THE INCORPORATION OF CORPORATE GOVERNANCE RECOMMENDATIONS IN MANDATORY LAW: THE CASE OF SPAIN

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Abstract

Traditionally the Spanish Corporate and Securities Law did not devote much attention to corporate governance issues. This situation started to change after the publication of different corporate governance codes since the year 1997. Although the recommendations of these codes did not have mandatory character, some of them have been incorporated in the mandatory law by the legislator through different instruments. The main objective of this paper is to examine these mechanisms and the purpose of the legislator with each one. The analysis shows that in Spain, the corporate governance recommendations have had a very important role in the creation of corporate governance mandatory rules.

Keywords: Corporate Governance, Corporate Governance Codes, Company Law, Mandatory Rules, Fiduciary Duties, Independent Directors

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1. Introduction

The creation of corporate governance law implies the interaction of very different types of instruments such as statutes, regulations, case law, contractual agreements or codes of conduct to give some examples.

Whereas in some legal systems such as those of the US and the UK, the statutes and the case law have had a primary role in the development of corporate governance rules, in others such as the Spanish the process has been different.[40] Traditionally, the Spanish statutory law, through the Commercial Code[41], the Companies Act[42] and the Stock Markets Act[43] developed the company and securities law paying poor attention to corporate governance issues.[44] The case law has neither been a source of development of corporate governance rules for different reasons.[45] The first attempt to construct a coherent corporate governance framework started in March 1997 when the Spanish Government entrusted a special Commission, The Olivencia Commission[46], to develop an *Ethical Code of Good Governance*.[47] The Olivencia Commission published a report in 1998[48] in which adopted many of the principles of the Anglo-Saxon tradition of corporate governance, emphasizing the responsibility of the directors in relation to the shareholders and adopting a self-regulatory approach assuming that those firms that adopted the recommendations would be rewarded by the market.[49] On 19 June 2002, the Spanish Government entrusted another commission, the Aldama Commission[50] with the task of developing guidelines that should apply to companies which issue securities and instruments admitted to listing on organized markets, as well as the revision of the application of the principles of the Olivencia Code.[51]

[40] It must be specially remarked the low weight of case law in the creation of corporate governance rules in the civil law jurisdictions as well as its later development if compared to the UK and the US. This situation is analyzed by Fleischer (2006) in relation to the development of the concept of fiduciary duties.

[41] Royal Decree of 22nd of August 1885.

[42] Royal Legislative Decree 1568/1989 of 22nd of December.

[43] 24/1988 Act of 28th of July.

[44] For example the real development of the fiduciary duties in the Companies Act can be traced to the year 2003.

[45] For an explanation of some of the reasons see infra, footnote n 30.

[46] The name of the Commission was 'Special Commission to Consider a Code of Ethics for Companies' Boards of Directors'; it was mainly composed by experts in the field of company law and chaired by Mr. Manuel Olivencia Ruíz.

[47] Prior to this date there were other attempts to develop corporate governance rules but not with the same scope and influence as after 1997. One example of these attempts would be the Code developed by the Circulo de Empresarios (a Spanish lobby group) to improve the functioning of the boards of directors.

[48] 'Code of Good Governance', or 'Olivencia Code.'(Available at: http://www.ecgi.org/codes/documents/codigo_eng.pdf).

[49] See epigraph III.3 of the Olivencia Code.

[50] 'Special Commission to Foster Transparency and Security in the markets and in listed companies.' This Commission was also composed by experts and was chaired by Mr. Enrique de Aldama y Miñón.

[51] It must also be considered that in the period between the two commissions, the financial world suffered the consequences of financial scandals such as Enron and

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This Commission published a report[52] in January 2003 with a deeper analysis of the issues previously discussed by the Olivencia Code; in addition to this, the Aldama Commission not only recommended the use of voluntary self-regulation by the firms to implement the recommendations but also some legislative changes, for example in the field of director's fiduciary duties. In response to the Aldama Commission, in 2003 the Transparency Act[53] introduced in the statutory law some of the recommendations of the Aldama Code.[54] More recently, in 2005 the Government set up a working group[55] to advise the Spanish Securities Commission (CNMV) on the harmonization and update of the recommendations of both Olivencia and Aldama Codes. The result was the 2006 Unified Code[56] which combined the recommendations of both codes, introduced some new[57] and omitted those recommendations which were already incorporated in the statutory law.

It can be thus said that the corporate governance reform action in Spain was leaded by non mandatory instruments.[58] Although the recommendations established by this reports, which took the form of corporate governance codes[59], did not have mandatory character, the legislator made some of them becoming mandatory through different mechanisms.[60] In this paper three of them are addressed: The first one is the incorporation of the recommendations in the statutory law; the second the delegation from the legislator to the firms to develop the content of a code's recommendation in their bylaws; the third consist of the introduction of the *comply or explain* principle, by which firms must comply with the recommendations of the code's or explain why not. Each of these mechanisms will be analyzed by using the examples of three recommendations established by the corporate governance codes on the fields of director's fiduciary duties, shareholder's electronic voting and director's independence respectively. The final purpose is to explain how corporate governance's non mandatory recommendations may have a significant impact in the creation and development of Corporate Governance Law.

2. The incorporation of corporate governance codes recommendations in mandatory law: the case of the fiduciary duties

The first way by which the code's recommendations may create mandatory law is by their incorporation by the legislator in the statutory law as mandatory rules. In this sense, the codes recommendations may be adopted, not only by the firms but also by the legislator who may enact mandatory rules following the recommendations of the codes. The legislator may make this choice in relation to those areas in which there is not a previous statutory regulation or where that regulation is incomplete or inefficient and, at the same time, her aim is to ensure a general application of those rules amongst the companies.

This is the case of the regulation of director's fiduciary duties in Spain; until the year 2003 the regulation and content of the fiduciary duties of the directors was very general and incomplete. The main rule was contained in article 127 of the Companies Act and merely nominated the duty of care, loyalty and secrecy without developing the meaning of each one;[61] this rule was not developed neither by the

Parmalat that forced governments and firms to reconsider their regulatory strategies in the field of corporate governance. An analysis of some national-level reforms after these scandals is provided by Mc.Cahery and Vermeulen (2005) in Hopt, Wymeersch, Kanda and Baum, (Eds.), (2005).

[52] The 'Aldama Code' or 'Report of Special Commission to Foster Transparency and Security in the markets and in listed companies.' (Available at: http://www.ecgi.org/codes/documents/informefinal_e.pdf).

[53] 26/2003 Act of 17th of July.

[54] For example the development of director's fiduciary duties in the Companies Act (see infra, footnotes number 27 and 28).

[55] 'Special Working Group' chaired by Mr. Manuel Conthe.

[56] 'Unified Code' or 'Report of the special working group on the good governance of listed companies.' (Available at: http://www.cnmv.es/index.htm).

[57] For example, the Unified Code introduced some of the recommendations suggested by European bodies, such as the 'Recommendation of 14 December 2004 (2004/913/EC) on the remuneration of directors of listed companies' (Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF) or the 'Proposal for a Directive on the exercise of voting rights by listed company shareholders (COM (2005) 685 final), approved by the Commission on 5 January 2006.'(Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0685:FIN:EN:PDF).

[58] For the purposes of this paper it is important to distinguish between mandatory rules and instruments. Mandatory instruments are those with the intrinsic capacity of imposing obligations binding the parties. An example of these instruments would be the statutory law or the case law in common law countries. Mandatory rules are those who had the effect of creating obligations for the regulated; this would be the case of a direct regulation of the legislator. It may happen that a mandatory instrument sets rules which are not mandatory, for example when the legislator delegates the voluntary regulation of a specific issue to the regulated. Examples of these situations are provided in this paper. Buxbaum (2002) tries to explain the concept of mandatory rules in relation to the corporation laws of the United States.

[59] The role of corporate governance codes in the development of corporate governance is analyzed by Wymeersch (2005).

[60] This paper only addresses the change from non mandatory to mandatory due to legislative activity. Other ways such as the judicial activity or pure self-regulation by the firms are out of the scope of the paper.

[61] Article 127 of the Spanish Companies Act states that: '1. The directors will act with the diligence of a responsible businessmen and as a loyal representative. 2. They must

doctrine, nor by the courts nor by complementary regulations, with the consequence that there was little application of these duties in the corporate practice.[62] In 1998 the Olivencia Code clearly recognized this situation and attempted for the first time to define what the meaning of these duties was;[63] in doing so it established some general recommendations is areas such as conflicts of interest, secret information and use of company's assets and business opportunities.[64] This was later complemented by the Aldama Code which devoted more efforts to complete the fiduciary duties, especially by making a deeper definition of director's duties and by extending the range of parties bounded by the duties of loyalty[65]. Many of the recommendations on fiduciary duties of these two codes acquired mandatory character in 2003 with the passing of the Transparency Act, which amended and introduced new articles in the Companies Act developing the duty of care[66] and especially the duty of loyalty[67] in a combination of the recommendations of both codes, specially those of the Aldama Code.

The change from non mandatory to mandatory happened, firstly through the legal instrument used to implement the recommendations of the codes which was the Companies Act, a mandatory legal instrument; secondly, through the mandatory character of the precepts developing the fiduciary duties which, in no case, gave any discretion to the firms or any other constituency, to opt out of the principles of the Companies Act. By this dual mechanism the legislator gave the recommendations of the Olivencia and Aldama Codes mandatory character.

So, why would the legislator incorporate the non mandatory recommendations of the Olivencia and Aldama Codes on fiduciary duties as part of the mandatory statutory law?

keep secret all the confidential information, even after leaving the directorship.'

[62] As the Aldama report refers: 'It is true that the legal coverage provided by this generic loyalty clause could have been sufficient for the doctrine and case law to develop abundant criteria and clear rules of guidance in this area down through the year. However, in practice very little has been achieved in this direction.' (Recommendation III.2.2)

[63] Epigraph II.8.1 of the Olivencia Code: 'The highly abstract and generic nature of this precept –in reference to former article 127- makes it advisable, in our opinion, for the company's internal rules of operation to detail the main duties arising out of the general obligations of diligence and loyalty so as to encourage directors to take cognizance of the commitments they are assuming when taking office and to facilitate the evaluation of their performance.'

[64] See epigraph 8 of the Olivencia Code.

[65] Such as individuals who represent directors who are legal persons or 'hidden' directors, whose instructions are implemented by the company's directors (see recommendation 2.3 of the Aldama Code).

[66] Article 127 of the Companies Act.

[67] Articles 127.bis, 127.ter, 127.quater of the Companies Act.

The first question it should be formulated is why the legislator used the recommendations of the codes as a model for the legislative reform. The answer lies in the lack of references which the Spanish Corporate Law tradition offered in relation to the concept of fiduciary duties of directors. In other legal systems such as those of the UK and the US these duties have been widely developed specially by case law[68], which established mandatory rules binding directors to act accordingly to the principles of care and loyalty. In Spain these duties were not developed neither by statutory law, case law nor by the firms themselves, thus, did their content remain incomplete.[69]Alike in common law countries, the first development of the duties in Spain was not done by mandatory rules but by the Olivencia and Aldama Codes, which had not mandatory character. Due to the importance of these principles for achieving a good corporate governance system,[70] the legislator may had found useful and appropriate to follow the recommendations of the codes, which, so far, were the only on the issue of fiduciary duties in the Spanish legal system.

The second question is why the legislator incorporated the recommendations in the mandatory statutory law. One may suggest that the development of the duties should have been let to the self regulation by the firms. This option was suggested by the Olivencia Code.[71]

[68] For example, the duty of loyalty was developed early in UK by cases such as 'Aberdeen Ry v Blaikie (1854) 1 Macq HL 461' (in relation to transactions with the company) or 'Regal (Hastings) Ltd v Gulliver [1942] All ER 378' (in relation to corporate opportunity). In the US, 'Meinhard v. Salmon 249 N.Y. 456, 464 (1928)' is another example of an early definition of the duty of loyalty (in this case between partners).

[69] McKean (2003) tries to explain the lack of development of director's obligations established in statutory law the by using different arguments: 'First, judges may have been wary of taking an activist role in interpretation of the law in the face of potentially harsh reactions of controlling shareholders or other constituencies. Second, there have been relatively few shareholder suits, perhaps due in part to the lack of dispersed ownership of Spanish corporations in the past. More significantly, however, Spanish law has set up various impediments which have prevented minority shareholders from bringing derivative suits against directors.'

[70] It must be remarked that this concept has been essential for the development of many Corporate Law systems, specially in common law countries; as stated by Pistor and Xu (2002:2): 'In Anglo-American law, fiduciary duty is the core legal concept to address conflicts among directors/managers and shareholders.'

[71] Epigraph 12.1 of the Olivencia Code states: 'The reflections and recommendations contained in this Report are basically for guidance purposes. The Commission considers that they should not be included in legislative regulation nor imposed upon the parties to which they are addressed, not even indirectly through systems controlling their adoption which might distort the voluntary nature of the Code of Good Governance. In our opinion, companies' freedom and autonomy must be fully guaranteed, since our

TABLE I		
LISTED FIRMS WITH INTERNAL RULES ON DIRECTORS' FIDUCIARY DUTIES		
Response	Year	
	1999	2001
Yes	90%	80%
Partially	7%	7%
No	2%	14%
Not available	2%	0%

Source: CNMV (1999: table 12; 2001: table 12)

However, years later this possibility was not recommended anymore by the Aldama Code which considered that self regulation by the firms would be not appropriate when dealing with certain situations related to conflicts of interest.[72] Indeed, the surveys conducted after the approval of the Olivencia Code showed that not all the listed firms followed the recommendations, by establishing the duties of care and loyalty as part of their internal rules, as showed in Table I.

Although most of the surveyed firms stated that they established internal regulations concerning the fiduciary duties, this approach was not general, probably due to the lack of interest of many directors in developing rules which may operate against their own interest. In addition to this, the fact that part of the companies had rules in practice did not mean that they established these regulations accordingly to the same principles, because they might have interpreted the recommendations of the codes in a different manner. Another relevant problem was that in case of infringement of the duties the judges did not have an adequate guidance and experience on how to interpret and apply duties which were not developed by mandatory law. In this scenario the only way to achieve a general and, to some extent, uniform application of the concept of fiduciary duties, was its incorporation in the mandatory statutory law, which was the solution adopted by the legislator with the Transparency Act in 2003.

This is an example of how non mandatory rules may have direct impact in the development of an essential corporate law concept such as that of fiduciary duties when those rules are incorporated by the legislator in the mandatory statutory law.

Although this mechanism is the most direct to give the code's recommendations mandatory character, the legislator may also use indirect ways to produce a similar effect. These are examined in the next epigraphs.

3. The incorporation of corporate code's recommendations in the bylaws: the case of the electronic voting

Even in the cases in which the legislator incorporates the recommendations of the codes in the statutory law, she may do it in a way that the recommendations do not acquire, at least, in a first stage, a mandatory character. This will mainly happen when the statutory law delegates to the firms the possibility of regulating a recommendation previously established in a non mandatory instrument, such a code of conduct by using their self regulatory powers.[73] In these cases, the firms freely decide whether to self regulate or not. However, if the firms decide to do it, depending on the way the delegation is provided by the law, they may be constrained to create rules that, finally, will acquire mandatory character. This is the case of the electronic voting system, introduced in the Companies Act in 2003.

The electronic voting system was firstly suggested in 2003 by the Aldama report which recommended that firms may *implement the necessary systems for an electronic calculation of the quorum, and the granting of proxies and voting by post or electronic means*[74] The purpose of this recommendation was to increase the representation of shareholders in the general meeting.[75] The same year the Transparency Act added two paragraphs to article 105 of the Companies Act allowing the electronic

companies' capacity to adapt to the internal and external situations which they must face depend greatly on those two factors.'

[72] Recommendation III.1 of the Aldama Code: 'This Commission is of the opinion that legislation would be advisable in this area to compensate for the weakness of the discipline provided by market forces in cases of an outright clash between the company's interests and the interests of the parties involved in managing it. The basic instrument would be an orderly drafting of the cases and the regime of liabilities for directors in the event of breach of the duty of loyalty.' Also advocating for the mandatory character of fiduciary duties, Eisenberg (1989:1461) considers that: '…top managers in publicly held corporations should not have power to determine or materially vary the core fiduciary and structural rules that govern matters in which their interests may materially diverge from those of the shareholders'

[73] These cases could be considered an example of regulated self-regulation, more concretely a delegated self-regulation. A regulatory function can be delegated by the legislator in two ways. Firstly, the legislator may decide to delegate to the firms the regulation of a particular issue, being mandatory for the firms to develop it (for example the delegation for the establishment of the bylaws by the company and their minimum content would fit into this type). The second option for the legislator is to delegate the regulation of a certain issue to the firms, which can freely decide whether to develop that regulation or not. In this epigraph I will refer to the second type of delegated self-regulation. The different types of regulated self- regulation are clearly explained by Cafaggi (2006:17-18), in this case applied to European Contract Law.

[74] Recommendation IV.1.6 of the Aldama Code.

[75] The European Commission has also considered the potential of this mechanism as a way to increase shareholder participation at the European level as showed by the 'Proposal for a Directive on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market' (See: Commission of the European Communities, 2006:3)

voting for the shareholders of listed firms.[76] However, the approach of the statutory law was not to impose an obligation on the firms to provide remote voting for the shareholders in the general meeting. Instead, the statutory law allows the firms to voluntarily introduce this procedure as part of their functioning by using their self-regulatory powers; the final decision remains at the free choice of the companies. The reason for this legislative approach lied in the main purpose of the statutory change which was not to establish an obligation but a right. Before the amendment operated by the Transparency Act, even if a firm wanted to establish an electronic voting system this would have legally been difficult because the former version of the Companies Act only contemplated the traditional voting system, that was, in the general meeting by the shareholders or by their representatives. By modifying the Companies Act, those firms aiming to establish a remote voting system have the right to introduce it. Under this legal approach, those firms who decided not to develop this right were not compelled to do so. After this preliminary consideration, a question arises: to what extent, in the case the companies provide an electronic voting system this provision may acquire mandatory character; meaning that the company will be obliged to provide that right? For answering this question it is important to underline that the legislator adopted a particular formula for delegating the regulation of the electronic voting to the firms. The Companies Act clearly establishes the bylaws as the document which may contain and develop the right of remote voting.[77] The firms freely choose whether to establish or not a remote voting system, but once they decide to introduce it, this right may acquire mandatory character for the firm because it must be regulated by a mandatory instrument, the bylaws.[78]

Table II shows data on the implementation of electronic voting systems since the 2003 Companies Act's amendment. So far, many companies of the Spanish Stock Exchange main Index, the Ibex 35[79] have widely implemented the remote voting system by developing this right in their bylaws.

TABLE II

IMPLEMENTATION AND EFFECTIVE PROVISION OF ELECTRONIC VOTING IN THE GENERAL SHAREHOLDER MEETINGS AMONGST IBEX-35 FIRMS

Year	2004	2005	2006
Establishment of procedures in the bylaws	14.30%	57.20%	65.70%
Effective provision of the right in the general meeting	0.20%	45.70%	65.70%

Source: CNMV (2007-a: 77, 2007-b: 77)

However, during the first two years there was a gap between the percentage of firms which incorporated the electronic voting in their bylaws and the effective provision of this right in the general meeting. This may have two explanations. The first would be related to the need to create electronic networks for the electronic voting, which might have taken some time after the measure was formally adopted. The second would be connected to the provisions adopted by some companies which, in a way to increase their discretionary powers, implemented the article 105.4 of the Companies Act in a way that the final decision on whether to allow the electronic voting or not in each general meeting remained a board of directors issue[80]; more particularly the board must ensure that there are safe mechanisms in practice to guarantee the identity of the person exercising the electronic voting.[81]

Although these kinds of provisions might have acted as a constraint for the real implementation of the electronic voting system, in 2006 there was no difference between the formal adoption of the procedure in the bylaws and its use in the general meeting. This is an indicator that, in practice, once a safe system for electronic voting is formally adopted in the bylaws and admitted to use in the general meeting, virtually acquires mandatory character. In case the directors would try to private shareholders of this right it would be difficult for them to justify why a right that has been formally recognized in the

[76] The additions to article 105 of the Companies Act stated that:'…the vote of the proposals on points included in the agenda of the general meeting could be delegated or exercised by the shareholder by postal, electronic correspondence or any other remote media, whenever the identity of the subject exercising the voting rights is properly guaranteed. 5. The shareholders who vote by remote means will have to be considered with the object of constitution of the meeting like presents.'

[77] The first part of article 105.4 of the Companies Act states: 'In accordance with the bylaws…'

[78] The mandatory character of the bylaws in Spanish Company Law is recognized by several articles of the Companies Act such as articles: 48, 50.3, 63, 64,65, 67, 72, 91, 102…An study of the bylaws mandatory character can be found in Eisenhofer and Barry (2004), in this case for the Delaware jurisdiction.

[79] The Ibex 35 index comprises the 35 most liquid Spanish stocks traded in the Madrid Stock Exchange General Index, which are reviewed twice annually.

[80] This is for example the case of Telefónica SA, one of the most important Spanish telecommunications company, which is also part of the Ibex-35 index; it's General Shareholders Meeting regulation, article 17.bis states: 'Pursuant to the provisions of Article 17 bis of the By-Laws, and independently of the right of the shareholders to vote from a distance as provided in Article 20 bis of these Regulations, shareholders with the right to attend the General Shareholders' Meeting held at the place indicated in the notice of the call to meeting may exercise such right by electronic or data transmission means of long-distance communication when it has so been resolved by the Board of Directors after taking into account the current techniques and verifying the appropriate conditions for security and unambiguousness.' (Available at: http://www.telefonica.es/accionistaseinversores/ing/pdf/ing_reglamentojunta.pdf).

[81] As required by article 105 of the Companies Act.

bylaws and already employed in the general meeting is not allowed in a particular case.[82] Thus, the provision of electronic voting, through this particular mechanism of delegated self-regulation has acquired a *de facto* mandatory character amongst the companies who have decided to develop it.

In addition to the introduction of code's recommendations in the mandatory law, either by direct regulation or by delegating self-regulation there is also the possibility that the recommendations are not introduced in the mandatory law at all. In these cases the recommendations also acquire mandatory character. This is analyzed in the next epigraph.

4. The voluntary adoption of code's recommendations by the firms and the constraints of the principle of 'explain or comply': the case of directors' independence

The legislator has not always directly regulated or delegated the regulation of code's recommendations to the firms. Many recommendations have only remained part of the corporate governance codes and have not formally entered the statutory law or the bylaws of the firms. In these cases it should be asked whether these recommendations may also acquire mandatory character and, more concretely, to what extent the legislation may create obligations for the firms in relation to the recommendations of the codes of conduct which are not formalized in mandatory law. The answer to this question is given by the rule of 'comply or explain' introduced in the Spanish Securities Law by article 116 of the Stock Markets Act which obliges the firms to comply with the recommendations of the codes or, if not, to explain the reasons. For understanding better the meaning and significance of this principle I will use the example of the independence of directors which has not been developed by statutory law in Spanish Corporate or Securities Law. The concept of independent director was not common in the Spanish corporate tradition.[83] This is why the problem of the independence of directors has been recurrent and widely developed in the different codes in Spain. The recommendations about the independence of the members of the board pointed in two directions: Firstly, the codes defined the different types of directors a company may have[84], introducing the concept of independent director; secondly, they suggested a balance[85] between the different types of directors in order to increase the independence of the board. The statutory law has not incorporated the recommendations regarding the independence of directors. The amendments operated in the Companies Act did not make any reference to the balance between dependent and independent directors neither to the concept of what an independent director is, thus, the issue of the independence of directors initially remained, at least from a formal point of view, a non mandatory recommendation without binding effects for the firms.

The statistics conducted after the approval of the Olivencia Code initially showed that, on average, the recommendations regarding the percentage of independent directors were followed by the firms as showed in Table III:

TABLE III STATEMENTS OF LISTED FIRMS ABOUT THE PROPORTION OF INDEPENDENT DIRECTORS ON THE BOARD					
Year	1999	2001	2004	2005	2006
Independent/directors	43%	33%	31.7%	31.1%	30.3%

Source: CNMV (1999 and 2007-a)

However a main question remained with no answer: to what extent the firms were not properly complying with the qualification of a director as independent, considering independent directors those who, in reality, were not. If this hypothesis was true the data on the balance between independents and not independents did not reflect the reality of the firms. So, faced with this problem, how to ensure that the concept of independent director was respected by the firms when disclosing their data? The solution was incorporated in the statutory law, and was provided by the Transparency Act in 2003 which introduced the

[82] The main argument for not allowing the electronic voting would be the lack of security of the transaction. This argument could difficultly be justified by the board of directors because the procedure is strictly monitored. The electronic voting is based in the electronic signature (regulated by the 59/2003 Act on the Electronic Signature), in most cases provided by a public certification authority (Ceres) and the procedure involves the participation of the public authorities as well as Iberclear (The depository of the shares) and the issuing company itself.

[83] This was probably related to the traditionally concentrated ownership structure of the Spanish firm in which a small number of shareholders held big stakes in the company and thus, nominated their directors (who would, thus, fit in the category of external domanial directors accordingly to the Aldama Report). The ownership structure of Spanish firms is deeply analyzed by Gutiérrez Urtiaga and Tribo (2004).

[84] The Aldama Code (Recommendation IV.2.1) provided a description of the different types of directors. It mainly distinguished between internals or executive (those with management functions and a contract with the company apart form their status as directors) and externals, and, amongst this group, those who are domanials (appointed by shareholders who, individually or collectively, own a stable participation in the share capital) and independent (persons of reputed professional prestige satisfying the conditions that ensure impartiality and objectivity).

[85] For example the Olivencia report recommended that the non-executive directors (both domanial directors and independent directors) should have an ample majority over executive directors, and the proportion between domanial directors and independent directors should take account of the ratio between the significant holdings in capital and the other shareholders (Epigraph 2.2). The Unified Code took a more concrete approach and considered that the number of independent directors shall invariably be three or more and, represent at least a third of all board members (Recommendation number 16).

new article 116 of the Stock Markets Act.[86] The main purpose of this reform was to establish the obligation for listed firms of publishing an Annual Report containing certain data about the functioning of the company. Its fourth paragraph introduced the so called principle of *comply or explain*[87], by which firms must explain to what extent they are complying with the recommendations of corporate governance, and, if not, explain the reasons. This principle has a direct effect on the nature of the recommendations of the codes, whose compliance is incorporated in the companies' annual reports. Following with the example of the balance between non independent and independent directors, initially the code's recommendations are not mandatory, as long as they have not been incorporated in the statutory law or the bylaws. The only mandatory rule for the companies is to explain whether they are complying with the recommendations on the proportion of independent directors on the board; if that is not the case, they are just obliged to state the reasons. However once the firm makes a statement in the annual report on the proportion of independents in the board of directors, for example stating that the number of independents is *reasonable,* they must also respect the definitions of independent directors used in the corporate governance codes. It could thus be considered that in these cases the concept of independent director of the codes' recommendations would acquire an *ex-ante* mandatory character. Moreover the misstatement in this sense, attributing independence to directors which were not during the year the annual report refers to, could be used as the basis for a legal action against the company as it would consist of a breach of article 116 of the Stock Markets Act. This legal change may explain why after 2003 the statements on independent directors on the board provided by the firms showed a decrease in the number of independent directors if compared to the previous years as showed in Table III. The 2006 Unified Code served as a clarifier and developer of the 'comply or explain' principle. The Code recognizes its voluntary character but makes reference to the binding definitions by it provided: *Listed companies can freely decide to comply or not with the Code's good governance recommendations, but their reporting on the same must invariably respect the underlying concepts used. So, for instance, it is up to companies whether they follow Recommendation 13 on independent directors, but what they cannot do is call a director "independent", for the purposes of disclosure requirements, if that person does not meet the minimum conditions stated in point 5 of Section II.*[88]

Although what acquires mandatory character is the statement on the proportion of independent of directors, and not the independence itself, the introduction of the new article 116 of the Stock Markets Act and the new definitions of the 2006 Unified Code[89] could have a dramatic impact. Some firms may have been using the annual reports as a way to make up their corporate governance practices[90] by using misstatements on directors' independence. After the incorporation of the statements on corporate governance codes' compliance as part of the mandatory law, these types of opportunistic behaviors may be more difficult for the firms.

Conclusions

The purpose of this paper was analyze to what extent the corporate governance code's recommendations have contributed to the creation of mandatory law in the Spanish legal system through legislative activity. In order to do that, firstly the Spanish corporate governance framework has been explained in order to show how the corporate governance codes have introduced the first general set of rules on the field of corporate governance. Secondly, three recommendations of the codes were analyzed in order to see to what extent they were incorporated in the legal framework. The results show that the recommendations may be incorporated by the legislator in the mandatory law through three main mechanisms. The first way is direct regulation of the legislator by incorporating a code's recommendation in statutory law; this happened in the case of the recommendations on directors' fiduciary duties which were incorporated in the Companies Act; The second way may appear in cases of regulated self-regulation;

[86] As part of a new Title of the Law (Title X on listed firms), introducing articles 111 to 117 on the Stock Markets Act.

[87] The Statement of the European Corporate Governance Forum on the comply-or-explain principle (Available at: http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm) gives a clear explanation of this principle, underlining the importance of an appropriate regulatory framework for ensuring its application (for example with its incorporation in corporate law or listing standards). This principle can also be found in other European legal systems such as the Dutch (see the explanations of the Dutch Corporate Governance Code (2003: 4,41,47) or the British - MacNeil and Li (2005), analyze the development of this principle in the UK-.

[88] Anex.I.I of the Unified Code.

[89] The Unified Code introduced a much clearer definition of what an independent director is as well as to the proportion of independents in the board of directors (for example, the recommendation number thirteen of the Code provides a more precise definition about the proportion of independent directors, by stating that the number of independent should represent at least one third of all board members, in comparison to the more generic terms used by Olivencia and Aldama).

[90] The reports of the Spanish Secuties Supervisor (CNMV) detected that some firms have considered as independent directors persons who, in reality, were not (for example those maintaining a concerted relation with significant shareholders or holding an ownership that exceeds the threshold set for significance in the company's bylaws (CNMV, 2007:32).

the case of the right to vote electronically in the general meetings has been analyzed. The legislator has delegated the voluntary regulation of electronic voting to the firms but establishing that the firms must develop that right in their bylaws if they decide to regulate it; by doing so, the provision of this right may acquire mandatory character for the firms. Thirdly, a code's recommendation may become mandatory even if there is not specific regulation or delegated self regulation. The introduction of the principle of 'comply or explain' in the Stock Markets Act obliges the firms to respect the definitions of the code's recommendations when they state they are complying with them; this may have a decisive impact in some recommendations such as those about director's independence. The reasons for the different legislative approaches are related with the purpose of the legislator. In some cases the legislator may opt for a direct regulation if she wants to ensure a general and to some extent uniform application of a code's recommendation, by converting it into an obligation for all the regulated, such as in the case of the fiduciary duties. In other cases the main purpose of the legislator may be not the creation of an obligation but the provision of a right such as in the case of the electronic voting. Finally, the legislator may be interested in the avoidance of opportunistic behaviors by the firms in relation to their statements on the compliance with corporate governance codes, such as in the case of statements on directors' independence. These three examples show how recommendations which initially were not mandatory may, through legislative intervention, become mandatory rules which create real obligations for the parties.

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