLVENCY

b) A series of situations in which the situation of insolvency of the debtor has been externalized. These situations are listed in Article 2.4 and are the following:

THE OBJECTIVE PREMISE FOR INSOLVENCY

- (i) The general suspension of the current payment of the debtor's obligations.
- (ii) The existence of seizures or foreclosures pending with an overall effect on the debtor's aggregate assets.
- (iii) Unlawful removal or hasty or ruinous liquidation of her assets by the debtor.

THE OBJECTIVE PREMISE FOR INSOLVENCY

(iv) The generalised breach of obligations of any of the following classes:

- (a) The payment of tax obligations during the three months prior to applying for insolvency.
- (b) The payment of social security obligations.
- (c) The payment of salaries and other compensations and remunerations arising from employment relations during the three months prior to applying for insolvency.

THE OBJECTIVE PREMISE FOR INSOLVENCY

However, these situations are only indications that a situation of insolvency has been reached. When a creditor or creditors apply for insolvency proceedings to be initiated and it is admitted by the judge the debtor can oppose the proceedings.

THE OBJECTIVE PREMISE FOR INSOLVENCY

Article 18.2 of the Insolvency Act states that:

The debtor may base his or her opposition on the untruthfulness of the facts on which the petition is based or, even when the facts are true, that he or she is not in a state of insolvency. In the latter case, the burden of proof of solvency shall lie with the debtor and, if legally obliged to keep accounts, that evidence must be based on those kept by him or her pursuant to the law.

THE OBJECTIVE PREMISE FOR INSOLVENCY

The existence of insolvency proceedings is also dependent upon there being more than one creditor. Article 2.1 of the Insolvency Act speaks about the existence of a *common debtor*. If that were not the case, then the substitution of normal enforcement proceedings for insolvency proceedings could not be justified.

LEGITIMACY FOR APPLYING FOR INSOLVENCY PROCEEDINGS

Insolvency is of course simply an economic fact which acquires legal relevance only when the debtor is declared insolvent by a Court. Without that declaration then insolvency does not produce any legal effects. The Court cannot declare the insolvency of a legal or physical person *ex officio*. It can only respond to an application for insolvency.

LEGITIMACY FOR APPLYING FOR INSOLVENCY PROCEEDINGS

Article 3.1 of the Insolvency act declares that the debtor is entitled to petition for insolvency proceedings. Article 22 of the Insolvency Act refers to this as voluntary insolvency.

Article 3 also attributes legitimacy to petition for insolvency to any of the creditors of the debtor and the insolvency mediator (more of which we shall hear about later).

LEGITIMACY FOR APPLYING FOR INSOLVENCY PROCEEDINGS

Article 3 also attributes this legitimacy to shareholders, partners, members or parties who are personally liable for the debtor's debts by law.

Additionally, in the case of the creditors of a deceased debtor, the heirs and the executor of the assets may petition for the opening of insolvency proceedings of the inheritance if it has not been accepted unconditionally.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

As we have seen, the debtor can apply for the opening of insolvency proceedings. When the debtor is a legal person this allows the directors to petition for insolvency. However, the debtor is not simply able to petition for insolvency proceedings when he or she finds himself or herself insolvent.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

Article 5 of the Insolvency act configures the duty of the debtor to petition for a judicial declaration to open insolvency proceedings.

Article 5.1 states that:

A debtor shall petition for a declaration opening the insolvency proceedings within two months of having known of his or her state of insolvency or within two months following the date from which he or she was in a position to know of his or her insolvency.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

The presumption that the debtor knew of his or her state of insolvency can be disproved but it will be assumed he or she knew when any of the series of situations described in Article 2.4 have taken place.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

The consequence for the debtor of not petitioning for bankruptcy when he or she had the obligation to do so is contained in Article 165.

The insolvency proceedings are presumed to be tortious (which means that the debtor has acted in bad faith with malicious intent or negligence) and will be responsible for further damages caused as a result.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

Article 367 of the CEA constitutes the joint liability of the directors when they fail to apply for a court ruling to institute insolvency proceedings within two months of being aware of the insolvency of the corporation.

However, this two month period shall not apply when, despite being insolvent, the corporation is in negotiations with its creditors to refinance its debts or an out of court payment agreement (that we shall examine later). The corporation has the obligation to inform the Court of the existence of these negotiations within the two month period mentioned.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

This communication to the court has the effect of preventing the seizure of any assets of the corporation deemed to be essential to the running of the business, and any process of enforcement that is under way will be suspended.

THE PETITION FOR INSOLVENCY PROCEEDINGS FROM THE DEBTOR

However, once three months have passed since the communication was received by the court, and whatever the result of the negotiations, the debtor is obliged to petition for the opening of insolvency proceedings, unless the debtor is not now insolvent.

INSOLVENCY PROCEDURE

The law governing insolvency proceedings is, to a great extent, procedural law. As a general rule it is the Mercantile Courts that are competent to hear and decide on insolvency. The territorial competence of the Court to declare and deal with the insolvency lies with the Mercantile Court in whose territory the debtor has her main interests. This is understood to be the place where the debtor usually performs the management of those interests. In the case of a legal person the centre of its main interests is presumed to be at the place where the registered office is located.

INSOLVENCY PROCEDURE

If the insolvency proceedings are requested by the debtor the Court may either:

- a) Issue an order declaring the opening of the insolvency proceedings if from the documentation produced, appreciated overall, it is possible to deduce the existence of any of the situations described in Article 4.2.

INSOLVENCY PROCEDURE

b) The Court may refuse to initiate the insolvency proceedings, in which case the debtor may lodge an appeal against this decision at the same court.

INSOLVENCY PROCEDURE

When the petition to open insolvency proceedings comes from a creditor and is founded on a situation that is by itself sufficient to accredit the existence of the insolvency of the debtor (a failed seizure or investigation of assets or an administrative or judicial declaration of insolvency), the judge shall order the opening of insolvency proceedings on the first working day thereafter.

INSOLVENCY PROCEDURE

When the petition for insolvency is presented by any legitimated party other than the debtor and for a reason other than that foreseen in the circumstance just described, the Court will admit it to consideration and summon the debtor to appear before it within five days in order to present opposition to the petition.

The debtor may show his or her conformity with the petition for insolvency, oppose the petition or chose not to formulate any opposition.

INSOLVENCY PROCEDURE

As we have already seen, Article 18.2 of the Insolvency Act states that:

The debtor may base his opposition on the untruthfulness of the facts on which the petition is based or that, even when the facts are true, that he or she is not in a state of insolvency. In the latter case, the burden of proof of solvency shall lie with the debtor and, if legally obliged to keep accounts that evidence must be based in those kept by him or her pursuant to the law.

INSOLVENCY PROCEDURE

If the debtor exercises her right to oppose the petition for insolvency proceedings the judge will notify the parties and have an audience with them. The following outcomes are then possible:

a) The debtor does not attend the audience with the judge, in which case the judge will dictate a resolution ordering insolvency proceedings to be opened.

INSOLVENCY PROCEDURE

b) The debtor will appear, and if he or she can, will deposit the sum of the claims against him or her at the hearing, or shall accredit having done so before the hearing. If not, then the creditor is obliged to state the reason why he or she has not deposited the money. If several creditors have appeared and their insolvency petitions have accumulated, the debtor must deposit the sums owed to all of them. If the money is duly deposited then this brings an end to the insolvency proceedings.

INSOLVENCY PROCEDURE

c) The creditor or interested party who petitioned for insolvency does not appear, or, having done so, does not ratify his petition. The Court may consider, despite this, that there is still an objective case to declare the insolvency proceedings open when the proceedings show the existence of other possible creditors. The Court shall in this case grant these creditors a term of five days to formulate the allegations that they may deem convenient.

THE DECLARATION OF INSOLVENCY PROCEEDINGS

The order that declares the opening of insolvency proceedings must contain a series of pronouncements according to Article 21 of the Insolvency Act, among these are:

1. The compulsory or voluntary nature of the insolvency. The insolvency proceedings are considered voluntary when the first of the petitions submitted was that of the debtor himself or herself, in other cases the insolvency shall be considered compulsory.

THE DECLARATION OF INSOLVENCY PROCEEDINGS

2. The effects on the rights of management and disposal of the debtor with regard to his or her aggregate assets as well as the appointment and powers of the insolvency practitioners.

3. The preservation measures that the Court considers necessary to assure the integrity, conservation or management of the debtor's aggregate assets until the insolvency practitioners accept the office.

4. The publicity that is to be given to the declaration of the opening of the insolvency proceedings.

THE DECLARATION OF INSOLVENCY PROCEEDINGS - NOTIFICATION

The insolvency administration shall serve an individual notice, without delay, to each one of the creditors whose identity and domicile are recorded in the insolvency proceedings, informing them that they have been declared open and of their duty to lodge their claims in the manner established by the law.

The notice shall be served by telematic, computer or electronic means when the electronic address of the creditor is recorded.

THE DECLARATION OF INSOLVENCY PROCEEDINGS - NOTIFICATION

The notification shall be addressed by electronic means to the State Tax Administration Agency and the General Treasury of the Social Security.

The representatives of the workers of the company (if any) shall be notified, informing them of their right to appear as a party in the proceedings.

THE DECLARATION OF INSOLVENCY PROCEEDINGS - PUBLICITY

Publicity of the declaration of the opening of the insolvency proceedings shall be made by telematic computer and electronic means.

An extract of the statement of the opening of the insolvency proceedings shall be published free of charge in the Official State Gazette and shall contain only the date that is indispensable to identify the insolvent debtor. This information will include the following:

- a) Her tax identity number
- b) The competent court
- c) The case number
- d) The general number of the proceedings

THE DECLARATION OF INSOLVENCY PROCEEDINGS - PUBLICITY

- e) The date of the court order declaring the opening of the insolvency proceedings
- f) The identity of the insolvency practitioners

The Court, on its own motion or at the request of the party concerned, may order any complementary publicity it may consider indispensable for the effective diffusion of the insolvency proceedings.

THE DECLARATION OF INSOLVENCY PROCEEDINGS- PUBLICITY IN THE REGISTRIES

If the debtor is a natural person, the declaration opening the insolvency proceedings shall be registered at the Civil Registry.

If the debtor is registered in the Commercial Registry, then the declaration opening the insolvency proceedings shall be inscribed on the sheet open for the company.

THE ABBREVIATED INSOLVENCY PROCEEDINGS

The abbreviated procedure may be applied at the discretion of the Court given certain circumstances or it may be obligatory.

A) The discretionary application of the abbreviated insolvency proceedings

According to Article 190 of the Insolvency Act, the Court may apply the abbreviated procedure when, considering the information available, it considers that the insolvency proceedings are not of special complexity according to the following set of circumstances.

THE ABBREVIATED INSOLVENCY PROCEEDINGS

- 1) When the list submitted by the debtor includes less than fifty creditors.
- 2) When the initial estimation of liabilities does not exceed five million euros.
- 3) When the valuation of the assets and rights of the debtor does not reach five million euros.

THE ABBREVIATED INSOLVENCY PROCEEDINGS

The Court may also apply the abbreviated procedure when the debtor files a proposal for early composition or a proposed composition that includes a structural modification that conveys all his assets and liabilities.

THE ABBREVIATED INSOLVENCY PROCEEDINGS

B) The obligatory application of the abbreviated insolvency proceedings

The Court is obliged to apply the abbreviated procedure when the debtor submits, along with the petition for insolvency proceedings, a winding-up plan that contains a binding written proposal to purchase the production unit in operation, or if the debtor has fully ceased his or her activity and has no work contracts in force.

THE ABBREVIATED INSOLVENCY PROCEEDINGS - CONVERSION

C) The conversion of the proceedings

The Court, on its own motion, at the request of the debtor or the insolvency practitioners, or any other creditor, may at any time, considering the modification of the circumstances of the situation and according to the greater or lesser complexity of the insolvency proceedings, transform an abbreviated procedure into an ordinary one, or an ordinary procedure into an abbreviated one.

THE SPECIAL FEATURES OF THE ABBREVIATED INSOLVENCY PROCEEDINGS

Once the Court has declared the abbreviated insolvency procedure open, the procedure presents two specialities.

- 1) A substantial reduction in the duration of the proceedings.
- 2) A simplification of the process by which the inventory of assets and the list of creditors can be challenged.

THE OUT OF COURT PAYMENT AGREEMENT

Article 231 of the Insolvency Act regulates out of Court payment agreements. It deals first with natural (physical) persons and then legal persons.

Natural persons who are insolvent can begin a procedure to reach an out of court settlement on payment with their creditors as long as the initial estimation of their liabilities does not exceed five million euros.

THE OUT OF COURT PAYMENT AGREEMENT

Legal persons have to satisfy the conditions of Article 231.2 of the Insolvency Act. These conditions are the following:

- a) That they are insolvent.
- b) The insolvency proceedings must not be especially complex in the sense described by Article 190 of the Insolvency Act.
- c) They must have sufficient assets in order to be able to settle the expenses inherent to the agreement.

THOSE INELIGIBLE TO REACH AN OUT OF COURT PAYMENT AGREEMENT

However, the following may not reach an out of court payment agreement:

1) Those who have been condemned in a final ruling for offences against the social and economic order, for forging documents, for offences against the Public Treasury, for offences against the Department of Social Security or offences against the rights of workers – in the 10 years prior to the declaration opening the insolvency proceedings.

THOSE INELIGIBLE TO REACH AN OUT OF COURT PAYMENT AGREEMENT

2) Persons who, within the last five years, have reached an out of court payment agreement with creditors, have obtained judicial homologation of another out of court payment agreement or have been declared bankrupt.

The prohibition on reaching an out of court payment agreement also applies to those who are negotiating a refinancing agreement with their creditors or whose petition for insolvency has been admitted to consideration.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

Debtors that wish to reach out of court payment agreements with their creditors must apply for the appointment of an insolvency mediator.

If the debtor is a subject inscribed in the Commercial Registry, then the application must be addressed to the corresponding Registrar.

In all other cases, then the application must be addressed to a notary located in the area corresponding to the domicile of the debtor.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

Both legal and natural persons may also direct their applications to the Chamber of Commerce providing that it has assumed the functions of a mediator.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

The petition must be written out on a standardised form and must include an inventory of the cash and liquid assets available to the debtor, as well as the assets and rights held and the ordinary revenue foreseen.

The petition must also include a list of creditors (specifying their identities, addresses and emails) and state the amount and maturity of their respective claims. It shall also include a list of the contracts in force and the monthly expenses foreseen.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

The information in these lists has to be accurate. If not, then Article 164.2.2 of the Insolvency Act is applied. The consequence of the application of this article is that, if the out of court agreement fails and insolvency proceedings have to be opened, the fact that the information provided was false will mean that the insolvency will be classified as tortious without the possibility of the debtor submitting proof to the contrary.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

According to Article 233 of the Insolvency Act, an insolvency mediator is appointed from among those included on an official list published on the Web Site of the Official State Gazette (BOE) and supplied by the Register of Mediators and Mediation Institutions kept by the Ministry of Justice.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

In order to be included on the list the insolvency mediator must fulfil the conditions for mediators contained in Article 27 of Act 5/2012 of the 6th of July in Civil and Mercantile matters.

However, in order to act as an insolvency practitioner they must also comply with the subjective conditions required for this appointment contained in Article 27 of the Insolvency Act.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

The insolvency mediator has to accept the appointment. Once accepted, the Public Notary or Chamber of Commerce that appointed the mediator has to report the commencement of negotiations to the judge competent for the declaration of insolvency in the case. It must also communicate the fact to any relevant public registries (such as the Civil Registry and the Property Registry).

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

These Registries are informed of the negotiations pursuant to the objective of Article 5.4 bis of the Insolvency Act which, as we have seen, prevents any judicial or extrajudicial foreclosures taking place on the assets of the debtor until an extrajudicial agreement on payments is adopted or, if the negotiations fail, insolvency proceedings are declared open.

THE PROCEDURE FOR OUT OF COURT PAYMENT AGREEMENTS

In ten days following the acceptance of office, the insolvency mediator is obliged to verify the data and the documentation provided by the debtor, and, within the same term, summon the debtor and the creditors who are recorded on the list submitted by the debtor, or whose existence is known by any other means, to a meeting that will be held within two months of the mediator having accepted her office.

THE EFFECTS OF THE COMMENCEMENT OF OUT OF COURT PAYMENT PROCEDURES ON THE DEBTOR

Once the opening of the out of court payment procedure is applied for, the debtor may continue with his or her labour, business or professional activities but has to abstain from performing any act of administration and disposal of assets that would exceed the acts or operations inherent to the business or trade of his or her activity.

THE EFFECTS OF THE COMMENCEMENT OF OUT OF COURT PAYMENT PROCEDURES ON THE CREDITORS

For their part the creditors, following notice of the opening of negotiations, may not commence or continue any judicial or extrajudicial execution whatsoever on the assets of the debtor while the out of court agreement is being negotiated, for up to a maximum of three months.

THE EFFECTS OF THE COMMENCEMENT OF OUT OF COURT PAYMENT PROCEDURES ON THE CREDITORS

This prohibition does not apply to:

- a) Public authorities.
- b) Creditors who had an *in rem* security that does not affect assets or rights that are necessary for the continuity of the professional or business activity of the debtor nor his or her usual place of abode.

THE EFFECTS OF THE COMMENCEMENT OF OUT OF COURT PAYMENT PROCEDURES ON THE CREDITORS

The creditors are also prohibited from performing any action that is aimed at improving their situation with regard to the common debtor. For example, private negotiations for payment plans.

THE PROPOSAL FOR AN OUT OF COURT PAYMENT AGREEMENT

At least twenty days before the date on which the meeting is to be held, the insolvency mediator has to send the creditors a proposal for a payment agreement on the claims pending payment on the date of the petition.

THE PROPOSAL FOR AN OUT OF COURT PAYMENT AGREEMENT

This proposal may contain any of the following measures:

- a) A moratorium for a term not exceeding ten years.
- b) Write downs.
- c) The conversion of debt into shares or stakes in the company.
- d) The conversion of debt into participation loans or bonds or any other financial instrument with a rank, maturity or characteristic different from the original debt.

THE PROPOSAL FOR AN OUT OF COURT PAYMENT AGREEMENT

The proposal shall include a payment plan with detail of the resources foreseen for its fulfilment and a feasibility plan that shall contain a proposal for the regular fulfilment of new obligations, including, where appropriate, establishing a sum for the maintenance of the debtor and his or her family.

THE PROPOSAL FOR AN OUT OF COURT PAYMENT AGREEMENT

During the ten days following the submission of the proposed agreement by the insolvency mediator to the creditors these may present alternative proposals or modification proposals. Once the term has elapsed the insolvency mediator shall send the creditors the final payment and feasibility plan accepted by the debtor.

THE PROPOSAL FOR AN OUT OF COURT PAYMENT AGREEMENT

However, if before these ten days elapse a group of creditors representing a majority of the liabilities that would be affected by this agreement decide not to continue with the negotiations and the debtor is in a situation of actual or imminent insolvency, then the insolvency mediator must immediately apply for the opening of insolvency proceedings.

THE MEETING OF THE CREDITORS

The creditors summoned must attend the meeting, except if they have declared their approval or opposition within ten days prior to the meeting. The consequence of not attending the meeting when summoned is that, with the exception of those creditors that have an in rem security established in their favour, their claim will be classified as subordinate if the negotiations fail and insolvency proceedings are opened.

THE MEETING OF THE CREDITORS

This means that they will not be paid until any privileged creditors and all ordinary creditors have had their debts satisfied.

This does not apply to any public authorities.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

In order for the out of court payment to be considered accepted the following majorities are required, calculated on the basis of the total liabilities that may be affected by the agreement.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

A) If the agreement is for a moratorium either of the principal or the interest owed on loans for a term not exceeding five years, or write downs that do not exceed 25% of the total amount of the claims, or the conversion of debt into participation loans for the same five year term, then the majority needed for the agreement to be accepted is 60% of the total liabilities to be affected by the out of court settlement. However, this does not affect those creditors who have an in rem security and nor does it affect public authorities.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

B) If the agreement is for a moratorium on the principal or interest on debts for a term of five years but less than ten years or write downs that exceed 25% of the total sum owed then a majority of 75% of the liabilities that would be affected by the agreement need to vote in favour. Again this does not affect creditors who have an in rem security or public authorities.

NON-ACCEPTANCE OF THE AGREEMENT

If the proposal for an agreement is not accepted and the debtor remains insolvent, then the insolvency mediator must immediately petition the competent court to declare the insolvency proceedings open.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

If the agreement is accepted, then the decision of the majorities just described are binding not only on those who voted in favour of the agreement but also those who either did not attend the creditors' meeting or who voted against the agreement.

It affects the creditors who have an ad rem security only to the extent that the security does not cover the full quantity of the debt owed.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

If the agreement is accepted by the creditors, then the agreement has to be recorded in public deed by a notary. Those affected by the agreement cannot initiate or continue with enforcement proceedings against the patrimony of the debtor for debts that existed before the publication of the agreement. However, those affected by the agreement and that opposed it retain the right to seek full satisfaction of their debts against those who responded jointly and severally for those debts or those who acted as personal guarantors of the debtor.

THE ACCEPTANCE OF THE OUT OF COURT PAYMENT AGREEMENT

By virtue of the out of court agreement claims shall be offset, remitted or extinguished as agreed.

With regard to the creditors who signed the out of court agreement, the maintenance of their rights before other parties obliged such as backers or guarantors shall depend on what was established in their respective legal relationship (i.e. the terms agreed by the parties by contract).

CHALLENGING THE AGREEMENT

Once the agreement has been made, it may only be challenged for:

- a) Failure to have reached the majorities required by law, taking into account the creditors who, having the right to attend the meeting, were not summoned.
- b) Exceeding the legal limits established for the agreement contained in Article 236.1 of the Insolvency Act.
- c) The disproportionate nature of the measures agreed.

CHALLENGING THE AGREEMENT

Those who may legitimately challenge the agreement are:

- a) Creditors who had not been summoned to the creditors' meeting.
- b) Creditors who had previously stated their opposition to the agreement.

The agreement must be challenged within the ten days following its publication, and the challenge does not suspend the execution of the agreement. The challenge to the agreement must be presented before the Court that would be competent to hear the insolvency proceedings of the debtor.

THE ANNULMENT OF THE AGREEMENT

If the challenge is successful, then the agreement is annulled.

The ruling annulling the agreement will be published on the Public Insolvency Register.

The ruling on the challenge to the agreement shall itself be subject to appeal to the Higher Court with preferential processing.

Annulment of the agreement will give rise to the opening of insolvency proceedings.

COMPLIANCE AND BREACH OF THE AGREEMENT

The insolvency mediator supervises the compliance with the agreement.

If the out of court payment agreement is completely fulfilled, then the insolvency mediator must record this in a notarial certificate that will be published on the Public Insolvency Register.

If the out of court payment is violated, then the insolvency mediator must file insolvency proceedings and the debtor in breach shall be deemed in a state of insolvency.

CONSECUTIVE INSOLVENCY PROCEEDINGS

According to Article 242 of the Insolvency Act, Consecutive Insolvency Proceedings status shall be attributed to those declared at the request of the insolvency mediator, of the debtor or of creditors due to the impossibility of complying with an out of court payment agreement or due to the breach of one. It will also be attributed to those called due to the annulment of an out of court agreement.

CONSECUTIVE INSOLVENCY PROCEEDINGS

Consecutive insolvency proceedings shall be governed by the terms provided for by the abbreviated proceedings, but has a number of special features. Among those special features are the following:

- 1) If the petition for insolvency is lodged by the debtor or by the insolvency mediator, it must be accompanied by an early composition proposal or a winding up plan.

CONSECUTIVE INSOLVENCY PROCEEDINGS

2) The petition filed by the insolvency mediator needs to be accompanied by the following documents:

- (i) An analysis of the data and circumstances of the debtor
- (ii) The state of the debtor's accounts
- (iii) An inventory of the aggregate assets
- (iv) A list of creditors
- (v) A winding up plan where appropriate

CONSECUTIVE INSOLVENCY PROCEEDINGS

3) In the case of insolvency proceedings of a natural person a pronouncement must be issued on whether the legally established requisites are met for the benefit of exoneration of the unsettled liabilities under the terms foreseen in Article 178 bis of the Insolvency Act. This is only possible when the debtor has acted in good faith. Article 178.3 bis explains what it means to have acted in good faith by stating that:

CONSECUTIVE INSOLVENCY PROCEEDINGS

- (i) The insolvency proceedings cannot have been declared tortious.
- (ii) The debtor has not been declared guilty in a final judgement for offences against the social economic order, for documentary forgery, against the Public Treasury or the Social Security or against the rights of workers in the 10 years prior to the declaration of insolvency proceedings.
- (iii) That she has attempted an out of court settlement.
- (iv) That she has settled preferential insolvency claims.

CONSECUTIVE INSOLVENCY PROCEEDINGS

4) The expenses of the out of court agreement and other claims that are considered as such pursuant to Article 84 that have been generated during the out of court proceedings and that have not been settled shall also be considered claims against the estate.

CONSECUTIVE INSOLVENCY PROCEEDINGS

5) The term of two years to determine acts that may be revoked shall be counted from the date of application to the Commercial Registry or Public Notary or the Chamber of Commerce for the opening of insolvency proceedings.

CONSECUTIVE INSOLVENCY PROCEEDINGS

6) Holders of claims who had signed the out of court agreement do not need to apply for recognition.

PARTIES TO INSOLVENCY PROCEEDINGS

Insolvency is a complex process involving a number of parties that is designed to satisfy collectively the claims of a number of creditors.

THE JUDGE IN INSOLVENCY PROCEEDINGS

Insolvency proceedings take place under the control and guidance of a judge. As we have already seen in Article 8 of the Insolvency Act, it is the Mercantile Courts that are competent to hear and decide on insolvency and their jurisdiction is exclusive, and it excludes others in a number of domains.

THE JUDGE IN INSOLVENCY PROCEEDINGS

Among these exclusions are the following:

(a) Civil actions with an economic content lodged against the insolvent debtor's aggregate assets with the exception of those exercised in proceedings on - (i) capacity (ii) filiation (iii) marriage (iv) minors.

THE JUDGE IN INSOLVENCY PROCEEDINGS

(b) Labour actions intended for collective extinction, amendment or suspension of employment contracts in which the employer is the insolvent debtor, as well as the suspension or extinction of senior management contracts.

THE JUDGE IN INSOLVENCY PROCEEDINGS

(c) All enforcement on properties goods and rights pertaining to the insolvent debtor's aggregate assets, whatever the authority that may have ordered them.

(d) All preservation measures that affect the insolvent debtor's aggregate assets.

INSOLVENCY PRACTITIONERS

The order that contains the opening of insolvency proceedings has to contain a pronouncement appointing an insolvency practitioner.

Article 27 of the Insolvency Act contains the subjective conditions for the appointment of insolvency practitioners.

INSOLVENCY PRACTITIONERS

According to article 27:

- (a) A single insolvency practitioner is appointed to administer the insolvency.
- (b) Natural or legal persons may be appointed to the post but they must be registered on the Public Insolvency Register and be duly qualified according to implementing regulations of the Register.

INSOLVENCY PRACTITIONERS

- (c) For the purposes of appointing insolvency practitioners a distinction is made between small, medium or large scale insolvency proceedings.
- (d) The appointment of an insolvency practitioner is carried out by rotation of those who are registered on the list of the Public Insolvency Registry who fulfil the conditions required.

INSOLVENCY PRACTITIONERS

(e) In cases of large scale insolvency proceedings the court may decide to appoint an insolvency practitioner other than the one assigned by rotation if their profile is better suited to the characteristics of the insolvency proceedings. Among the criteria for making such an appointment may be the experience of the practitioner with the financial instruments used by the debtor or specialisation in the field of activity of the debtor.

INSOLVENCY PRACTITIONERS

(f) If the insolvency proceedings affect a credit institution, then the Court will appoint an insolvency practitioner from among those proposed by the Fund for Orderly Bank Restructuring. If the insolvency affects an entity subject to the supervision of the National Stock Exchange Commission, then the Court will appoint a candidate proposed by them. In the case of insurance companies the proposal will be made by the Insurance Compensation Consortium.

PROHIBITIONS OF INSOLVENCY PRACTITIONERS

Article 28 contains a list of those who cannot be appointed as insolvency practitioners. Among those mentioned are:

- a) Those who are prohibited from being the directors of public or private limited companies.
- b) Those who have provided any kind of professional services to the debtor or persons especially related to his or her within the last three years.

THE FUNCTIONS OF THE INSOLVENCY PRACTITIONERS

Insolvency practitioners have wide ranging functions that can be divided into the following groups:

- a) Of a procedural nature
- b) Inherent to the debtor - that is those which would otherwise have been performed by the debtor or its governing bodies

THE FUNCTIONS OF THE INSOLVENCY PRACTITIONERS

- c) In labour matters.
- d) Related to the rights of the creditors.
- e) Report and evaluation functions.
- f) Functions to obtain the value of assets and for winding up the business.
- g) Secretarial functions.
- h) Any other functions attributed to them by law.

A) FUNCTIONS OF A PROCEDURAL NATURE

Among the procedural functions that insolvency practitioners have to carry out are the following:

- i) To take action against the partner or partners personally responsible for the debts prior to the declaration of insolvency proceedings.
- ii) To apply, where appropriate, for the seizure of assets and rights of the directors who have held the status within the two years prior to the date of declaring the insolvency proceedings.
- iii) To interrupt actions taken against the debtor prior to the declaration of the insolvency proceedings.
- iv) To apply for the enforcement of the ruling in the event of the Court having condemned the directors.

A) FUNCTIONS OF A PROCEDURAL NATURE

- v) To apply, if appropriate, to raise and cancel seizures imposed when their maintenance severely hinders continuity of the professional or corporate activity of the insolvent debtor (except for administrative seizures).
- vi) To substitute the debtor in the on-going judicial procedures.

B) FUNCTIONS INHERENT TO THE DEBTOR

Among the functions performed by insolvency practitioners that would otherwise have been performed by the debtor are:

- i) The acts of disposal that are considered indispensable to secure the treasury needs required by the insolvency proceedings.
- ii) To undertake the exercise of voting rights to which the debtor is entitled in other companies with prior judicial authorisation.

C) FUNCTIONS IN LABOUR MATTERS

Among the functions attributed to insolvency practitioners in labour matters are the following:

- i) To enforce judicial rulings made on the date of the declaration of insolvency proceedings on material modification of collective labour conditions, collective dismissal, suspension of contracts and the reduction of working hours.
- ii) To extinguish or suspend the contracts held by the insolvent debtor with top management personnel.

D) FUNCTIONS RELATED TO THE RIGHTS OF CREDITORS

Among the functions of the insolvency practitioner related to the rights of the creditors are the following:

- (a) To amend the payment order of the credits when it is convenient to do so under the terms foreseen in Article 84.3 of the Insolvency Act.

This is possible when the claims of salaries for the last thirty days of work prior to insolvency proceedings being declared open have been paid (providing they do not exceed double the minimum inter-professional salary) and when it is assumed that the aggregate assets are sufficient to settle all the claims against the estate. This may not affect claims for tax and Social Security.

D) FUNCTIONS RELATED TO THE RIGHTS OF CREDITORS

(b) To prepare the list of creditors.

(c) To apply to the Court to make payments of ordinary credits in advance when payment of the credits against the aggregate assets and preferential credits are deemed to be sufficiently covered.

E) REPORT AND EVALUATION FUNCTIONS

Among the report and evaluation functions of the insolvency practitioners are the following:

a) To submit the report required by Article 75 of the Insolvency Act to the Court. This report contains an analysis of the data and circumstances of the debtor, the state of the debtor's accounts, a list of the creditors and an inventory of the aggregate assets.

E) REPORT AND EVALUATION FUNCTIONS

b) To propose the appointment of independent experts to the Court.

F) FUNCTIONS TO OBTAIN THE VALUE OF ASSETS AND FOR WINDING-UP

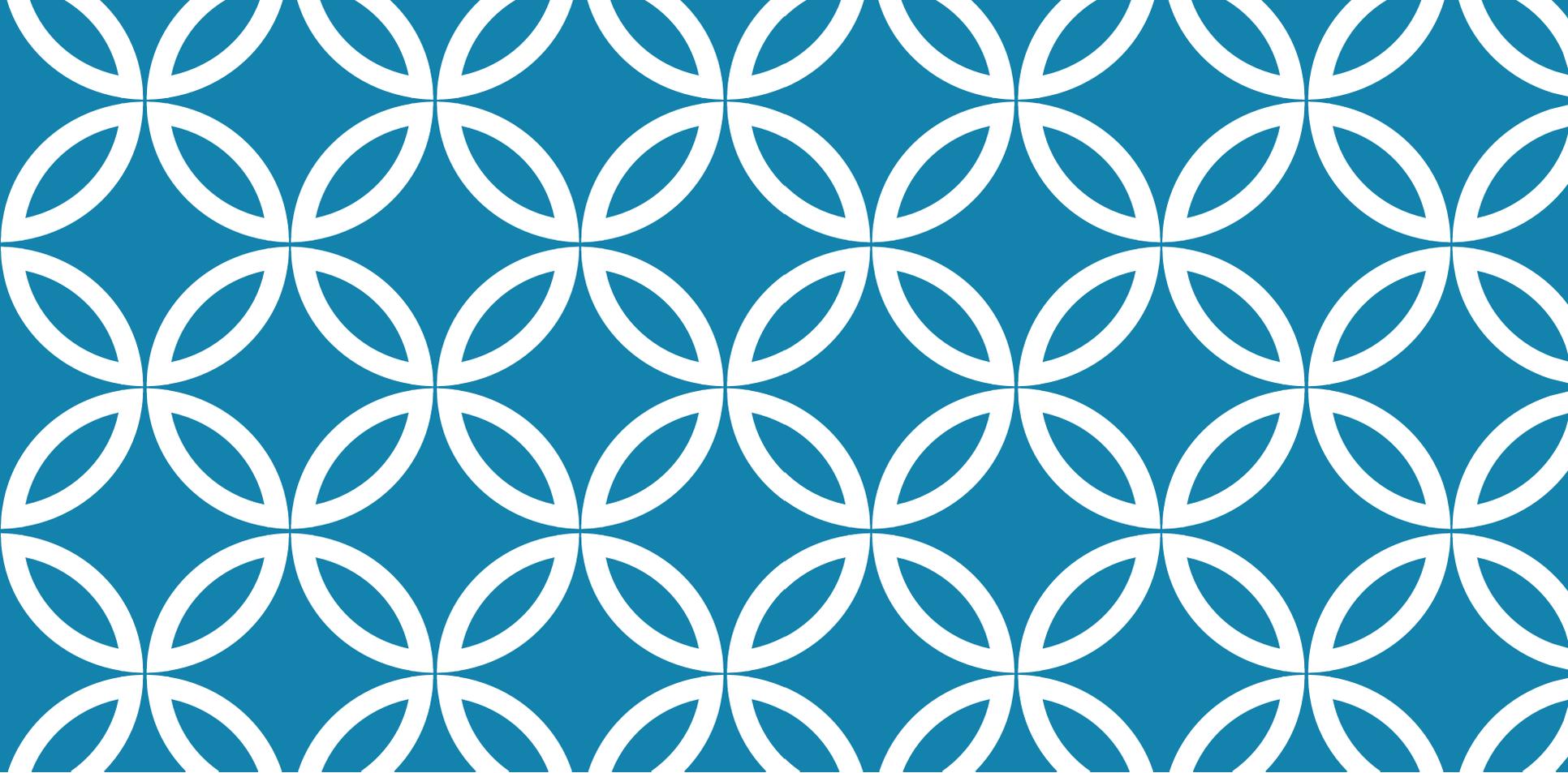
Among the functions related to winding-up the business of the debtor and obtaining the value of assets are:

- a) Replacing the directors or liquidators when the winding up phase is opened.
- b) To apply to the Court for direct sale of assets assigned to credits with special preference.
- c) Submitting a winding-up plan to the Court to dispose of the assets and rights forming the aggregate assets of the insolvency proceedings.

G) SECRETARIAL FUNCTIONS

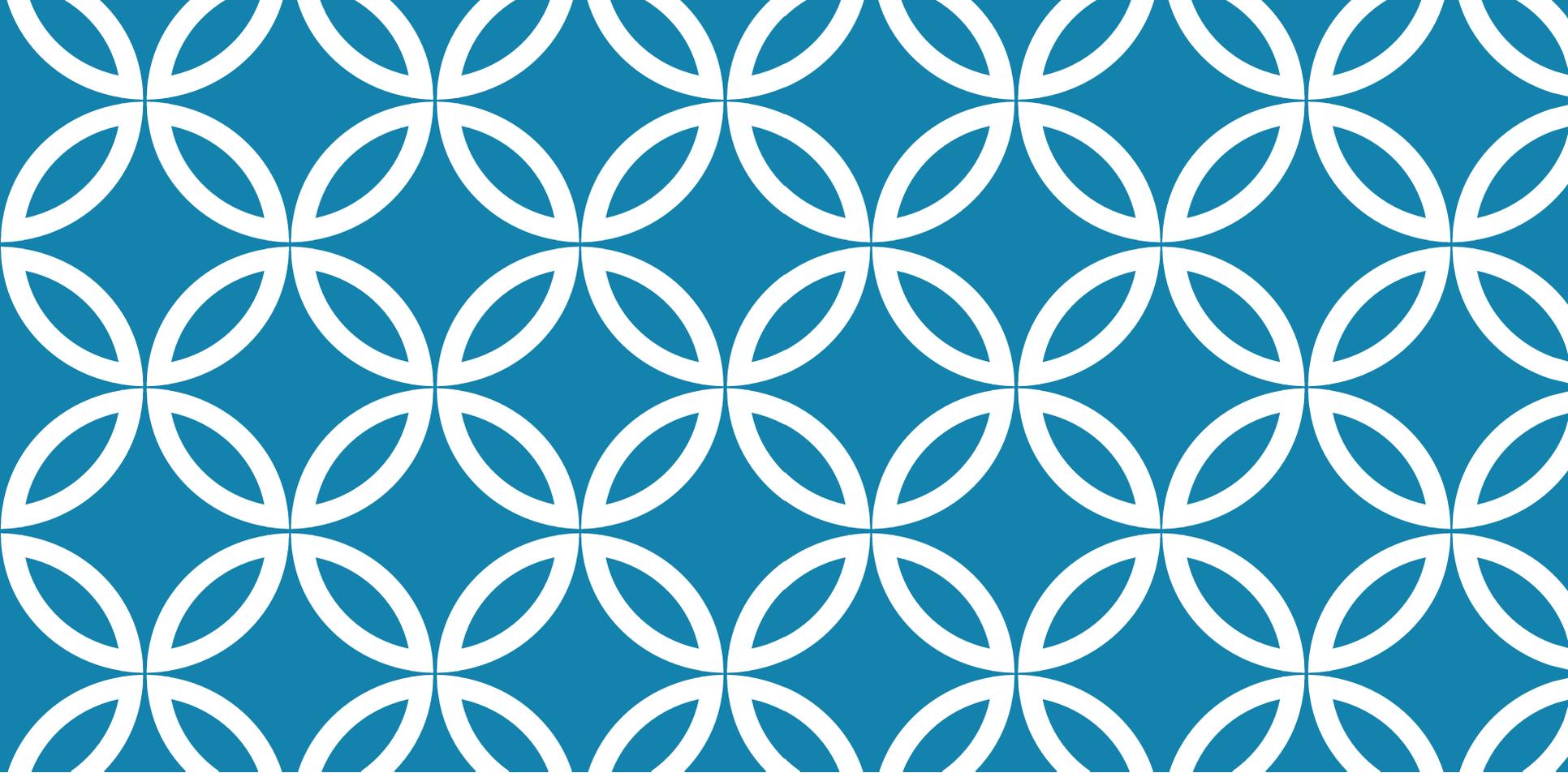
Among the secretarial functions of the insolvency practitioners are the following:

- a) The electronic communication of the state of insolvency to the State Tax Administration Agency and the General Treasury of the Social Security.
- b) Notifying the creditors of the declaration of insolvency proceedings and the obligation to notify their credits as well as receiving their notifications.
- c) Attending the creditors' meeting.



INSOLVENCY PART 2

THE EFFECTS OF THE
OPENING OF
INSOLVENCY
PROCEEDINGS



THE EFFECTS OF INSOLVENCY ON THE DEBTOR

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

The declaration of the opening of insolvency proceedings does not necessarily interrupt the professional or business activity of the debtor according to Article 40.1 of the Insolvency Act.

The article states that:

In the event of voluntary insolvency, the debtor shall conserve the rights of management and disposal of his aggregate assets, the exercise whereof shall be subject to intervention by the insolvency practitioners, via their authorisation or approval.

So in the case of voluntary insolvency, the debtor continues to have the faculties of managing and disposing of his property (although this requires the authorisation of the insolvency practitioner).

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

However, as Article 40.2 states:

In the case of compulsory insolvency, exercise by the debtor of the rights of management and disposal of assets shall be suspended being substituted therein by the insolvency practitioners.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

In this way the legislator wishes to motivate the debtor to comply with his or her obligation to apply for the opening of insolvency proceedings.

These measures are not inflexible, given that Article 40.3 of the Insolvency Act decrees that:

Notwithstanding what is set forth in the preceding paragraphs, the Court may resolve suspension in the event of voluntary insolvency or mere intervention in the case of compulsory insolvency.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

The insolvency practitioner may also petition the Court to change the situation initially established by law. Article 40.4 declares that:

On petition by the insolvency practitioners and having heard the insolvent debtor, the Court may resolve at any time by order to impose a change in the situations of intervention or suspension of rights of the debtor over the aggregate assets.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

If the Court declares that the insolvency is tortious, then the ruling must contain a pronouncement barring the person affected by the classification from administering the assets of others for a period of between two to fifteen years.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

There are some effects of insolvency on the debtor which must be regulated by an organic law, given that they directly affect the Constitutional rights of the debtor.

These effects are contained in LO 8/2003 on the reform of the Insolvency Process.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

Among those rights affected by the insolvency process are:

- (i) The authority of the judge to grant permission for the intervention of the communications of the debtor.
- (ii) The authority of the judge to issue a warrant permitting the domicile of the debtor to be searched.
- (iii) The authority of the judge to issue an order that obliges the debtor to remain in the vicinity of her domicile, or to remain under house arrest.

When the debtor is a legal person these measures can be applied to its directors.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

The Insolvency Act recognises that the debtor is frequently a legal person and not a physical person, and many of its dispositions account for this fact.

It permits the legal person to retain its organs (the general meeting and the directors), without prejudice to the fact that it may decree the suspension of the functions of the directors.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

Article 48 ter of the Insolvency Act also permits the assets of the directors, liquidators or general managers to be seized or frozen (either those who presently occupy this position or those who had occupied the post within the past two years from the opening of the insolvency proceedings).

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

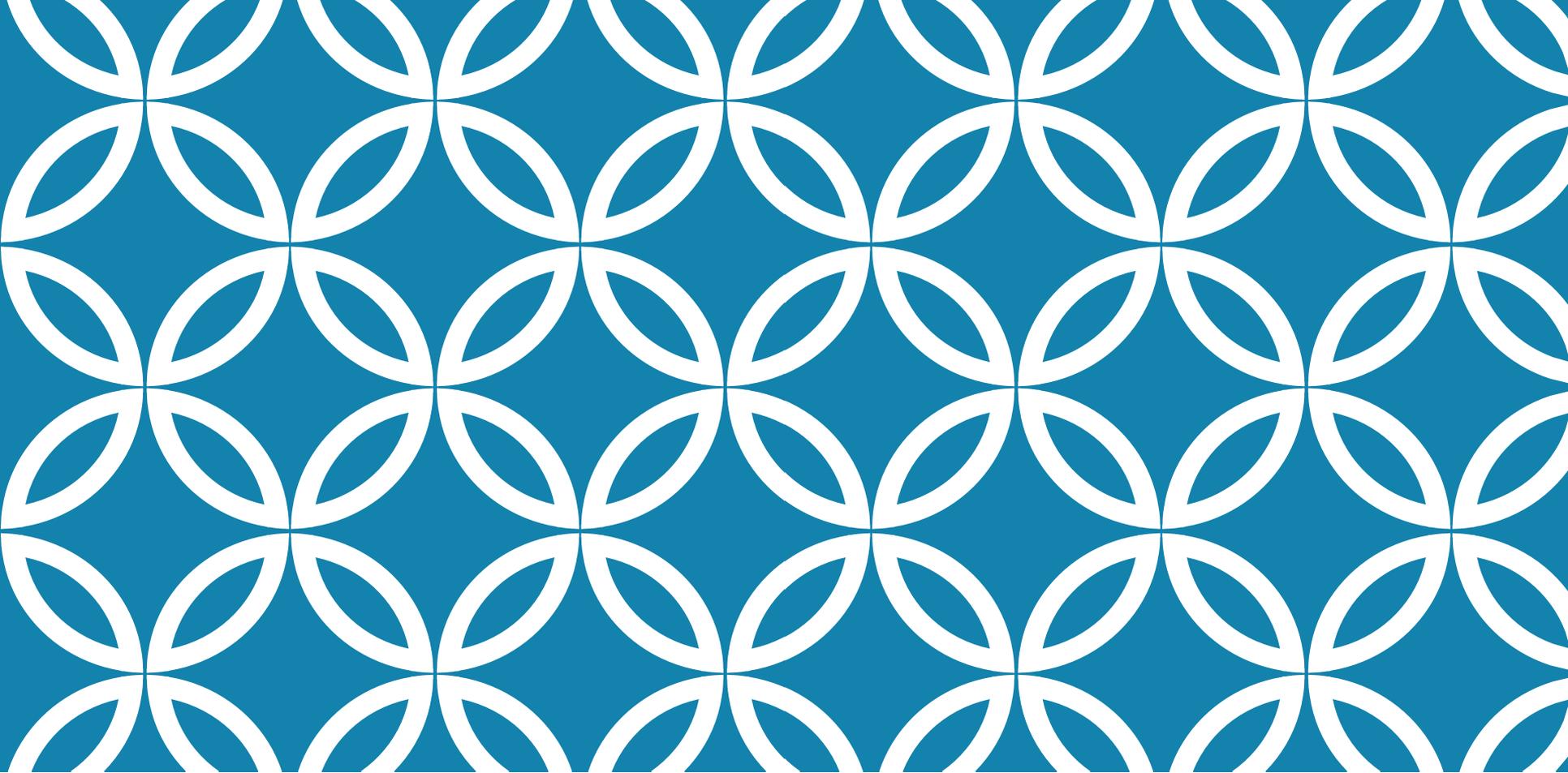
This is possible when, in view of the evidence gathered, there are grounds for believing that there is a possibility that in the insolvency ruling the persons affected by the seizure will be condemned to cover the deficit resulting from liquidation. This is a preventive measure that seeks to guarantee the provisions of Article 172 bis of the Insolvency Act. This article states that the Court shall condemn all or some of the directors, liquidators or general managers to the total or partial coverage of the deficit existing after the sale of the assets of the debtor, to the extent that their conduct has given rise to the tortious classification of the insolvency or has aggravated the insolvency.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

The Insolvency Act (48.1 bis) also authorises the insolvency practitioners to take action against the shareholder or shareholders that are personally liable for debts of the Corporation prior to the declaration of insolvency proceedings, while article 48 quater attributes exclusive competence to the insolvency practitioners to exercise liability actions of the insolvent legal person against its directors, auditors or liquidators.

THE EFFECTS OF INSOLVENCY ON THE DEBTOR

While, as stated earlier, the opening of insolvency proceedings does not automatically result in the dissolution of the Corporation, if during the course of these proceedings the liquidation phase is initiated then it shall automatically entail the dissolution of the company. (Article 361.2 CEA)



THE EFFECTS OF INSOLVENCY IN PUBLIC REGISTRIES

THE EFFECTS OF INSOLVENCY IN PUBLIC REGISTRIES

The declaration of insolvency proceedings may affect a great number of people. It is therefore logical that it is accompanied by adequate publicity. This is not only achieved by the publication of the opening of proceedings in the Official State Bulletin (BOE), but also by the various public registries.

INSCRIPTION IN THE CIVIL REGISTRY

The Law of the Civil Register of 1957, which is still in force today, requires that in the case of physical persons, their insolvency is inscribed in the margin alongside their date of birth in the Civil Registry. This disposition will be superseded once the new Law of the Civil Register comes into force on the 30th of June 2017. This new law requires that the declaration of insolvency proceedings be inscribed in the Civil Registry along with their suspension from exercising the faculties of directing and owning a business (when this has been declared by a judge).

INSCRIPTION IN THE COMMERCIAL REGISTRY

When the debtor of the insolvency proceedings is registered in the Commercial Registry, the Insolvency Act requires that the judicial secretary of the Commercial Court where the proceedings are to be held initiates the inscription in the Commercial Registry of the judicial order that declares the opening of the proceedings.

If the debtor were legally obliged to be inscribed but had not done so, the law requires that the subject first be inscribed so that the insolvency proceedings can also be noted in the Register.

INSCRIPTION IN THE PROPERTY REGISTER

Article 142 of the Mortgage Regulation Act 1947 permits a note to be inscribed alongside the entry of the owner of a property alerting those who consult the registry that the owner is the subject of insolvency proceedings.

INSCRIPTION IN THE PROPERTY REGISTRY

This has effectively been superseded by Article 24.4 of the Insolvency Act which requires that:

If the debtor has property or assets registered on public registers, the declaration opening the insolvency proceedings, the intervention, or when appropriate the suspension of his rights of management and disposal, shall be preventively annotated on the relevant folio for each one, stating the date, as well as the appointment of the insolvency practitioners.

THE EFFECTS OF INSOLVENCY PROCEEDINGS ON THE CREDITORS

As has previously been mentioned, insolvency is a procedure for the collective enforcement of debt titles against the debtor, when the debtor does not have sufficient patrimony to repay all her creditors.

The initiation of insolvency proceedings has a series of general effects on the creditors.

THE PARALYSATION OF INDIVIDUAL ACTIONS

Once insolvency proceedings have been declared open by a judge, the process of collective enforcement has the effect of paralysing any individual claims against the patrimony of the debtor.

a) Article 49.1 of the Insolvency Act determines that once the insolvency proceedings are declared open, all the creditors to the debtor, ordinary or otherwise, shall be integrated, whatever their nationality and domicile.

If the debtor is married under the joint property regime then the creditors of the spouse are included in insolvency proceedings for any credits for which the married couple or their joint assets are liable.

THE PARALYSATION OF INDIVIDUAL ACTIONS

b) Article 50 of the Law on Insolvency orders that the Civil Courts and (where relevant) the Labour Courts must abstain from hearing any petitions against the debtor which should be made to the Insolvency Court. If they were admitted they must be set aside and declared null and void.

THE PARALYSATION OF ENFORCEMENT PROCEEDINGS

c) According to Article 55 of the Insolvency Law, once proceedings are open then singular judicial or extrajudicial enforcements may not be initiated, nor may administrative or tax demands for payments against the debtor's assets be continued.

THE PARALYSATION OF ENFORCEMENT PROCEEDINGS

Creditors that have an in rem security against the insolvent debtor's assets that are required for the continuity of her professional business activity may not foreclose or forcibly execute the security until an agreement is reached whose content does not affect the exercise of that right, or until one year has elapsed without the winding-up having commenced.

THE PARALYSATION OF ENFORCEMENT PROCEEDINGS

The decision as to whether an asset is indispensable or not to the operation of the debtor's business (economic activity) will be taken by the Insolvency Court.

Suspension of the foreclosure procedure can only be raised once there is a ruling by the court that declares that the assets or rights are not necessary for the continuity of the business activity of the debtor.

THE PARALYSATION OF ONGOING PROCEEDINGS

d) Once the insolvency proceedings are declared open and until their conclusion, the procedures initiated prior to the declaration of the insolvency proceedings and in which actions have been exercised to claim corporate obligations against directors or insolvent corporations that have breached the duties imposed in the case of a cause of dissolution, shall be suspended.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

Insolvency proceedings have a direct effect on the debts themselves, derived from the general principle of equality of the creditors (who will collectively suffer the losses incurred by the insufficient patrimony of the debtor).

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

(a) The prohibition of set-off

Article 1196 of the Spanish Civil code allows for one debt to set-off and compensate for another given certain conditions. That is if A owes B 10,000 euros and B owes A 9,000 euros then the result of a compensation of debts is that A owes B 1,000 euros.

However, article 58 of the Insolvency Law prohibits set-off once insolvency proceedings are declared open, unless the requisites for set-off were met prior to the declaration of insolvency.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The conditions for set-off are given in Article 1196 of the Civil Code which determines that for set-off to apply:

- (a) Each obligor is a principal obligor and in turn the principal creditor of the other.
- (b) The debts consist of an amount of money, or in the case of fungible objects, that they are of the same type and quality.
- (c) Both debts are outstanding.
- (d) They are due and payable.
- (e) There is no attachment or dispute over them by third parties that has been duly notified to the debtor/s.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

b) The suspension of the accrual of interest

From the moment of the declaration of the insolvency proceedings legal or contractually agreed interest shall be suspended except:

- (i)** On claims with an in rem security up to the value of the security.
- (ii)** Salary claims that shall accrue legal interest (an amount set every year by law in the State Budget).

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The freeze on interest is necessary in order to determine the extent of the debt of the debtor, which would otherwise keep growing in different proportions at different moments throughout the proceedings and make especially complex the calculations of pro-rata payments to the creditors, and which would unfairly favour those that had charged a higher rate of interest than others.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The freeze on the accrual of interest only affects the debt of the debtor subject to insolvency proceedings, if there were other debtors who responded jointly and severally for the debt in question then the creditor could demand payment of both principal and accrued interest from any of them.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The freeze on the accrual of interest is not necessarily permanent. The Law allows for the reactivation of the interest suspended in two cases.

(i) The insolvency agreement may agree on the total or partial payment of interests calculated according to the terms of the relevant contract or by applying the rate of legal interest, whichever is lower, when the insolvency agreement **does not involve** a reduction of the principal of the credits owed.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

(ii) When the liquidation of the debtor's business has been carried out and a remainder is left after the payment of all the insolvency claims, calculated at the rate stipulated in the relevant contract.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

c) The suspension of withholding rights

Withholding rights refer to the right of a creditor to retain products that she has the contractual obligation to deliver until she receives payments due. Once the insolvency proceedings are declared open, the exercise of withholding rights on assets and rights integrated in the aggregate assets of the debtor will be suspended.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The suspension of withholding rights prevents certain creditors from obtaining payments outside of the insolvency procedure.

The suspension will not affect withholdings imposed by administrative, tax, labour and Social Security Laws.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

d) The interruption of prescription

From the declaration opening the insolvency proceedings until their conclusion the expiry of actions against the debtor for claims prior to the declaration will be interrupted.

In the case that there are several debtors who are jointly and severally liable for a debt, then prescription will only be interrupted for the debtor that is the subject of insolvency proceedings.

Nor does it interrupt the prescription of the action against any guarantors of the debtor.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

However, the declaration of the opening of insolvency proceedings **does** interrupt the prescription of actions against shareholders and against directors, liquidators and auditors of the debtor when that debtor is a legal person (for example the actions for the personal responsibility of the directors).

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER THE DEBTS

The term for expiry shall begin again at the moment of conclusion of the insolvency proceedings. This means that at this point the counter for prescription will be set back to zero and the term will start to compute again.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

A business activity involves a series of bi-lateral contracts for the purchase, supply and sale of goods as well as for the provision of technical assistance, insurance, and all other types of services. The law obviously needs to determine exactly how these bi-lateral contracts are to be treated once insolvency proceedings have been declared open.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

The general principle

a) If one of the bi-lateral parties had completed their obligation but the other side had not, then the debtor's credit or debt shall be included in the aggregate assets or liabilities of the insolvency proceedings.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

The general principle

b) When there are reciprocal obligations pending fulfilment then the mere declaration of insolvency proceedings will not affect the validity of the contracts. The services that the insolvent debtor is due to provide shall be charged to the aggregate assets.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

Exception to the general principle – the extinction of bilateral contracts

However, the insolvency judge can declare the resolution of the contract when he or she deems it in the interests of the insolvency proceedings and only at the request of the insolvency practitioners or the insolvent debtor.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

In this case, the Court Clerk will summon the insolvent debtor, the insolvency practitioner and the other party to the contract to a hearing before the Court, and if an agreement is reached with regard to the rescission and its effects, the Court shall hand down an order declaring the contract rescinded.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

The declaration of the opening of insolvency proceedings does not affect the right to terminate contracts due to the subsequent breach by any of the parties, although clauses that establish the right to rescind or terminate a contract due solely to the declaration of the opening of insolvency proceedings will be deemed to be non-existent.

THE EFFECTS OF INSOLVENCY PROCEEDINGS OVER BILATERAL CONTRACTS

However, the insolvency judge can rule in favour of the fulfilment of the contract even when there exists a cause for termination if she believes it to be in the best interests of the insolvency proceedings.

The services due by the insolvent debtor will be drawn from the aggregate assets.

THE EFFECTS OF THE INSOLVENCY PROCEEDINGS ON LABOUR CONTRACTS

As we have already mentioned, once insolvency proceedings have been opened, the Court has jurisdiction over matters pertaining to the modification, suspension and extinction of work contracts.

THE EFFECTS OF THE INSOLVENCY PROCEEDINGS ON LABOUR CONTRACTS

If collective redundancy or collective contract suspension or reduction of working day proceedings are already being processed at the date of the declaration of insolvency, then the labour Court shall send a written record of these to the Court hearing the insolvency proceedings.

Within three days following the reception of these proceedings the Court shall summon the parties legitimated to state and justify if appropriate the continuation of the processing of these collective measures. The actions performed in the preceding proceedings up to the date of the declaration opening the insolvency proceedings shall remain in force in the proceedings conducted before the Insolvency Court.

THE EFFECT OF INSOLVENCY PROCEEDINGS ON TOP MANAGEMENT STAFF CONTRACTS

During the insolvency proceedings, the insolvency practitioners, at their own initiative or at the debtor's request may extinguish or suspend contracts of the debtor with top management staff.

The decisions taken by the insolvency practitioners in this sense may be challenged before the Court hearing the insolvency proceedings.

THE EFFECT OF INSOLVENCY PROCEEDINGS ON TOP MANAGEMENT STAFF CONTRACTS

- (i) In the event of suspension of the contract, the contract may be extinguished if the executive so wishes, with one month's advance notice, conserving the right to compensation.
- (ii) In the case of extinction of the employment contract the insolvency court may moderate the compensation to which the executive is entitled, in which case the terms agreed in the contract shall be without effect, with the limit of the compensation established in the labour laws for collective dismissal.

THE REHABILITATION OF CONTRACTS

The law contemplates the possibility of reactivating certain contracts that had been extinguished or were about to be extinguished, providing that they comply with certain conditions. The idea behind this faculty is that it enables the business in question to continue in its operations and so pay back more money to the creditors.

THE REHABILITATION OF CONTRACTS

- (i) With respect to **loan contracts** Article 68 states that insolvency practitioners, at their own initiative or at the request of the insolvent debtor, may reinstate loan contracts and others of credit in the debtor's favour whose early maturity due to failure to honour the repayments or pay interest accrued has taken place within three months preceding the declaration opening the insolvency proceedings.

THE REHABILITATION OF CONTRACTS

This is possible as long as

- (a) Prior to conclusion of the term to present lodging of the claims the creditor is served notice of that rehabilitation.
- (b) All sums owed at the moment of the rehabilitation are paid.
- (c) Future payments are undertaken to be covered by the aggregate assets.

It is not possible when

- (a) The creditor opposes it.
- (b) Prior to the opening of insolvency proceedings the creditor has exercised an action to claim payment against the debtor, joint and several co-debtors or any guarantor.

THE REHABILITATION OF CONTRACTS

(ii) With respect to contracts to **acquire assets by instalments**: once again the insolvency practitioners, at their own initiative or at the request of an insolvent debtor, may rehabilitate contracts to acquire moveable or immovable goods whose rescission has occurred in the three months preceding the declaration opening insolvency proceedings (due to non-payment).

THE REHABILITATION OF CONTRACTS

This is possible providing that:

- (i) They inform the other party to the contract.
- (ii) They pay or deposit all the sums owed at the moment of the rehabilitation.
- (iii) They undertake to make future payments from the aggregate assets of the debtor.

THE REHABILITATION OF CONTRACTS

The other party to the contract may oppose the rehabilitation when prior to insolvency proceedings being declared open she had:

- (a) Commenced the exercise of actions to terminate the contract, or to recover the asset conveyed.
- (b) Recovered the material possession of the asset by legitimate means, refunding any payments made.
- (c) Performed acts of disposal to a third party.

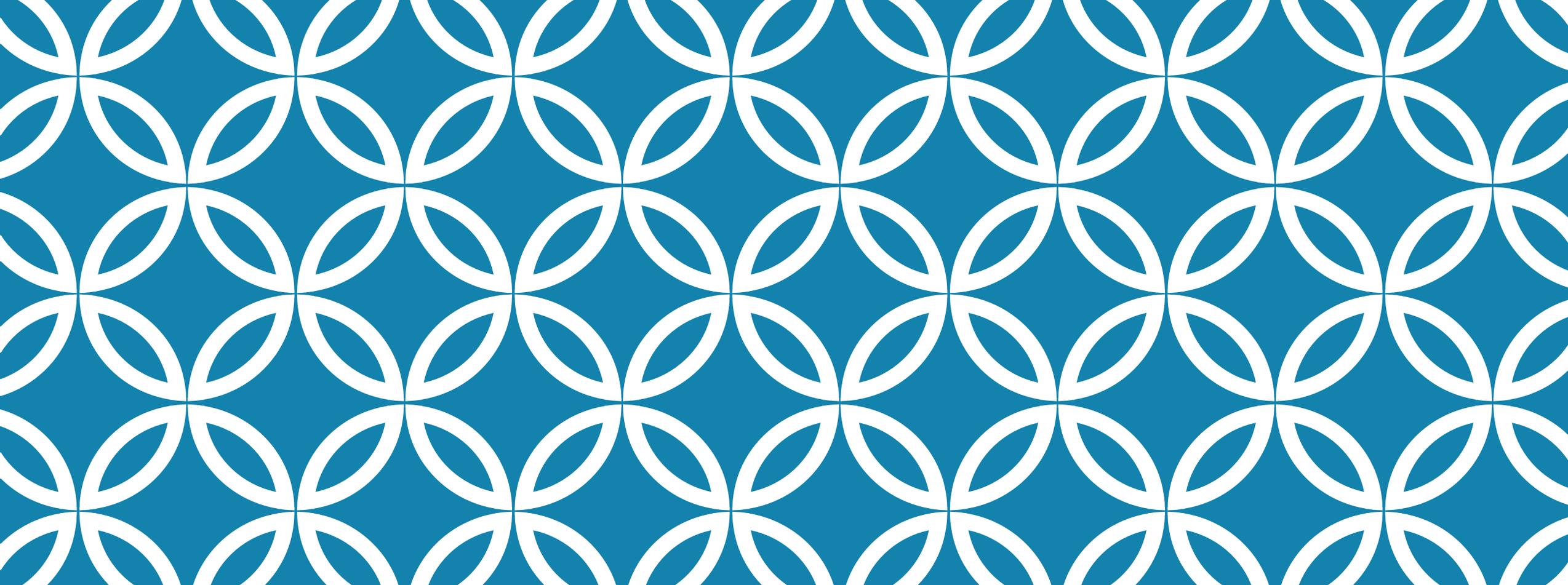
THE REHABILITATION OF CONTRACTS

(iii) With regard to urban leases

The insolvency practitioners may stop eviction actions exercised against the debtor prior to insolvency proceedings being declared open as well as rehabilitating the life of the contract up to the moment of effectively evicting the debtor.

THE REHABILITATION OF CONTRACTS

In this case, all the rents and items pending shall be paid by the aggregate assets, as well as the possible procedural costs arising up to that moment.



**THE DETERMINATION OF THE AGGREGATE
ASSETS AVAILABLE FOR PAYMENT**

THE DETERMINATION OF THE AGGREGATE ASSETS AVAILABLE FOR PAYMENT

Insolvency procedures are designed to pay the creditors, either through the liquidation of assets or through reaching an agreement (known as a composition). For that reason it is extremely important to identify the aggregate assets belonging to the debtor that can be subject to an enforcement procedure.

THE DEFINITION OF THE AGGREGATE ASSETS OF THE DEBTOR

Article 76.1 of the Law on Insolvency provides us with a definition of the aggregate assets of the debtor:

The aggregate assets of the debtor of the insolvency proceedings are the properties, goods and rights forming part of the debtor's estate on the date of declaring the insolvency proceedings open and those reintegrated thereto or acquired until conclusion of the proceedings.

THE DEFINITION OF THE AGGREGATE ASSETS OF THE DEBTOR

Article 76.2 then informs us that:

What is set forth in the preceding paragraph does not include the properties goods and rights that, even if of an economic nature, may not be legally seized.

THE DETERMINATION OF THE AGGREGATE ASSETS OF THE DEBTOR

The first task is therefore to determine exactly what the aggregate assets of the debtor are and to make sure that they are conserved during the process of insolvency.

It is important to remember that the debtor is not necessarily deprived of the faculties of the management and disposal of her patrimony (although as a general rule in the case of compulsory insolvency the exercise by the debtor of the rights of management and disposal of her assets will be suspended and substituted by the insolvency practitioners).

THE DETERMINATION OF THE AGGREGATE ASSETS OF THE DEBTOR

However, we have seen that the judge in the insolvency case can order the preservation measures that he or she considers necessary to assure the integrity, conservation or management of the debtor's aggregate assets, up until the time that the insolvency practitioners accept their office.

THE GENERAL PRINCIPLE REGARDING THE CONSERVATION AND MANAGEMENT OF THE AGGREGATE ASSETS

Article 43 (points 1 and 2) establishes the general principle concerning the conservation and the management of the aggregate assets:

When performing the duties of management and disposal of the aggregate assets, their conservation shall be looked after in the most convenient way to the interests of the insolvency proceedings. To that end, the insolvency practitioners may petition the court for the assistance they consider necessary.

THE GENERAL PRINCIPLE REGARDING THE CONSERVATION AND MANAGEMENT OF THE AGGREGATE ASSETS

Until judicial approval of the composition is secured or the winding up is commenced, the properties, goods and rights forming the aggregate assets may not be disposed of or encumbered without approval by the court.

THE GENERAL PRINCIPLE REGARDING THE CONSERVATION AND MANAGEMENT OF THE AGGREGATE ASSETS

The exceptions to the ban on disposing of or encumbering the goods and rights that form part of the aggregate assets are listed in Article 43.3 of the Insolvency Act. There are essentially three of them:

(a) Acts of disposal that the insolvency practitioners consider indispensable to secure the feasibility of the business or the cash flow needs required for the continuity of the insolvency proceedings.

THE GENERAL PRINCIPLE REGARDING THE CONSERVATION AND MANAGEMENT OF THE AGGREGATE ASSETS

- (b) Acts of disposal of assets which, although not necessary for the continuity of the activity, materially coincide with the value that they have been given by the inventory.

- (c) Acts of disposal inherent to continuation of the professional or business activity to the insolvent debtor.

THE CONTINUATION OF THE PROFESSIONAL OR BUSINESS ACTIVITY

As we have mentioned before, the declaration of insolvency proceedings does not interrupt the continuation of the professional or business activity performed by the debtor.

The insolvency practitioners may determine the acts or operations inherent to the business or trade of the activity that according to their nature or amount are deemed authorised in general terms.

THE REPORT OF THE INSOLVENCY PRACTITIONERS

In order to determine the aggregate assets of the debtor as well as the aggregate liabilities the insolvency practitioners have to prepare a report within two months of their acceptance of the post.

Remember that normally only one solvency administrator is appointed and only in exceptional cases more are named. This period is very short, especially for more complex cases, and the law does allow for an extension of not more than four additional months when the number of creditors is over two thousand.

THE REPORT OF THE INSOLVENCY PRACTITIONERS

If the insolvency practitioner does not submit the report on time, then:

- (a) He or she loses his or her right to the remuneration established by the Court.
- (b) Must return any sums received to the aggregate assets.
- (c) May incur in the liability mentioned in Article 36 of the Insolvency Act.

THE STRUCTURE OF THE INSOLVENCY REPORT

The insolvency report has to follow a structure pre-determined by law.

Among the points that it must cover are the following:

- a) An analysis of the data and the circumstances of the debtor
- b) The state of the debtor's accounts and financial statements
- c) If the debtor has not submitted the relevant annual accounts for the financial year prior to the declaration opening insolvency proceedings, then the insolvency practitioner has to draw them up using the data he or she can obtain from the debtor's books and documents.
- d) A memorandum of the main decisions and actions taken by the insolvency practitioner.

THE DOCUMENTS THAT MUST BE ATTACHED TO THE INSOLVENCY REPORT

The following documents have to be attached to the insolvency report:

- a) An inventory of the aggregate assets.
- b) A list of creditors.
- c) Any compositions (agreements) proposed.
- d) When appropriate, a winding-up plan.
- e) An evaluation of the business overall and of the production units that form it for the purposes of continuation of the operations and the winding-up of the business.

THE INSOLVENCY REPORT - CONCLUSION

The report shall conclude with a reasoned explanation by the insolvency practitioner of the financial situation of the debtor and all the data and circumstances that may be relevant to the subsequent processing of the insolvency proceedings.

THE INVENTORY

The insolvency practitioners have to draw up an inventory as soon as possible that contains the list and valuation of the properties, goods and rights of the debtor included in the aggregate assets.

(i) In the case of the insolvency of a married person who shares any type of joint property regime with her partner the inventory must include a list and valuation of the private assets and rights of the insolvent debtor as well as those of the marital or common properties, goods and rights.

THE INVENTORY

(ii) The inventory should contain the nature, characteristics, location and the identifying data of the properties, goods and rights listed. It should also note any encumbrances or liens affecting these properties.

(iii) The valuation of the properties goods and rights must be performed according to their market value.

(iv) If the insolvency practitioners consider advice by independent experts necessary to estimate the value of goods and assets or the feasibility of actions they should propose their appointment and the terms of their engagement to the Court. If appointed, these experts will be paid from the remuneration of the insolvency practitioners.

THE ASSETS THAT CONSTITUTE THE AGGREGATE ASSETS - DEFINITION

As we have seen, aggregate assets are the

- 1) Properties
- 2) Goods
- 3) Rights

forming part of the debtor's estate on the date of declaring the insolvency proceedings open.

And

those integrated into the debtor's estate before the conclusion of the proceedings.

ASSETS THAT ARE EXCEPTED FROM THE AGGREGATE ASSETS

- 1) The assets belonging to others that are in the possession of the insolvent debtor and in respect whereof he or she does not have the rights of use, security or retention shall be delivered by the insolvency practitioners to their legitimate owners (at their request).
- 2) The holders of credits with preferences over ships and aircraft may separate those assets from the aggregate insolvency assets by exercising the actions to which they are entitled in their specific legislation through the relevant procedure (and outside of the insolvency process).

THE IMPOSSIBILITY OF SEPARATION

If the assets and rights liable to separation have been disposed of to a third party of good faith by the debtor prior to the insolvency being declared open and these cannot be reclaimed, the right holder may choose between:

- (a) Informing the insolvency practitioners of the relevant claim for the value of the properties goods and rights that the debtor had at her disposal.
- (b) If the third party in question has not yet paid the debtor, then the creditor can request that he or she substitutes the debtor and receives payment in his or her place.

MATRIMONIAL GOODS

In principle, in the case of married persons the aggregate assets shall only include the properties goods and rights which pertain exclusively to the insolvent debtor.

However, as we saw earlier, if the matrimonial regime is any type of joint patrimonial property regime, then the aggregate assets shall also include the joint or common assets these are liable to the obligations of the insolvent debtor.

MATRIMONIAL GOODS

In this case the spouse of the insolvent debtor can petition for the dissolution of the marital partnership or property regime and the court can resolve its liquidation and the division of the assets, this division will be carried out in coordination with what arises from the insolvency composition or liquidation.

MATRIMONIAL GOODS

Once the insolvency proceedings of a person married under the separate matrimonial property regime are declared open, it will be presumed, unless proven otherwise, that the debtor donated to the spouse any consideration (money) to acquire assets, when this consideration came from the patrimony of the debtor subject to the insolvency proceedings.

If the origin of the consideration cannot be proved, then it will be assumed, if there is no evidence to the contrary, that half was donated by the insolvent debtor to the spouse, as long as the acquisition of the assets was performed in the year prior to the declaration of the opening of insolvency proceedings.

These presumptions will not be applied if the spouses are separated judicially or de facto.

JOINT BANK ACCOUNTS

The credit balances of bank accounts in which the insolvent debtor is recorded as a joint holder will be integrated in the aggregate assets, in the absence of evidence to the contrary.

THE DETERMINATION OF THE AGGREGATE LIABILITIES

There is a distinction between:

- a) Aggregate liabilities
- b) Claims against the estate

THE DETERMINATION OF THE AGGREGATE LIABILITIES

Once insolvency proceedings have been declared open, the individual actions of the creditors are frozen and are grouped together in a collective enforcement procedure against the aggregate liabilities of the debtor.

Article 84.1 of the Insolvency Law tells us what constitute the aggregate liabilities.

The aggregate liabilities are formed by claims against the common debtor that, pursuant to the Law on Insolvency, are not considered claims against the estate (Article 84.1 of the Law on Insolvency).

We therefore have to know what constitute claims against the estate, for these are not counted as aggregate liabilities of the debtor. The creditors of the claims against the estate will not be grouped with the other creditor, but rather their claims will be paid when the money is due (when the debt reaches maturity), with the exception of salaries for the last thirty days before insolvency proceedings were opened, as these will be paid out immediately.

CLAIMS AGAINST THE ESTATE

Article 84.2 of the Law on Insolvency lists the claims against the estate, among which are the following:

1. Claims of salaries for the last thirty days of work prior to insolvency proceedings being declared open and in an amount that does not exceed double the minimum inter-professional salary.
2. The judicial costs and expenses caused by the petition for and the declaration of insolvency proceedings. This includes the adoption of any preservation measures, publication of any judicial resolutions required by Law and the attendance and representation of the insolvent debtor and the insolvency practitioners during the proceedings.

CLAIMS AGAINST THE ESTATE

3. The costs of the maintenance of the debtor and of the persons he or she is legally required to provide for.

4. Those generated by the exercise of the professional or business activity of the debtor after the insolvency proceedings are declared open. This includes labour claims such as compensations due in the event of dismissal or extinction of employment contracts, or fines for breaches of obligations in labour health and safety matters.

CLAIMS AGAINST THE ESTATE

5. Services provided by the insolvent debtor under reciprocal contracts and obligations that remain in force after insolvency proceedings are declared open.
6. Those arising from obligations validly contracted by the insolvency practitioners during the proceeding, or with their authorisation or approval.

THE DETERMINATION OF THE AGGREGATE LIABILITIES

In order to determine the quantity of the aggregate liabilities the process detailed in the Law on Insolvency has to be followed.

1) From the day following the publication of the judicial order declaring the opening of insolvency proceedings the creditors of the insolvent debtor have a month in which to lodge their claims with the insolvency practitioners.

THE DETERMINATION OF THE AGGREGATE LIABILITIES

2) The insolvency practitioners have to determine whether to include or exclude from the list of creditors the claims evidenced during the course of the proceedings. This decision has to be made both about those claims that are specifically notified as well as those claims that are discovered in the books and documents of the debtor, or are evidenced for any other reason.

THE DETERMINATION OF THE AGGREGATE LIABILITIES

- 3) Article 86.2 includes a list of claims that are necessarily included in the list.
- a) Claims that have been recognised by arbitral award or judicial ruling.
 - b) Claims contained in documents to which the law grants executive force.
 - c) Claims recognised by administrative certification.
 - d) Claims secured with an in rem security registered on a public registry.
 - e) Claims of employees whose existence and amount are recorded in the books and documents of the debtor or are evidenced during the course of the insolvency proceedings by any other means.

THE PUBLICITY AND THE CHALLENGING OF THE LIST OF CREDITORS

1) The list of creditors has to accompany the report that the insolvency practitioners submit to the Court along with an inventory of the assets of the debtor.

2) At least ten days prior to submission of the report to the Court the insolvency practitioners will send an electronic notification to those creditors who have communicated their claims informing them of the draft inventory and list of creditors (whether or not they are included in the list). The same notice will be published on the Public Insolvency Register.

THE PUBLICITY AND THE CHALLENGING OF THE LIST OF CREDITORS

3) Creditors can apply to the insolvency practitioners up to three days before the report is submitted to the court for any error to be corrected or for the data notified to be completed.

4) Submission of the insolvency practitioners' report and complementary documentation (including the list of creditors admitted) to the Court shall be notified to those who have appeared in the insolvency proceedings and shall be published at the Public Insolvency Register and on the bulletin board of the Court.

THE PUBLICITY AND THE CHALLENGING OF THE LIST OF CREDITORS

5) The parties who have appeared may contest the inventory and list of creditors within ten days of notification.

6) The challenges will be dealt with as an insolvency procedural plea and the Court may accumulate them for joint resolution. The rules for Insolvency Procedural Pleas are contained in Articles 192 – 196 of the Law on Insolvency.

THE CLASSIFICATION OF CREDITORS' CLAIMS

Article 157.1 of the Law on Insolvency states that:

Payment of the ordinary claims shall be performed against the aggregate assets that remain once the claims against the estate and the preferential claims have been paid.

Article 89 states that: the claims included on the list of creditors shall be classified for the purposes of the insolvency proceedings as preferential, ordinary and subordinated. Preferential claims in turn shall be classified as claims with special preference, if they are secured in certain properties, goods or rights, and general preference claims, if they affect all the assets of the debtor.

THE RANKING OF CLAIMS

From these articles we can draw up a basic hierarchy of claims:

- 1) Claims against the estate
- 2) Preferential claims - i) Special Preference ii) General Preference
- 3) Ordinary claims
- 4) Subordinated claims

CREDITORS WITH SPECIAL OR GENERAL PREFERENCE

Article 94.2 contains a list of those creditors that have general or special preference, and it divides them into different classes.

1. Creditors under Labour Law
2. Creditors under Public Law
3. Financial credits (holders of financial credits such as loans)
4. The rest of the creditors, including those in commercial operations not included in the preceding three categories.

CLAIMS WITH SPECIAL PREFERENCE

As we have seen, after the claims against the estate, the next credits in the hierarchy of payment are the claims with special preference.

Article 90 provides a list of the claims with special preference that includes:

1. Claims secured with a mortgage either on moveable or immovable assets.
2. Claims secured with an antichresis on the yield of the immovable assets encumbered. Antichresis is described in Articles 1881 ff of the Civil Code and is a contract by which a creditor acquires the right to the fruits of an immovable object belonging to a debtor and these fruits are used to pay back both the principal and interest of a credit extended.

CLAIMS WITH SPECIAL PREFERENCE

3. The credits derived from investment in or the repair of objects belonging to the debtor.
4. Claims for financial leases or the purchase by instalment contracts of moveable or immovable assets in favour of the lessors or sellers or (where appropriate) the financiers on those assets leased with reservation of ownership, with prohibition of disposal or with a termination condition in the event of failure to pay.
5. Claims guaranteed with securities represented by account entries on the encumbered securities.
6. Claims guaranteed with a pledge constituted in a public document on the pledged goods or rights that are in the possession of the creditor or a third party.

CLAIMS WITH SPECIAL PREFERENCE

According to Article 155.1 payments of claims with special preference shall be performed against the assets and rights vested, whether subject to separate or to collective foreclosure. This means that these creditors are not affected by the insolvency procedure to the same degree as the other creditors.

However, if no insolvency agreement is reached that does not affect these rights, or a year passes from the moment that the insolvency proceedings were opened without the process of liquidation being initiated, then the insolvency administrators can avoid the execution of these guarantees by their title holders by requiring them to receive payment from the aggregate assets.

CLAIMS WITH SPECIAL PREFERENCE

Article 155.2 states that:

The insolvency practitioners may serve notice on the holders of these claims with special preference that such payment shall be settled from the aggregate assets and without foreclosing on the properties, goods and rights secured. Once that option has been notified, the insolvency practitioners shall without delay settle all the repayment of principal and interest payments that have matured and shall undertake the obligation to honour the following ones as claims against the aggregate assets and in the amount that does not exceed the value of the security.

CLAIMS WITH SPECIAL PREFERENCE

This releases the assets in question from the process of foreclosure and allows them to be sold by the insolvency administrators, perhaps at a higher price than would be possible by auction.

It also means that these debtors have the possibility of obtaining payment sooner than they might have otherwise received it if they had had to wait for the process of execution on the rights or property to be realized (and the assets sold at auction).

CLAIMS WITH GENERAL PREFERENCE

Article 91 details the claims that have a general preference:

These include:

- 1) Claims for salaries that are not recognised as having a special preference. The limit placed on this is the amount obtained by multiplying by three the minimum inter-professional salary by the number of days of salary pending payment.
- 2) Compensations arising from the extinction of contracts up to the amount corresponding to the minimum legal compensation that does not exceed three times the minimum inter-professional salary.

CLAIMS WITH GENERAL PREFERENCE

- 3) Compensations arising from an industrial accident or diseases accrued prior to the insolvency being declared open.
- 4) Tax and Social Security owed by the Insolvent debtor in fulfilment of a legal obligation.
- 5) Claims for tortious civil liability and claims for tortious liability due to a criminal offence.

ORDINARY CLAIMS

According to Article 89.3, ordinary claims are those that are not classified as preferential or subordinated. The consequence of the claim being classified as an ordinary claim is that the creditors receive payment from the aggregate assets that remain once the claims against the estate and the preferential claims have been paid.

SUBORDINATED CLAIMS

Article 92 of the Law on Insolvency lists the subordinated claims. The order is important as it determines the hierarchy of payment.

Among the subordinated claims are:

- 1) Claims that, having been lodged late are included in the list of creditors by the insolvency practitioners or, that not having been duly lodged, or having been lodged late, are included on that list by subsequent notifications, or by the Court when resolving the motion to challenge it.
- 2) Claims or fines and other monetary penalties
- 3) Claims held by any of the persons especially related to the debtor, referred to in Article 93 (with certain exceptions).

THE PERSONS SPECIALLY RELATED TO THE INSOLVENT DEBTOR – PHYSICAL PERSON

Following on from the previous article, the law provides a list of those persons that it considers to be persons specially related to the insolvent debtor, depending on whether those persons are legal or natural. Among these are the following:

- 1) The spouse of the insolvent debtor, or a person who has been such during the two years prior to a declaration opening the insolvency proceedings, or individuals who co-habit with him or her in a similar relation of affection, or who have usually co-habited with the individual during the two years prior to the declaration of the opening of the insolvency proceedings.
- 2) The ascendants, descendants, and siblings of the insolvent debtor, or any of their spouses.
- 3) Legal persons controlled by the insolvent debtor.
- 4) Legal persons who form part of the same group of companies as those controlled by the insolvent debtor.

THE PERSONS SPECIALLY RELATED TO THE INSOLVENT DEBTOR LEGAL PERSON

- 1) Partners who have unlimited personal liability for corporate debts and all others who at the moment of the credit right arising are direct or indirect holders of at least 5% of the share capital.
- 2) The directors, *de jure* or *de facto* or the liquidators of the insolvent debtor that is a legal person and the proxies with general powers of the company, as well as those who have acted as such during the two years preceding the declaration of the opening of insolvency proceedings.
- 3) Companies forming part of the same group as the company declared insolvent and its shareholders and partners.

THE SOURCES OF COMMERCIAL LAW

Answer the following questions using the notes I have given you as a guide.

1. How can you account for the discrepancy between the wording of Articles 2 and 50 of the Spanish Code of Commerce?
2. In what two main ways has the fact that the existing Code of Commerce is outdated in many areas been compensated for?
3. In what areas of Commercial Law does the State have exclusive legislative competence? Do the Autonomous Communities have any competences attributed to them?
4. What are the modern day uses of commercial practices in Commercial Law? Must these practices always be proved by the party that wishes to apply them?
5. What are the consequences of a Member State not implementing a European directive?
6. How has the European Court of Justice tried to compensate for the lack of horizontal direct effect of directives that have not been incorporated by a Member State?

PRACTICAL 2 – This practical is based on the notes on the Commercial Registry. Answer the questions that accompany each of the situations described and justify your answers by reference to the law.

1) María is a sole trader who is not inscribed in the Commercial Registry. She is married to Juan in an economic regime that provides for a certain shared patrimony.

- a) Does María have the obligation to inscribe in the Commercial Registry?
- b) What legal presumption operates regarding the shared patrimony of the couple and the personal patrimony of Juan?
- c) What can Juan do in the case that he wishes his part of the shared patrimony of the couple to remain unaffected by María's liabilities?

2) Juan & Marcus Limited Partnership is inscribed in the Commercial Registry. They have signed a contract with the joint trading company Johnson Supplies for the provision of certain materials. According to the Commercial Registry a Ms. Louisa Fuentes is a general manager of Juan & Marcus Limited Partnership and it was her that signed the contract.

- a) Juan & Marcus Limited Partnership claim that Ms. Louisa Fuentes was never appointed manager. Is their claim sufficient to invalidate the contract?
- b) If Ms. Louisa Fuentes **had been** employed as a manager but had subsequently been fired, in what circumstances might this change the answer given to question (a)?
- c) What would be the consequence for Johnson Supplies if Ms. Louisa Fuentes had been only 17 years old at the moment of signing the contract?

3) The registrar has not given its approval for the inscription of the name Jones and Company Limited Partnership in the Commercial Registry.

- a) What steps can Jones and Company take to challenge the decision of the registrar?
- b) If the decision to not inscribe is ultimately upheld, what help can be offered by the Central Commercial Registry?

PRACTICAL 3 – Answer these questions using the law to support your answers.

1. The 5 partners of Mishma Corporation intended to form a limited liability company. However, a year has passed without it having registered in the Commercial Registry even though the company has continued its commercial activity. **What regime of responsibility will be applied to the partners for the debts of the company? Explain how that regime functions.**
2. Ms. Natasha Kinski is one of the 4 founding partners of *Paris-Texas Joint Stock Company*. She proposes that the founders receive a yearly cash payment amounting to 12% of the yearly profits (after the deduction of the legal reserve) over the next 15 years. **Is her proposal possible?**
3. A public share offering is announced for shares in the joint stock company Passolini Pictures. **By what process must this company be formed? Write a short description of the four basic steps involved in the formation of this company.**
4. The Tyrone Corporation is a joint stock company that has been in existence for one year. The corporation has a total capital of 200,000 Euros and legal reserves of 35,000 Euros. This year it has made a profit of 60,000 Euros. **How much of this amount is available for distribution via dividends?**
5. Mr. Herzog purchased a picture from the auction House Sotheby's for 50,000 Euros. Five months later, he wishes to exchange the picture and some land he owns in Denia in return for shares in the joint stock company "Janus Corporation". **What procedure must be followed in order for these exchanges to take place?**
6. Dr. Jane Campion paid 25% of the price of her shares in BOC Corporation but has not settled the outstanding sum. **What are the consequences for her of non-payment with respect to her rights as a shareholder? What happens if she refuses to pay and the shares are not sold?**
7. Dr. Pynchon is a molecular biologist who is a stakeholder in a limited liability company. The stakes acquired contain the obligation to perform ancillary commitments connected to his profession and the economic objective of the Company. **Can Dr. Pynchon transmit the stakes to his friend Doug Stanhope?**

PRACTICAL EXERCISE NUMBER 4

1. EXPLAIN THE LEGAL CONSEQUENCES OF THE FOLLOWING SITUATIONS WITH REFERENCE TO THE LAW.

a. McDonalds' Coffee Shop was ordered by a Commercial Court to change its denomination in a judgement dated 13 months previously. The Court ruled that the coffee shop had violated the McDonalds trademark. What legal consequence should follow automatically and where is this precept contained?

b. Vonnegut Corporation voted in its general meeting to reduce its capital to below the legal minimum established for joint stock companies. A year has passed since that vote and no entry has been recorded in the Commercial Register on company conversion, or dissolution and there has been no subsequent increase in the company capital. What is the legal consequence of this situation?

c. Jennings Corporation has had to reduce its equity to lower than one half of its share capital due to losses. The capital of the corporation is not subsequently increased or decreased and no application for insolvency can be made according to the Law on Insolvency.

2. AMIS CORPORATION (A JOINT STOCK COMPANY) IS GOING TO TAKE THE DECISION TO DISSOLVE. ANSWER THE FOLLOWING QUESTIONS ABOUT THE INSOLVENCY PROCESS USING THE LAW TO SUPPORT YOUR AFFIRMATIONS.

a. Who must convene the general meeting to decide on whether the corporation is dissolved?

b. In the case that there exists a circumstance that constitutes a cause of dissolution within what time-frame must the meeting be called?

c. What is the consequence of the meeting not being called within this time-frame?

d. What is the quorum required in order for the meeting to be held? What is the quorum required for the decision to dissolve the company to be taken?

e. In what circumstances is it possible to reactivate the dissolved corporation?

3. ANSWER THE FOLLOWING QUESTIONS CONCERNING LIQUIDATION.

1. What is meant by the term liquidation?

2. What is the immediate consequence of liquidation for the directors of the corporation?

3. When may partners or shareholders receive their liquidation dividend?

4. The liquidators must formalize the termination of the corporation by way of a public instrument. What declarations must this instrument contain?

5. What liabilities may the liquidators incur?

Combined practical exercises - 5 and 6.

Answer the following questions using the law to support your answers.

Practical 5

1. A creditor of Slothrope joint stock company petitions the Commercial Court of Alzira for the opening of insolvency proceedings on the basis that they have not paid their employees their wages for the last seven months.

(i) Can Slothrope joint stock company oppose the opening of proceedings? (ii) On what grounds? (iii) What procedure will be followed for the opposition? (iv) If finally the judge orders insolvency proceedings to be opened, then what must the order declaring their opening contain?

2. Slaven joint stock company wish to reach an out of court payment agreement with their creditors.

(i) What conditions must be met in order for them to be able to opt for such an agreement? (ii) How is the insolvency mediator who will help negotiate the agreement appointed? (iii) What must the petition for the out of court payment agreement contain? (iv) To whom must the insolvency mediator communicate the opening of negotiations? (v) How does the opening of negotiations affect creditors in litigation with the debtor? (vi) What measures may the proposal for a payment agreement contain? (vii) What majorities are required for the out of court payment agreement to be accepted? (viii) Who may challenge the agreement and on what grounds?

Practical 6

3. Scarlett Hibernian joint stock company has had voluntary insolvency proceedings opened against it by the Commercial Court of Alzira.

(i) What immediate effect does the opening of insolvency proceedings have on the directors of the company if it is still operational? (ii) In what circumstances might the personal patrimony of the directors be affected? (iii) What effect does the opening of insolvency proceedings have on the creditors of Scarlett Hibernian? (iv) How does the opening of insolvency proceedings affect the debts of the company (set-off, accrual of interest, withholding rights, prescription? (v) What effect does the opening of insolvency proceedings have on any bi-lateral contracts?

4. Slaine joint stock company (a producer of chocolate biscuits) has reached the winding-up phase of the insolvency proceedings.

(i) What effects does the opening of the winding-up phase have over the creditors of Slaine joint stock company? (ii) Under what prohibitions are the insolvency practitioners placed regarding the assets of Slaine joint stock company? (iii) What special rules apply if another joint stock company wishes to acquire the production units of Slaine joint stock company?