

## LESSON 8: SHARES AND EQUITY PARTICIPATIONS

### SUMMARY:

- 1.-Concept of shares and equity participations
- 2.-Shares and equity participations as part of share capital
  - a) Classes and series of shares and equity participations
  - b) Different values of shares and equity participations
  - c) Shares and equity participations with issue premiums
- 3.-Documentation
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- 4.-Transfer
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  - b) Transfer of equity participations
- 5.-Vocabulary

### **1.- Concept of shares and equity participations**

The shares of a public LLC can be defined under three different approaches:

- A share is a part of the capital.
- A share contains the rights and obligations which correspond to its owner.
- A share is a traded security or a negotiable instrument.

Equity participations are also parts of the share capital of a private LLC, but with one difference. Equity participations are not traded securities, they cannot be represented by certificates or book entries and cannot be called shares (art. 92 LSC).

Some common features between shares and equity participations should be taken into account (art. 90 LSC):

- Both are cumulative. One partner or shareholder can have more than one equity participation or share.
- Both are indivisible. In this way, the number of shareholders or partners cannot grow without increasing share capital.
- Both can contain different rights and obligations. There can be shares and equity participations with different par values, corresponding each one of them to different series. There can be also shares or equity participations with different rights, corresponding each one of them to different classes.

### **2.- Shares and equity participations as part of share capital**

One of the main features of a public and private LLC is that the share capital is divided into shares and equity participations. Both are instruments whereby each partner's contributions can be gathered, and both determine to what extent each partner or shareholder participates in the company.

*a) Classes and series of shares and equity participations*

Shares and equity participations do not need to have the same content. There can be shares and equity participations of the same class which grant the same rights to their owners and, within each class, there can be share or equity participation series. Shares or equity participations included in the same series have the same nominal value.

As a result, it is possible to distinguish between ordinary shares or equity participations, which grant their owners all the ordinary rights and obligations involved in the partner's legal status and preferred shares or equity participations, which confer their owners some kind of advantage or special privilege. These advantages or privileges are, nevertheless, subject to certain limitations. In this sense, the issuance of shares or equity participations granting the right to receive an interest is forbidden. In the same way, shares and equity participations which do not respect the proportionality between their par value and the preferential subscription right of shares or the preferential assumption right of equity participations cannot be issued.

*b) Different values of shares and equity participations*

Shares and equity participations not only have a par value established in the articles of association, but also other values which depend on the economic situation of the company and other circumstances of a different nature. According to that, three different values should be mentioned:

- **Par value.** This represents the minimum amount of money which a shareholder or partner must contribute to the company to acquire a share or an equity participation (art. 23 d LSC). There must be a correspondence between the number of issued shares or equity participations, their par value, and the amount of share capital set out by the articles of association. The share capital must be the result of multiplying the number of shares or equity participations by their par value.
- **Market value.** This represents the amount of money received by the shareholders or partners who sell their shares or equity participations. If the public LLC lists on the stock market, the market value of each share would be the share price agreed for it.

- **Issue price.** This represents the price at which shares or equity participations are first offered to investors. Shares or equity participations must be issued at a price equal to or higher than the par value, but the issue price can never be lower than the par value.

*c) Shares and equity participations with issue premiums*

Shares and equity participations can be issued at a price higher than the par value. The difference between the par value and the issue price, when it is higher, is called the issue premium and it can be agreed both at the time of the company's formation or when the share capital is increased. The issue premium must be fully paid up at the moment in which the shares are subscribed or the equity participations are acquired. The issue premium is not part of the share capital, it creates an unrestricted reserve which appears as a separate liability account and it can be distributed to all the partners or shareholders at any time.

**3.- Documentation**

*a) Documentation of shares*

The ownership of shares can be documented using PAPER CERTIFICATES or BOOK ENTRIES (shares electronically recorded) (art. 92 LSC). In both cases, shares are considered to be negotiable instruments. On the contrary, equity participations cannot be considered to be traded securities or negotiable instruments and, therefore, cannot be represented by certificates or book entries.

The articles of association set out the way in which the shares will be issued. Nevertheless, public LLCs listed on the stock market are obligated to record the shares electronically. This involves a "dematerialization" of shares because the paper certificate disappears and the transfer of shares is carried out electronically through a specific computer program. Law 24/1988 on Securities Markets (Ley 24/1988 del Mercado de Valores) regulates the issue and transfer of this type of share.

If shares have been documented by paper certificates, they may be registered shares or bearer shares.

**1.- Registered shares**

On this type of certificate, the full name of the owner of the share is written down. Registered shares must be included in a register kept by the administrative body in which the name of the shareholder, the successive share

transfers and the constitution of *in rem* rights over the shares must be registered.

The person whose name appears in the register as the owner of a share will be considered to be a shareholder. As a consequence, the presentation of the certificate will not be necessary in order to exercise the shareholders' rights included therein. The shareholders whose shares have been registered will be allowed to exercise the rights provided by law or by the articles of association and to transfer the shares.

Registered shares are required by the LSC in the following cases:

- If the company has issued shares through a capital call.
- If the company's articles of association establish restrictions on transferability.
- If the company has issued shares with ancillary services attached.

## 2.- Bearer shares

In these types of shares, the owner is considered to be the holder of the certificate. As a consequence, the presentation of the certificate (or any other document which proves that the certificates have been deposited in a financial institution) will be necessary to exercise the shareholder's rights included therein.

### *b) Documentation of equity participations*

The LSC sets out that the equity participations are not traded securities and, therefore, they cannot be represented by certificates or book entries and cannot be called shares (art. 92 LSC). The transfer of equity participations must be recorded in a public deed.

## 4.- Transfer

*a) Shares as negotiable instruments: transfer of shares (arts. 120 to 125 LSC)*

One of the main features of a public LLC, as an open corporation, is the FREE TRANSFER OF SHARES, which facilitates the entry and exit of shareholders. Bearer shares and registered shares will be transferred according to different procedures:

### 1.- Bearer shares:

The transfer of bearer shares must be carried out according to the general principles of Spanish law. The transfer requires an agreement between the transferor and acquirer (“título”) and the delivery of the certificate (“modo”) to the new holder.

### 2.-Registered shares

The transfer of registered shares requires not only an agreement between transferor and acquirer but also the registration of the transfer in the register kept by the administrative body. This enables the company to have knowledge of the transfer and the new owner to exercise all the shareholder’s rights.

As we have already seen, in a public LLC, shares are freely transferable. Nevertheless, the articles of association may lay down RESTRICTIONS ON TRANSFERABILITY OF SHARES. According to the LSC:

- These restrictions must be expressly laid down in the articles of association.
- These restrictions can only affect registered shares.
- The articles of association must include the content of the restriction.

The restrictions on transferability of registered shares are frequent in the articles of association of private corporations and have caused many interpretation problems in the Courts. In any case, the LSC and the RRM set out some limitations that must be observed when including restrictions on transferability in the articles of association of the company.

- As a general rule, restrictions which prohibit the transfer of shares to shareholders are not allowed. Nevertheless, the Trade Register can accept these restrictions under the condition that they do not last more than two years from the company’s formation.
- Restrictions which compel the shareholder to transfer a different number of shares are not allowed.
- Restrictions which prevent the shareholder from receiving the market value of the transferred shares are not allowed.

The articles of association of public LLCs include different types of restrictions, the most frequent ones are:

*1.-Granting the company shareholders a preferential acquisition right of the transferred shares.*

2.-*Submitting the share transfer for the company's authorization.* These kinds of restrictions are considered to be risky because they depend on the discretionary decision of those authorizing the transfer. In order to prevent this, the LSC requires the articles of association to include the reasons why an authorization can be rejected. In this way, the Spanish legislator tries to reduce possible discretionary decisions. In any case, if the company does not meet the shareholder's request within two months, the share transfer is assumed to be authorized.

3.-*Demanding the acquirer to meet specific conditions.*

These restrictions will be applicable to *mortis causa* share transfers or share transfers resulting from enforcement proceedings if allowed by the articles of association.

#### *b) Transfer of equity participations (arts. 106 to 125 LSC)*

The transfer of equity participations has been carefully regulated by the LSC. Private LLCs are considered to be private companies which try to control the entry of third parties who may have nothing in common with their initial founders or objectives. For this purpose, the transfer of equity participations to third parties is restricted by law.

##### 1.-Inter vivos transfer of equity participations

The transfer of equity participations should be regulated, in the first place, by the articles of association. Nevertheless, the LSC allows the partners to design the transfer procedure taking into account certain limits. Some clauses in the articles of association of a private LLC are forbidden:

1.-The clauses which make it practically free to transfer equity participations are null and void.

2.-The clauses which compel the shareholders to transfer a number of shares different from the one they offered at first are also null and void.

3.-The clauses which prohibit the *inter vivos* transfer of equity participations will only be valid if the articles of association provide the partners with the right to withdraw at any time.

4.-Nevertheless, the articles of association may prohibit the *inter vivos* transfer of equity participations without providing the company partners the right to withdraw during a period which cannot last more than five years from the company's formation or the capital increase.

When the regulation for the transfer of equity participations has not been provided by the articles of association, the regulation provided by the LSC will be applicable. According to this legal regulation, the equity participations will be freely transferred to the spouse, ascendant, descendant, another partner or company that belongs to the same group.

Apart from those cases, the *inter vivos* transfer of equity participations will be subject to certain limitations:

- The partners must inform the company in writing of their intention to transfer equity participations, indicating the number and characteristics of the equity participations to transfer, the identity of the person acquiring them, the price and other conditions of the transfer.
- The transfer of the equity participations will be subject to the company's consent. The consent will be expressed through a general meeting resolution.
- The private LLC can only reject its consent if it previously informs the transferor through a notary's office about the identity of one or more partners who want to acquire all the offered equity participations. The communication through a notary's office will not be necessary when the transferor has attended the general meeting where the resolution rejecting the transfer was adopted.
- All the partners attending the general meeting will have a preferential acquisition right in the offered equity participations. If there are several partners interested in the acquisition, the equity participations will be distributed according to each partner's contributions to share capital.
- The price of the equity participations, the payment method and other conditions will be those previously communicated to the company by the transferor.
- The partners will be allowed to transfer their equity participations under the conditions previously communicated to the company when a three-month period has elapsed from the communication to the company of their intention to transfer their equity participations without receiving any answer.

The transfer of equity participations must be recorded in a public deed and notified to the company in order to be registered in the Register of the partners kept by the administrative body. Nevertheless, the registration of the transfer has no constitutive effect. The partner acquires a legal status once the transfer is recorded in the public deed even if it is not registered. Equity participations cannot be represented by certificates or book entries, but partners can prove their legal status by showing the public deed in

which the acquisition of equity units is recorded or a certificate issued by the administrative body which indicates that the acquisition of their equity participations has been registered in the register of partners.

The transfer of equity participations carried out in breach of the LSC or the articles of association will have no legal effect on the company.

## 2.- Mortis causa transfer of equity participations

As a general rule, equity participations are transferred *mortis causa* to the heir or legatee. Nevertheless, the articles of association may provide the surviving partners with a preferential acquisition right of those equity participations. Their price will be calculated according to their real value at the time in which the partner died, and they will have to be paid in cash.

## 3.- Forced sale of equity participations

In case of forced sale of equity participations as a consequence of a judicial or administrative process, the judge or the administrative authority must communicate to the company the auction record or the award agreement of those equity participations.

Partners will be allowed to acquire those equity participations within a month after receiving the auction record or the award agreement. Partners will have to subrogate the creditors' legal position and cover the expenses incurred. If several partners want to subrogate the creditors' legal position, the equity participations will be broken down in proportion to each partner's contribution to share capital.

## 5.- Vocabulary

**Traded security-** Título-valor

**Share /equity participation classes-** Clases de acciones /participaciones

**Share / equity participation series-** Series de acciones / participaciones

**Par value-** Valor nominal

**Market value-** Valor de mercado

**Issue price-** Valor de emisión

**Issue premium-** Prima de emisión



**Unrestricted reserve-** Reservas de libre disposición

**Paper certificates-** Títulos

**Book entries-** Anotaciones en cuenta

**Registered shares-** Acciones nominativas

**Bearer shares-** Acciones al portador

**Register of registered shares-** Libro registro de acciones nominativas

**Register of the partners-** Libro registro de socios (SL)

**Holder of the certificate-** Poseedor del título

**Restrictions on transferability of shares-** Restricciones a la transmission de acciones

**Preferential acquisition right of** (shares / equity participations)- Derecho de adquisición preferente de acciones / participaciones

**Transfer of shares / equity participations-** Transmisión de acciones / participaciones

**Transfer resulting from enforcement proceedings-** Transmisiones que derivan de un proceso ejecutivo.

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