Quorum, unanimity and arbitration at board level

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Joint venture agreements usually pose problems regarding how to reflect at board level the shareholdings structure. The question is to balance, on the one hand, the interest of the parties so that their respective holdings have an influence on the main decisions and, on the other, to avoid making the decision process too difficult. Within this context, it is key to know how far the by-laws of the joint venture company may go in matters such as the quorum, the voting majorities and the resolution of deadlocks.

A resolution of the Spanish administrative body competent to decide on the appeals brought against the commercial registrars' decisions ("DGRN") rendered last year recognized the validity of a statutory provision of a private limited liability company ("SL") requiring that all board members attend board meetings for them to be validly held.

The commercial registrar had rejected the provision on the grounds that such quorum was against the very nature of corporate bodies, which are deemed to decide by majority. The registrar claimed that this particular provision amounted to unanimity.

The decision of the registrar was appealed and the DGRN overruled it, declaring the contested provision to be in accordance with Spanish law.

Several arguments were used to support the decision, but most significantly it is worth noting what was said about unanimity within corporate bodies.

The DGRN recognizes that the majority principle plays an essential role within companies, but not always with the same degree of intensity. Its strength – it adds- depends on the type of body (management body v. shareholders meeting), type of quorum (attendance v. voting) and type of legal entity one is looking at.

As regards shareholders' decisions, the majority principle is, no doubt, the applicable one. However, as far as the management of the company is concerned, the reach of this principle changes. A clear evidence of this is that, according to the DGRN, the Spanish Act itself contemplates the existence of joint directors, which is a type of management that requires unanimous action. This proves that *unanimity in the running of the entity is not something strange to companies' essence,* but something which can be justified f*or the best protection of corporate interest.*

The DGRN considers that the requirement that all board members be present at the meeting does not contradict the essence of collegial bodies, as it only aims at *the best collaboration and implication of all its members*. The problem would be if decisions were to be taken by unanimity, something which the DGRN implicitly rejects as incompatible with the collegial nature of a board of directors.

The resolution goes further and analyses whether the clause at hand introduced a *de facto* veto in favor of each of the directors (which could be exercised by simply not attending a meeting). The DGRN accepts that this possibility exists, but points out that it would have serious consequences. *Directors have the right but also the obligation to attend board meetings (…). Thus, an unjustified absence to a meeting may constitute a gross violation of directors' duties (…) capable of giving rise to the corresponding liability* vis-à-vis the shareholders and third parties.

We should add that the use of this veto power could lead to an even more serious consequence, should the decision making process be blocked altogether, i.e. the liquidation of the company.

There are different ways to resolve deadlocks at board level, but none seems to be final. Arbitration would provide finality, but it is far from clear that an arbitrator can take decisions on behalf of a deadlocked board.

The Spanish Arbitration Act allows to submit corporate disputes to institutional arbitration. The key point is to determine what a corporate dispute is and, in particular, when a board deadlock qualifies as an arbitrable conflict.

The DGRN had rejected in the past a statutory provision whereby, in case of a tied vote at the board, the decision was to be referred to arbitration. If directors were not able to reach an agreement and therefore, the corporate life was paralyzed, the only solution was the liquidation of the company.

However, some months ago the DGRN had the opportunity to consider again this matter. The commercial registrar had rejected a statutory provision referring directors' disputes to arbitration on the basis that directors do not exercise their own rights or interests but those of the company.

The DGRN overruled the decision accepting the validity of the provision in general, but ruled that the question of which board deadlocks can be submitted to arbitration has to be decided on a case by case basis by the arbitration tribunal. No test or criterion was laid down by the DGRN, safe to exclude *ad exemplum* the criminal liability of directors (something which was already clear, as criminal matters are excluded from arbitration).

In conclusion, it is possible to refer board issues to arbitration, but one has to bear in mind the possibility that the arbitration court dismisses the case on the grounds that the matter is not really a dispute than can be adjudicated, but a pure deadlock.

In those situations, however, recourse to the binding decision of a third independent party should be possible, in our view. The decision would still be capable to be challenged before a court or arbitration panel, but would provide a solution to the deadlock and avoid having to liquidate the company.

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