FUNDACIÓN PARA LA INVESTIGACIÓN SOBRE EL DERECHO Y LA EMPRESA

FIDE WORKING GROUP´S CONCLUSIONS AND PROPOSALS:

"5-25" PLAN TO IMPROVE THE GOVERNANCE OF PUBLIC COMPANIES IN SPAIN

Index:

1.- Initial Premises and Objectives of the Working Group

According to the OECD, State-Owned Enterprises are those companies in which the State exercises control, varying significantly in size and ownership structure between countries. At one extreme, the government can maintain a minority percentage and the company can enjoy broad management autonomy, while at the other extreme the companies can be 100% dependent on a public body and receive instructions from its Ministry of Trusteeship. SOEs often combine commercial and non-commercial objectives, although for both the OECD and the IMF the former must be predominant in order to be qualified as such.

In our country, within the Institutional Sector there are currently 5,751 public entities (companies, consortiums, foundations, autonomous bodies, universities, etc.) with their own legal personality and linked to a greater or lesser degree to a central, autonomous or local Administration. Of the above, 2,282 (39%) are mercantile companies or public business entities. If to these entities with differentiated personality we add the public administrations in their different forms of personification (autonomous communities, town councils, commonwealths, comarcas, etc.), we reach the 18,754 public entities that currently exist in Spain.

In the State Public Sector alone, SOEs hire 142,000 workers in Spain, have a turnover of 27.6 billion euros, manage assets worth 266 billion euros and maintain a debt of 63 billion euros (5.4% of total GDP). Likewise, by 2019, of the total investments made by the whole of the state Public Sector, 54% will be made through these entities, concentrating 91% of turnover and 89% of investment in seven companies. According to the latest available data, there are 1,519 public company directors in the state, of whom 1,121 (74%) are men and 398 (26%) are women.

In view of the importance of these figures, the Corporate Governance of these entities is a nuclear aspect not only for their correct functioning but also for the Spanish economy as a whole, and ensure the adoption of standards that improve their transparency, efficiency and adequate accountability.

In the state sector, both mercantile companies and public business entities are generally governed by a Board of Directors or Governing Council, and by a President whose appointment

corresponds to the government by Royal Decree at the proposal (discretionary) of the Ministry to which they are attached.

On the other hand, and unlike in other countries, there is currently no regulated procedure for the appointment of these high positions, with no involvement of an appointments committee or similar body. In this sense, there are proposals for regulators and supervisors, whose application to public companies should also be studied. With respect to the existence of independent Directors, except in singular cases such as that of the ICO or AENA, due to its listing nature, their existence is not generalized either.

Based on the recommendations of the different international bodies (OECD, International Monetary Fund, European Commission, etc.) on corporate governance, as well as the best practices of surrounding countries, the objective of the Working Group was to diagnose the current situation of public companies in our country, as well as to analyse which would be the most effective regulatory instrument for the possible introduction of improvements (expert recommendations, public company statute, legal regulations, etc.) and what they might consist of.

These recommendations are based fundamentally on the knowledge and analysis of the business entities of the State Institutional Public Sector, although the WG considers that most of them are applicable, with slight adaptations, to the great majority of the business entities of the Autonomous and Local Public Sector of our country.

2.- Summary of the Working Group's proposals

1. **Regarding the autonomy of Public Companies and the adequate separation between the owner Administration and the managers of the companies, the Fide´s Group proposes:**

   1.1. A clear and coherent *State Ownership Policy* should be drawn up, published and regularly updated, distinguishing the functions of the administrations owning the figure of the managers of public companies through the formulation of clear and objective transparent mandates accompanied by an active exercise of property rights.
   1.2. That the functions of ownership are separated of the functions of guardianship and the setting of objectives into different entities or ministries. If, for reasons of sectoral policy, decentralised ownership models are chosen, there should be a coordinating unit responsible for ensuring the homogeneity of criteria between the different companies.
   1.3. Depending on the centralised or decentralised model chosen, the objectives of public enterprises should be set (initially) by the supervising department and these objectives should be: transparent, reduced, quantifiable and stable over time.
   1.4. The State should not become involved in operational decision-making (such as contracting processes) and should avoid periodically redefining the objectives of public companies in a non-transparent manner, allowing them to operate autonomously in the achievement of previously defined objectives.

2. **Regarding the role of Public Enterprises in the market:**

2.1. That tax, accounting, financial or regulatory legislations do not unduly discriminate between public companies and their competitors in the market.
2.2. That, in the case of markets open to competition, public companies are required to achieve profitability similar to that obtained by competing private companies

3. **Regarding the form of appointment of the Presidents and Senior Executives of Public Companies:**

3.1. A system for appointing top managers should be established through objective selection mechanisms based on merit criteria.
3.2. The creation of an external, independent and qualified body for the selection of presidents and directors of public companies should be studied in depth, as is already being done in other neighbouring countries.
3.3. Appointments to senior positions in public companies should be made for a specified minimum period (e.g. five years) and appropriate justification should be given for any terminations that occur before the end of the term of office, only in exceptional cases that are properly assessed.
3.4. For appointments and removals, the appearance of the presidents and/or general directors of public companies in the Congressional or Senate Appointments Committees should be encouraged.

4. **Regarding the Good Governance and transparency of public companies:**

4.1. Public companies should have the same or higher standards of compliance and transparency towards society in general, and citizens, as listed companies have towards their shareholders and stakeholders.
4.2. That, without prejudice to the legal functions attributed to the control bodies, the presidents and senior executives of public companies assume responsibility for the design and implementation of the internal control systems, and the Boards of Directors their adequate and effective supervision.
4.3 Measures for the prevention of corruption in public companies should be strengthened through: common ethical standards; active exercise of the ownership function through clear and specific legal and regulatory frameworks; a culture of integrity and prevention of corruption through the development of risk management models; adequate supervision mechanisms by the competent authorities.
4.4. Under no circumstances should public companies be used as a means of financing activities of a political nature, such as contributions to parties, press campaigns or communications outside the company's activity, etc.
4.5. That in all larger companies there is an internal audit department, dependent on the audit committee, which acts with full autonomy and without restrictions on access to information.

4.6. To ensure greater and better coordination between the internal audit area, the audit committees and those legally responsible for control and financial supervisory bodies.

4.7. Statistical information should be drawn up on the total number of Directors, qualifications, suitability and remuneration in the different institutional sectors at state, regional and local level.

5. On the adequate composition, quality and functions of the Boards of Directors of Public Companies:

5.1. Urgent introduction of shock measures to promote equality on the Boards of Directors of public companies.

5.2. The Board of Directors should enjoy enough autonomy and receive a clear mandate, assuming final responsibility for the performance of the company.

5.3. Directors should not act as individual representatives of those who proposed them, but in the interest of the company in the short, medium and long term.

5.4. In order to encourage strategic debates, the Boards should be proportionally reduced in size, depending on the size of the company.

5.5. Structured, transparent and professional procedures should be established for the selection of the members of the Board of Directors, including public officials where appropriate, and they should be chosen on the basis of their qualifications, presenting an overall knowledge of both the sector and the different representative fields of company management (financial, legal, regulatory, IT, etc.).

5.6. The existence of a minimum number of independent Directors, as well as the advisability of setting up specialised Committees (audit, risks, etc.), should be foreseen depending on the company's activity.

5.7. When employee representation on the Board of Directors is envisaged, it should be exercised effectively and subject to the same rights and obligations as other Directors.

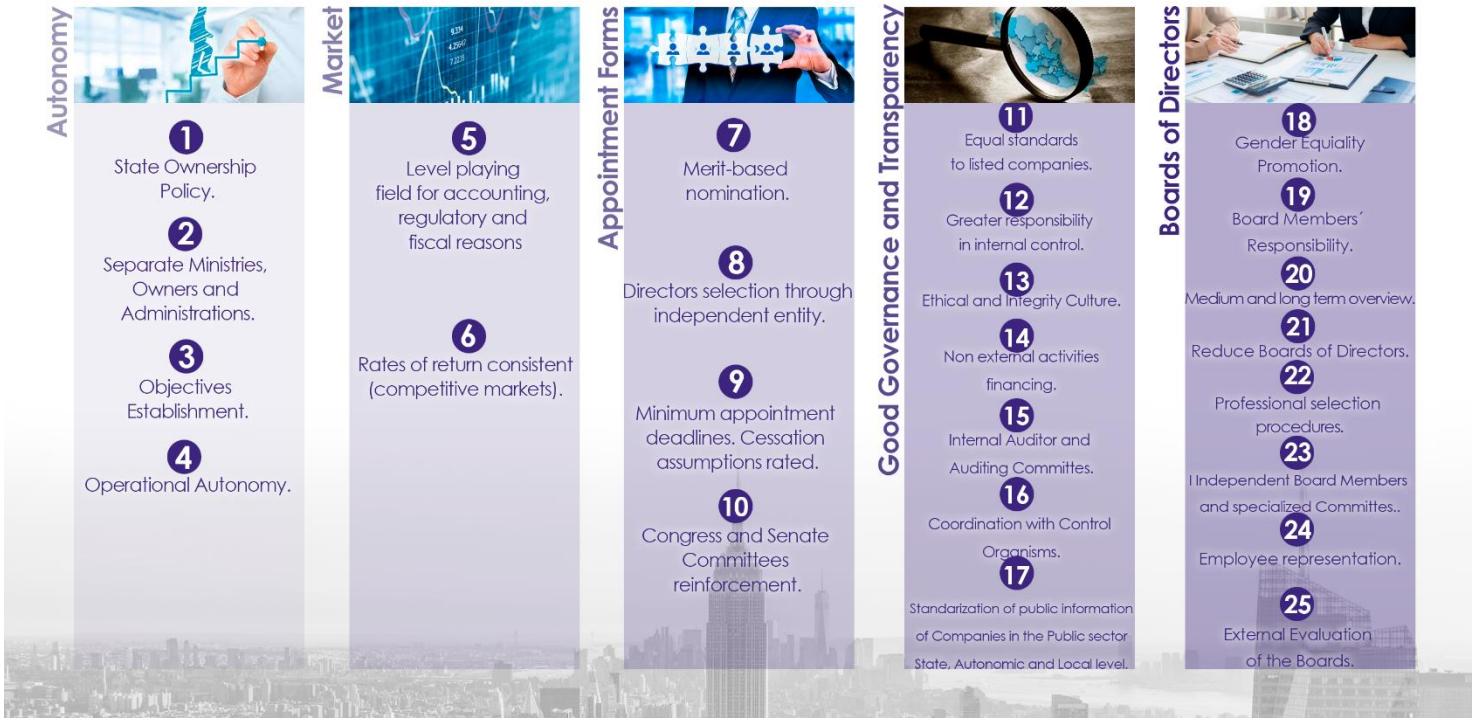
5.8. The adequate performance of the members of the Board of Directors should be evaluated at least every three years.

6. Regarding the normative instrument:

To study the most effective normative instrument for the possible introduction of these improvements (white book of expert recommendations, elaboration of a Public Company Statute, development through the Public Administration Heritage Law, etc.) and its application to state, regional and local public business sector entities.

Plan 5 - 25 for the reform of the **Institutional Public Sector in Spain**

The Plan 5 - 25 is configured around 5 AXES and 25 concrete PROPOSALS for the strengthening and development of the Business Sector in Spain and the improvement and sustainability of the economy.



3.- Document for improving the governance of public companies in Spain

1. INTRODUCTION

According to the OECD, **State-Owned Enterprises (SOEs)** are those companies in which the State exercises control, varying significantly in size and ownership structure between countries. At one extreme, the government can maintain a minority percentage and the company can enjoy broad management autonomy, while at the other extreme the companies can be 100% dependent on a public body and receive instructions from its Ministry of Trusteeship. SOEs often combine commercial and non-commercial objectives, although for both the OECD and the IMF the former must be predominant in order to be qualified as such.

Within the European Union, public ownership is particularly widespread in some of the new Member States such as Poland, Croatia, Romania and Slovenia, but also retains much of its former importance in countries such as France, Italy and Sweden, averaging around 10% of the employment share in Europe. This figure is widely exceeded in other countries such as India, Korea, the United Arab Emirates, Brazil and, of course, China. It should be pointed out that, despite what could be expected from the wave of privatisations in the 1980s and 1990s, in recent years there has been a rebound in the influence of this type of public shareholding companies: this is what is known as "state capitalism".

Although **there is no common definition** of what is to be understood by a "public enterprise", at European level those defined by the **European System of Accounts (ESA)** as public financial or non-financial institutions are generally considered as such: companies with independent legal personality over which an administration exercises control, irrespective of their percentage of ownership. In our country, Law 40/2015 on the Legal Regime of the Public Sector has incorporated a reference to this effect[1].

Among the **current reasons that justify the existence of public companies**, we can highlight: the existence of a natural monopoly that makes the market unviable; the fact that the State carries out the activity more efficiently than private operators; or that there are reasons of general interest, such as the maintenance of certain key sectors under State ownership, or the support of systemic companies in special crisis situations.

Due to their importance and size, these companies should be subject to special supervision by the respective authorities, as they may generate distortions in the very functioning of the market, or due to their high budgets inadequate monitoring may affect the finances and budgetary stability of the States.

Although it is a matter for which there is not enough econometric basis, a priori there is a certain consensus that there are **factors that cause lower efficiency in public companies** than in its private counterpart, especially regarding companies in unregulated sectors. Among others, we can cite: 1. multiple, complex, and sometimes contradictory objectives, which also tend to

[1] Public business entities will mostly be financed by market revenues. It is understood that they are mostly financed by market revenues when they are considered to be a market producer in accordance with the European System of Accounts. For these purposes, the classification of the different public entities will be taken into consideration for the purposes of the national accounts carried out by the National Accounts Technical Committee and will be included in the Inventory of Entities of the State, Autonomous Community and Local Public Sector. At present, within Subsector S.11001 (Public Non-Financial Companies Central Administration) are classified as such 3 of the 13 SPCs and 67 of the 140 State Mercantile Soc.

change over time; 2. diffuse definition of ownership among different ministries that diminish incentives to improve the efficiency of companies (emergence of free-riders); 3. excessive centralization in decision-making that causes loss of autonomy at intermediate levels; and 4. bureaucratic administrative controls that tend to reward repetitive and not very innovative behaviours.

In our country, within the Institutional Sector there are currently 5,751 entities (companies, consortiums, foundations, autonomous bodies, universities, etc.) with their own legal personality, and linked to a greater or lesser degree to a central, autonomous or local Administration. Of the above, 2,282 (39%) are mercantile companies or public business entities. If to these entities with personality we add the public administrations in their different forms of personification (autonomous communities, town councils, associations, comarcas, etc.) we reach the 18,754 public entities that currently exist in Spain[2].

To highlight the unequal evolution of these entities between the central, autonomous and local levels of our Administration. Thus, while since 1998 the number of state-owned public companies has been reduced by 116, in the case of the Autonomous Communities it has increased by 281 entities, and in the municipal sphere there is a notable hypertrophy with the net creation of 1,003 entities in the period. The cases of Andalusia (1,036 entities) and Catalonia (1,107) stand out, followed at a great distance by the Basque Country (476), Valencia (455) and Madrid (269).

Only in the State Public Sector do SOEs hire 142,000 workers in Spain, have a turnover of 27,600 million euros, manage assets worth 266,000 million €[3] and maintain a debt of 63,000 M € (5.4% of the total GDP). In order to highlight even more the importance of these entities, it is worth mentioning that according to the Preliminary Draft PGE of 2019, of all the investments made by the whole of the State Public Sector (State, Autonomous Bodies, Social Security, Business and Foundation Public Sector and other entities), 54% will be made directly through entities of the Institutional Public Sector, concentrating 91% of the turnover and 89% of the total investment in only seven companies[4].

Regarding the number and qualifications of the **directors of public companies**, their importance is also evident, both from the public resources allocated to their remuneration (over 8 million euros per year, according to data from the Court of Auditors) and from their high number. According to the latest information available, in the State Sector alone there are 1,519 members of Boards of Directors, of which 74% (1,121) are men and 26% (398) are women, an aspect on which it is unanimously considered that **shock measures should be introduced immediately to promote equality**. In addition, and although there is currently no aggregate public information (an aspect that already represents a deficiency), it is estimated that the total number of Councillors in the State, Autonomous Community and Local Sectors could be around 10,000, a figure that speaks in itself of the relevance of introducing common criteria of suitability and objectivity in their selection.

[2] State Public Sector Entity Inventory (INVESPE) and Public Sector Entity Inventory (INVENTE). General Intervention of the State Administration (IGAE). Ministry of Finance.

3 State Companies and Foundations. Economic-Financial Report 2017 (IGAE) and Yellow Book Project PGE-2019. State Secretariat of Budgets and Expenses. Ministry of Finance.

[4] ADIF Alta Velocidad (2.660M€), ADIF (2.244M€), RENFE (839M€), Puertos del Estado (827M€), Grupo ENAIRE (677M€), SEITTSA (554M€) and SEPI (306M€).

Once its quantitative importance was highlighted, the WG analysed the importance that the Good Corporate Governance of these entities can have for the efficient use of the public resources managed through them. In the group's opinion, there is no doubt that **adequate governance of these entities is a key aspect for their proper functioning**, and all those concerned with public management are obliged to propose the adoption of standards that improve their transparency, efficiency and adequate accountability and, at the same time, scrupulously respect the direction and political initiative of the government and the control of the constitutional bodies.

In this regard, despite the laudable regulatory attempts of recent years (mainly focused on transparency, incompatibility and the remuneration of Senior Officials), the reality is that the **improvement in the governance criteria (strictu sensu) of public entities has not evolved at the same pace as in the private sphere**. In this respect, and in line with international trends, in our country the latest amendments to the Law on Corporations and the periodic guides and recommendations of the CNMV have been particularly relevant. In spite of their soft-law nature, and under the principle of "comply or explain", in practice they have been imposed as quasi obligatory for private companies. Although under another area of responsibility, the CNMC's proactivity in this area should also be highlighted.

At the level of international bodies, there is **consensus among the different institutions that the models of governance of public companies are relatively weak**, and that they should be improved through **three lines of work**: 1. Development of a consistent ownership policy that does not interfere with the management of companies; 2. Greater and better financial supervision depending on whether there is a centralized model (the sole Ministry holding shares in public companies) or a decentralized model (distribution of ownership between different Ministries); and 3. Greater professionalism and independence of the Boards of Directors, through transparent selection procedures.

Returning to the case of the State Public Sector in Spain, both mercantile companies and public business entities are generally governed by a Board of Directors or Governing Board, and by a President whose appointment corresponds to the Shareholders' Meeting in the case of mercantile companies or to the government itself, at the (discretionary) proposal of the Ministry to which they are attached. Unlike what happens in other countries, **there is currently no regulated procedure for the appointment of these high positions**, nor does an appointment committee or similar body intervene, except for certain cases for the selection of members of the Judicial Branch.

Nevertheless, both Law 17/2006 and its subsequent amendments (in the case of RTVE) and Law 3/2015 regulating the exercise of High Office (in the case of supervisory and regulatory bodies and other entities such as the State Council, EFE Agency or the Economic and Social Council) are **gradually introducing suitability criteria and open selection systems through the Congressional and Senate Appointments Committees**, an aspect that is relatively new and, as can be seen in the case of RTVE to which reference will later be made, is the subject of heated debates. Bearing in mind these experiences, it seems necessary, therefore, to **analyse the opportunity of extending these measures to public companies.**

Another aspect to be analysed is the existence of **independent directors** in public companies, which, except in exceptional cases such as that of ICO or AENA due to their status as listed companies, are not currently widespread.

With regard to **management turnover**, it is noted with concern how the latest international reports (among others, "OECD, Government at a Glance 2017") place **Spain at the head of the OECD countries that most rotate public workers** facing a government change, compared to other countries (Austria, Belgium, Canada, Denmark, Estonia, Finland, Iceland, Ireland, Japan, Luxembourg, the Netherlands, Norway, Portugal, Sweden, the United Kingdom and the United States) where, under the same circumstances, senior management positions in the respective administrations rotate less than 5% of the time.

In relation to this same problem of organisational stability, the information provided to the WG is analysed (which should continue to be studied in greater depth), which shows that in the period 1995 to the present, **the term of office of the Presidents** of the eleven main public entities has averaged 3.1 years (12 presidents in the entity with the most rotations, and 5 presidents in the least) compared with other European public companies with average terms in the highest position: Switzerland (12.5 years), France (6.5), Germany (5.8) or Italy (4.8).

In view of the above data, the recommendations of the different international bodies (OECD, IMF and European Commission) on corporate governance, and the best practices of the countries around us, the WG advises the **need to make a diagnosis of the current situation of public companies in our country**, as well as to analyse which should be the **most effective regulatory instrument for the possible introduction of improvements** (expert recommendations, statute of the public company, legal regulations, etc.), and what they could consist of.

It is also agreed that, although the analysis of the size, typology and nature of the activities to be provided by Institutional Public Sector entities (with important differences in the evolution of the three levels of government - "autonomous NIS"-) may condition the model, in order not to enter into ideological discussions outside the group, it is considered appropriate to focus the analysis both on matters related to the governance of state public entities, as well as on the possibilities for improving the control and transparency systems of these entities.

In conclusion, it is agreed to focus the work of the WG on the following subjects, which have been the subject of the corresponding monographic sessions:

- Analysis of the different proposals for improving the efficiency of public companies (possible separation between owners and managers), good practices and possible conflicts of interest.
- Applicability of the OECD, IMF and European Commission Guidelines on Corporate Governance of Public Companies to the Spanish case.
- Positive and negative aspects of the application of hearings systems to the appointments of presidents and senior executives of public enterprises. Criteria for suitability and incompatibility and proposals relating to the term of office and cases of dismissal.
- Meritocracy and procedure for the selection of the members of the Boards of Directors of public companies: remuneration, suitability and legal responsibility.
- Opportunity for the introduction of Independent Directors and specialized Committees of the Board of Directors (audit, appointments, remuneration, risks...).

- Internal control systems in public companies: supervision of the board and responsibility of management. Establishment of common internal control frameworks and proposals for improving the transparency of public companies.

2. IMPROVING EFFICIENCY, GOOD PRACTICES AND POSSIBLE CONFLICTS OF INTEREST BETWEEN OWNERS AND MANAGERS IN PUBLIC COMPANIES

In relation to what the role of the State as owner of public enterprises should be, the OECD Guidelines advocate that it should at all times act as an **active and informed owner**, ensuring that the governance of public enterprises is carried out in a transparent manner.

According to this body, the main means to be used by the State to exercise such active ownership are: the establishment of a clear and coherent ownership policy; the formulation of general mandates and objectives for public enterprises; a structured, transparent and professionalized procedure for the selection of members of the Board of Directors; and an effective exercise of established property rights.

The State should define its objectives as an owner, indicating its priorities and explaining how the necessary commitments should be handled. At the same time, this presupposes that the **State does not become involved in operational decision-making** (such as intervention in contracting processes), **avoiding the periodic redefinition of the objectives of public companies** in a non-transparent manner, and consequently **allowing companies to operate autonomously** in the attainment of their objectives without intervening in their day-to-day management.

In this connection, an analysis is made of the significant differences between external and internal controls, depending on the type of public or private entities we are dealing with. The first controls have much smaller role in public companies than in private ones, for which self-regulation takes place both through the financial market itself and through the corporate, goods and services markets which exert a capital influence and which, in a similar way to Adam Smith's invisible hand, continuously generate a dynamic of appearance and disappearance of less efficient companies. As regards internal controls, the opposite is true, with the presence of strong control models in the field of Public Administrations (as a consequence of the abundance of regulations and the importance of administrative law), and relatively weak in private companies. Public companies would be located in an intermediate field, which means a field of action that must be subject to greater precision and definition in order to generate incentives, bring the objectives of shareholders and owners closer together, and reduce the possibility of discretionin the taking of decisions that affect public resources.

Regarding the actors involved in the various entities, it is also very significant to note that while in private companies, regardless of the role of the regulators, it is practically the only shareholders who issue directives to the directors of the companies -the only step-, in the public sphere there is a plurality of participants (citizens, politicians, ministries, owners, directors). This **complex chain of agents**, with decision-makers far removed from the decision-making chain, or difficult to identify, greatly complicates the adoption of decisions by managers, favours the dilution of responsibilities, and may lead to the emergence of intrinsic conflicts of interest between them that lead to decisions on criteria that do not respond to the interests of the company or the citizens.

Analysing **possible courses of action to reinforce these external controls in public companies**, it is suggested that, in relation to controls of a corporate nature, one possibility would be to encourage public companies to participate in the stock exchange by selling minority packages of shares (as in the case of AENA), something which, however, would only be feasible in relatively few companies due to its complexity and high costs. Another possibility would be to simulate behaviour or good practices taken from the private sector, an aspect on which there is practical unanimity that, although any responsible manager must continually analyse the best practices of his environment, the differences in one field and the other are considerable, and therefore **private experiences should not be transferred to the public sphere without first carrying out a detailed analysis.**

As far as financial mechanisms are concerned, another possibility analysed would be to eliminate the guarantees of public companies, warning that, as in the previous case, this would possibly lead to cost increases and, in practice, restrictions on access to credit for these companies. Finally, an even more extreme route, but one that would facilitate the aforementioned self-regulation (which sometimes should not even be considered as a possibility because it is already required by European Union law), would be to allow public companies *to go bankrupt*. This would be the case of companies that, usually operating in markets subject to competition, did not act efficiently, and the mercantile regulations imposed this obligation on them. As in the previous cases, the convenience of this measure (which, in practice, has already occurred in public companies of a municipal nature) is discussed, clarifying that what would be advocated would be processes of *orderly* liquidation of the companies, where the public entity would assume its corporate responsibility, and not before bankruptcy proceedings without assuming economic responsibilities.

With the aim of improving the **incentives** and credibility of the current model (which must respect political action in its entirety), it is discussed how, and by whom, the **setting and supervision of the objectives of public companies** should be carried out, without which it is warned that they should not function. The characteristics of these objectives would be: set (ideally) by the supervising department; transparent (e.g. through programme-contracts); as few as possible; quantifiable; and stable over time..

In short, and in summary form, these proposals for improvement would be articulated through **three elements**: 1. Separation in different entities or ministries of the functions of ownership of the functions of tutelage and setting of objectives; 2. System of appointment of the highest officials through objective selection mechanisms (even using specialized companies for this purpose); and 3. Annual appearance of the presidents of public companies in specialized committees of the Congress and/or Senate.

In relation to this same matter, the WG analyses an example that can be considered as a clear exponent of separation between the functions between owners and managers of the companies. This is the case of the **Spanish state-owned port system**, which is currently articulated through 46 ports of general interest, managed by 28 Port Authorities, whose coordination and efficiency control corresponds to the State Ports Public Body.

In this case, the different ports operate the maritime infrastructures, resulting in an asymmetrical situation between the parent entity and the respective port authorities. In this way, while *the direction and ordinary management* of the companies is carried out by the respective Port Authorities (functional autonomy), the strategic decision making and the *coordination and control of the efficiency of the whole*, fall into the hands of the State as owner.

In fact, one of the declared goals of Law 62/1997, *modifying State Ports and Merchant Marine*, was to **reinforce the aforementioned functional and management autonomy of the Port Authorities**, as well as to regulate the participation of the Autonomous Communities in the structure and organization of the ports of general interest, through the designation of the governing bodies of the Port Authorities. To this end, it was established that it would be the Autonomous Communities who would designate their President and determine the final composition of their Board of Directors, guaranteeing, of course, the presence of the local, autonomous and central Administrations, among other actors.

This model, the result of the so-called Majestic Pact of 1996, can be considered a success story since, despite its apparent organisational complexity (especially with regard to the appointments of its presidents and boards of directors), it cannot be ignored that Spanish ports currently manage, in a profitable manner, around 60% of exports and 85% of imports from our country, contributing close to 20% of the GDP of the transport sector as a whole.

Also cited is *Law 28/2006 on State Agencies*, which stressed the importance of a *new culture of public management* with the level of quality that society demands of public authorities, and allow citizens to visualize the aims of different public bodies and the management results entrusted to them. Something, by the way, that coincides with the very essence of the term "Civil Servant".

In relation to this matter, the WG concludes that **further clarification is needed between the figure of the owner** (either through a central ministry or through a coordinating entity that ensures homogeneity) **of the figure of the managers of the companies**. To this end, a distinction must be made between those entities that carry out activities of a predominantly economic nature and those that, despite being carried out through public companies, have a high administrative and service provision component for the promotion of the general interest.

3. APPLICABILITY OF THE OECD GUIDELINES ON CORPORATE GOVERNANCE TO THE SPANISH CASE.

The *OECD Guidelines on Corporate Governance* constitute a set of good practices and recommendations addressed to States on how to ensure that Public Enterprises act efficiently and transparently and are accountable for their activities. In general, it is considered that **Public Companies should have the same or higher standards of compliance and transparency towards society in general, and citizens in particular, such as those that listed companies have towards their shareholders and stakeholders**. In addition, and especially for those markets open to competition and with economic objectives, the "**level playing field**" principle must be complied with.

The Guidelines were originally drawn up in 2005 as a complement to the OECD *Principles of Corporate Governance*, and have been revised in depth in 2015. The *Guidelines on Integrity and Anti-Corruption* developed by the OECD Guidelines on so-called public companies are currently being drafted and are of general application to this type of entity. The guidelines are designed for those entities with their own legal personality that are controlled by the Administration and that carry out predominantly economic activities. The latter means that the Guidelines are not designed to be applied to entities whose main purpose is to engage in public policy activities, even if the entities have the legal form of a corporate enterprise. In addition, and although the

requirements of certain countries do not apply to the territorial levels of government, it is recommended that the criteria and recommendations of the guides be applied, in our case, and with the necessary adaptations, to entities directly or indirectly dependent on Autonomous Communities or City Halls.

From the legal point of view, although the Guidelines are considered soft-law by virtue of the legal status of the International Treaties governing relations between the OECD and its member countries, their direct application could be invoked.

It should also be noted that, although the Guidelines themselves recognise that few OECD countries fully comply with all the principles, it is essential that any legislative initiative affecting Public Companies take these recommendations into consideration.

The **principles or basic lines of action that should govern the operation of Public Companies** are summarized below:

1. In relation to the reasons justifying public ownership: ownership of PCs is exercised on behalf of citizens and, therefore, the State should carefully assess the objectives justifying public ownership, disseminate them appropriately through the development of a " State Ownership Policy" - which should be published, preferably via the Internet - and review the maintenance of these justifications on an annual basis. [5]
   It is considered essential that **any public policy objective be the subject of a clear and concrete mandate from the competent authorities** and may be complemented by stakeholders through public information procedures.

2. In relation to the role of the State as owner: the State must act as an informed and active owner while allowing the **PCs to operate with complete autonomy in the achievement of previously defined objectives.**
   The State, as a shareholder, **must refrain from redefining the objectives of the public company in a non-transparent manner.** It must also promote a "culture of integrity" (for example, through the establishment of whistle-blowers mechanisms) but without intervening in the management of companies, thus allowing the Boards of Directors to exercise their functions independently, professionally and effectively.

3. In relation to the role of Public Enterprises in the market: a level playing field and fair competition in the markets must be ensured. To this end**, fiscal, financial, or regulatory regulations should not unduly discriminate between public companies and their competitors in the market**. The access of these entities to the debt and capital markets must be carried out under market conditions. In addition, and precisely in order to avoid discrimination, **it should be required that the economic activities of Public Enterprises generate a profitability similar to that obtained by competing private companies** (or, conversely, that governments do not lower their profitability requirements in order to compensate them for the general interest objectives they may have been entrusted with, to the extent that this compensation must be carried out separately and through transparent and auditable procedures).

[5] The case of Sweden stands out from the different examples of Public Proprietary Policies and Aggregated Reports. Available from https://www.government.se/reports/2017/06/the-states-ownership-policy-and-guidelines-for-state-owned-enterprises-2017/ and https://www.government.se/reports/2018/09/annual-report-for-state-owned-enterprises-2017/

4. Regarding to Corporate Responsibility: The referred "State Ownership Policy" must recognize and respect the rights of the different actors and interest groups (workers, creditors, territorial entities, etc.)

So that there is no doubt about the expectations that the owner has about the business conduct of companies (Tone at the Top), the Boards of Directors of public companies, and their subsidiaries, should adopt, implement, supervise and disseminate with the respective adaptations a set of good practices such as:

- o Internal Control Systems and Methods,
- o Ethical codes,
- o Compliance programs,
- o Measures to prevent fraud and corruption.
- o Measures to promote the integrity of the actions of public companies,

As in the private sphere, the Boards of Directors of public companies must be guided by strict ethical criteria, especially when in these cases they may be subject to special pressures arising from the interaction between business and political considerations. An adequate control environment and a set of robust ethical principles will favour the right business climate for the country as a whole. Under no circumstances should Public Enterprises be used as a means to finance activities of a political nature (contributions to parties, press campaigns or communication outside the company's activity, etc.)

5. Regarding to Advertising and Transparency: Public Companies must maintain an adequate high level of transparency and submit (proportionately to the size of the companies) to at least the **same accounting, advertising, compliance and auditing requirements as listed companies.**

On this point, the following are considered to be good practices:

- **Publication of financial and non-financial information according to high quality standards.** It will include: Statement of the company's objectives and their fulfilment; Financial and operating results (with details of costs); Governance structure, ownership and voting; Remuneration of the members of the Board of Directors and main management positions (individually); Qualifications and appointment procedure of the members of the Board; Most significant risks; Financial aid and guarantees received from the State; any other important aspect related to employees and shareholders.
- **Specific state control procedures for public enterprises,** to which independent external audits based on high quality standards could be added. In any case, the complete autonomy of the auditors, both of the company itself and of the State owner, must be fully ensured.
- **Publication of a Consolidated Annual Report on Public Companies** (or, failing that, partial consolidated reports on comparable sectors) that allows citizens to have a clear idea of the overall results and evolution of the different public

companies. This report will detail the value of the State's portfolio, and the financial (profitability, investment, cash flows, dividends, etc.) and non-financial key indicators of these companies will be collected to a sufficient extent.

6. Regarding the Responsibility and functions of the Boards of Directors of Public Companies: As previously mentioned, **granting more power and improving the quality of the Boards of Directors is a fundamental step towards improving Corporate Governance.** Among others, the following aspects are considered to be key:

    - That the Board of Directors receives a clear mandate and assumes final responsibility for the performance of the company, being fully accountable to the owners (this point will be developed later).
    - The Boards should be small and proportional to the size of the company, in order to encourage genuine strategic debates.
    - It enjoys sufficient autonomy and authority and has (ideally) the capacity to set levels of remuneration for directors, which should be in line with the long-term general interest of the company.
    - All Directors, including, where appropriate, public officials, should be elected in a transparent manner and on the basis of their qualifications. Political positions with the capacity to influence the operating conditions of the companies themselves should not form part of the same or, at least, should go through a cooling-off period.
    - Directors should not act as individual representatives of those who proposed them, but in the interest of the company as a whole.
    - The existence of a minimum number of independent Directors is foreseen, as well as the convenience of constituting specialized Committees (audit, risks, etc.).
    - The Directors have knowledge of the sector, as well as a variety of representative knowledge of the company's various fields (financial, legal, regulatory, IT, etc.)
    - That there is an internal audit department (at least, in the larger Public Companies).
    - When employee representation on the Board of Directors is provided for, it should be exercised effectively and subject to the same rights and obligations as the rest of the Directors.
    - An annual, well-structured evaluation of the performance percentage of the Board of Directors should be carried out.

As a summary of the above points, and as already discussed in the second section of this document, we can point out that **each of the decisions surrounding public undertakings must be agreed at the appropriate level of decision**:

- **GOVERNMENT:** It is responsible for the establishment of a common State Ownership Policy, as well as the coordination and high-level monitoring of all the companies included in this Policy. It is recommended that the ownership function be clearly attributed to a central ministry. Where there are strong reasons for opting for a decentralised model (e.g. sectoral policy criteria), the requirement to establish a strong

coordinating entity between the different administrative departments involved must be met.

- **MINISTRY OR OWNERSHIP ENTITY:** It corresponds to the definition of the Objectives to be fulfilled by each of the Public Companies, as well as their follow-up and monitoring. It must also indicate its priorities and explain how to handle the necessary commitments, abstaining from interfering in operational matters. The development of these objectives may be the responsibility of the Ministry of Trusteeship, but in any case they should be reviewed by the owner Ministry. In order to avoid conflicts of interest, the Ministry or owner body (which should try to maximize the value of the company) should preferably be different from the Ministry or body that has normative or regulatory capacity over the companies.

- **BOARD OF DIRECTORS:** It is the highest decision-making body within the company, and it must exercise its functions without any type of political interference. It is responsible for approving a Strategic Plan that allows the effective fulfilment of the objectives established by the owner entity, as well as the supervision and monitoring of Management.

- **MANAGEMENT (Chairman and Senior Executives):** They are responsible for the execution of the Strategic Plan, as well as the day-to-day management of the company. The President of the company are responsible to the Board and is also responsible for the implementation, maintenance and supervision of an adequate internal control system, as well as the evaluation of its effectiveness. In certain cases, separating the position of Chairman from that of Chief Executive Officer may be a particularly useful practice in public entities, in which the independence of the Board of Directors from those responsible for the company must prevail.

Also comment on the admissibility of the **Advisory-board**, which is used in countries such as Germany, and which involves the coexistence of two separate boards, one for the management of the company and the other, the Supervisory Committee, which regularly advises and supervises the Board of Directors in its management of the company, participating in decisions of special significance.

Finally, as regards **integrity and anti-corruption criteria in public companies**, there are sectors such as electricity, mining, oil, gas and logistics, with a large presence of public companies (especially in Eastern European countries) where almost 40% of companies (according to OECD data) have presented irregularities or cases of corruption. For this reason, and as a complement to the Guidelines on Corporate Governance, work is currently underway on measures aimed at improving the transparency and internal control of companies that contribute to their eradication or, at least, avoid possible actions of responsibility vis-à-vis the directors and administrations that own them.

These fraud prevention measures are articulated through four main lines of action: **Integrity of the State**, applying ethical standards in the public service, and establishing property policies that lead to integrity**; Effective exercise of the property function** by establishing clear and specific legal and regulatory frameworks, and acting, as has been said, as an active and informed owner; **Promotion of a culture of integrity and the prevention of corruption** through the development of Risk Management Models (ERM, as expressed in Spanish) adapted to the company, such as

promoting internal controls and compliance standards and safeguarding the autonomy of companies when making decisions; and **Responsibility of Public Companies and the State** by establishing review mechanisms, taking appropriate measures in cases of detection of irregular situations, and receiving the different indications and inputs from civil society, the media and citizens as a whole.

4. REFERENCES TO THE CONCEPT OF PUBLIC ENTERPRISE IN EUROPEAN UNION LAW

Generally speaking, although *Directive 2006/111 on the transparency of financial relations between Member States and public undertakings* provides a definition of a public undertaking and establishes the obligation to keep separate accounts and to make contributions between States and public undertakings transparent, the EU **does not prejudge the system of ownership nor does it impose formal obligations on Member States on how they should organise their Public Undertakings.**

Notwithstanding the above, under the doctrinal analysis of the principle of equal treatment and the abundant jurisprudence on State aid, which aims to ensure that Member States do not grant companies, both public and private, aid incompatible with the common market, there is a progressive attempt by the Community authorities to make progress in matters of governance, which basically involves making explicit in a clear and measurable manner the different objectives to be taken into account by this type of company.

In recent years, the European Commission has carried out certain work to identify good practices, especially in recently incorporated countries[6]. As a result of these recommendations, the main objective for the reform of publicly-owned companies must be to improve the accountability and efficiency of decision-making. This requires an adequate framework for decision-making and adequate monitoring of both financial and non-financial objectives, and it is essential that company managers are sufficiently experienced and independent, especially when the company has purely commercial objectives.

With regard to the regulations of the Port, Electrical and Railway Sectors, the WG analyses that, although in the first two cases reference has been made for years to criteria of transparency and objectivity, it has been Directive 2012/34 establishing a single European railway area that has developed the concept of autonomy and independence that should govern the operation of railway companies and infrastructure managers in the most detailed way.

Thus, according to Directive 2012/34, these companies:

1. They must have their own assets, budgets and accounts;
2. They must be responsible for their management, administration and internal control;
3. They must be administered under the same principles that apply to commercial companies, regardless of their ownership regime;
4. They should be free to define their internal organisation, develop their market share and encourage the development of new technologies, and
5. They must be able to make their own personnel, asset and purchasing decisions.

[6] State-Owned Enterprises in the UE: Lessons learnt and ways forward in a Post-Crisis Context. July 2016.

In these sectors, moreover, the aspect already commented on about non-discrimination through the requirement of different rates of return is particularly important. **From the point of view of Community Law, it is irrelevant whether public services are operated by public or private companies,** it being understood, therefore, **that it is not acceptable to admit lower rates of return on investments in public companies than for private companies**, since this could provide a negative incentive for services classified as public service obligations to continue to be provided indefinitely by those that admit a lower IRR, this practice being a violation of the principle of "playing field". In addition, and with regard to the latter, there is a growing requirement to compensate public service obligations with the cost of an efficient company (Altmark case 2003).

5. THE CONCEPT OF RESPONSIBILITY, AUTONOMY AND DEPENDENCE IN PUBLIC AND PRIVATE COMPANIES.

Having addressed the Guidelines and recommendations of international bodies for improving management and transparency, it is now time to review our Positive Law in order to analyse the different scope of the concepts of **autonomy and responsibility** between public and private companies, as well as the different intensity of control exercised, in each case, by internal and external bodies.

There are many examples that, in the case of Spain, and given the importance of the principle of the autonomy of the will of the private sphere, highlight the greater dependence of public companies on their shareholders. One of these manifestations is undoubtedly the action of the **Guardianship**, the exercise of which may be carried out either by the Ministry which has a direct relationship with the object of the entity or, in the absence of an express attribution, through the Ministry of Finance.

Other manifestations of this reinforced control are the **control of efficiency and continuous supervision**, to which all entities belonging to the institutional public sector are subject. The first of these controls is carried out by the Department to which the different entities are attached through the Inspections of the Services, and its purpose is to evaluate compliance with the objectives of the specific activity of the entity and the appropriate use of resources. On the other hand, continuous supervision (introduced by Law 40/2015 and developed by Order HFP 371/2018) is carried out by the Ministry of Finance and Public Administrations through the General Intervention of the State Administration, and its purpose is to verify the subsistence of the reasons that justified the creation of the entities, as well as their financial sustainability. Both controls, and especially the second, are still in full development phase due to their recent nature.

Nor should we forget the high number of decisions that must be approved through the Council of Ministers, and even the possibility that the Ministry of Guardianship may issue instructions for institutional entities to carry out activities whose execution is in the public interest. This management capacity would be difficult to accept in the private sphere, and if it is not accompanied by other measures, it could lead to a decrease in the responsibility of the public administrators of these entities.

In short, the high number and intensity of the controls cited, together with the different game of ad-intra liability of public administrators versus ad-extra liability of private ones, leads us to conclude that our legal system would have wanted to attribute to public companies the fundamentally **instrumental** nature of these controls. This is reinforced by the publication of the public company, whereby the right of individuals to be compensated for the normal or abnormal

functioning of public services is carried out through the general procedure, even when compensation is demanded directly from the private law entity through which the Administration acts

Now, and in view of all the above, **what is then the reason that justifies the creation of a Public Company?**

In order to answer this question, we must not forget that, as we have already stated, together with other possible accounting or administrative motivations, sometimes alien to the search for effectiveness, the public company must be born to carry out a **fundamentally economic activity,** being necessary for a better allocation of resources to introduce business efficiency criteria that improve production processes and reduce transaction costs. It would not be so much a question of whether the shareholders of SOEs are public or private, but whether the management criteria of this type of entity can be inspired by private management techniques that have proved their worth. But these aspects will be threatened if, under the argument of the necessary (essential, we could say) administrative tutelage, public companies see their autonomy reduced in practice because they are obliged to consult ordinary management actions (patrimonial regime and contracting of goods and services, personnel hiring regime, etc.) that dilute the legal framework for action between ministerial bodies, subject to administrative law, and bodies of public companies, subject to private law. The right balance between the two principles will lead to some results.

Regarding to the **directors' liability**, their duty of loyalty in the private sphere results in both personal liability to society, liability to third parties under bankruptcy and tax legislation and even criminal liability. On the other hand, in the case of public companies, this personal liability has evolved from a normative point of view towards a public liability that is much more beneficial, undoubtedly, for the interests of third party creditors.

The last manifestation of this evolution was the introduction of article 115 of the Law on the Legal System of the Public Sector by which, compared to the system of personal liability of the administrator of the private company, the responsibility corresponding to the public employee as a member of the board of directors of commercial companies is **directly assumed by the General Administration of the State that appointed him**, the Administration being able to demand ex officio liability only when there has been wilful misconduct, or gross negligence.

Regarding this modification, the WG, although it is aware that one of the key aspects and recommendations for the improvement of Corporate Governance is to **grant more power and improve the quality of the Boards of Directors**, considers that in the Spanish case this apparent attribution of responsibility of the directors directly by the National Government is, on many occasions, more a perception than a reality, since in fact there are different jurisdictions where the condition of civil servant or public servant is even an aggravating circumstance of responsibility. **It is therefore considered advisable to maintain this protection of public directors, although within the extensive public business perimeter it would be advisable to homogenise the treatment of the representation of directors**, which in some cases is nominative, and in others they act as representatives of the legal person that has appointed them. In addition, the system of **liability of public administrators should be standardised** at state, regional and local level.

Regarding to control, the differences between the two spheres are again pointed out, as there is a debate as to how in private companies there is a greater distance between ownership and

management, while in the public case, controls (at least formal ones and, to a much lesser extent, those that analyse the efficiency of management) are more abundant due to the greater proximity between one and the other. In order to combat the hyper-development of controls, the introduction of **Risk Management Models** (reputational, operational, financial, security, etc.) which have already proved their effectiveness in other advanced countries is recommended.

Finally, to insist once again here that in the area of the institutional public sector, it is the **President and the Senior Executives of the companies who are responsible for the design and implementation of an effective internal control system** without us being misled by the reference in the general budgetary law that the General Intervention of the State will exercise internal control over the economic and financial management of the state public sector.

6. APPLICABILITY OF MERIT SYSTEMS TO THE SELECTION OF SENIOR EXECUTIVES OF PUBLIC COMPANIES.

Reference has previously been made to how data on turnover of management staff in the face of a change of government place Spain at the head of the OECD countries. In relation to this same aspect, it has also been pointed out how the presidents and senior executives of Spanish companies have a shorter term in office than their European counterparts. These changes in the **directions and strategies of companies for political reasons**, sometimes alien to business logic, **can generate lower productivity** and ultimately mean a worse use of public resources.

But the procedure for the selection and dismissal of senior officials of public companies, and how to move towards greater stability in them, is closely linked to the applicability (or not) of **merit systems** for their selection.

It is necessary to know in depth what are the current experiences of other countries in our environment since, for these countries, faced with criteria of a discretionary nature that are also legitimate, **meritocracy in the designation of the different posts is the main aspect to be dealt with in the reform of the "New Administration**".

In order to rigorously deal with these approaches, we must start from how the countries of Continental Europe and the countries with Anglo-Saxon administrative roots (influenced in this aspect by German organicism) have certain cultural differences that have generated the assumption of these differentiated administrative paradigms. This means that certain good practices of countries that consider merit as something cultural are not always adaptable to countries with a more administrative tradition such as Spain.

One of these differential aspects is, precisely, the way in which senior executives are selected and how to ensure that the managers of public companies (we insist once again, with a fundamentally economic vocation and not the provision of administrative services) are more results-oriented and do not focus exclusively on the application of regulations and procedures. Ahead of possible conclusions, we could now affirm that the **ideal situation will occur when politicians define objectives, and public managers have the capacity to decide the most appropriate means to achieve those objectives.**

But the administrative culture is highly resilient, and studies continue to be carried out that show how candidates for senior management positions with an internal origin in the Administration

value more the typical aspects of the administrative tradition (law, equity, transparency, social justice, presentation of accounts, etc.) while external candidates have a more results-oriented, efficient, sustainable and merit-oriented approach. Both approaches are equally admissible, but should be taken into account when designing the profile of the position to be filled.

Among the most novel experiences in recent years for the introduction of merit-based systems, the case of our peninsular neighbour stands out, without a doubt, which, in the Memorandum of Understanding signed with the Community Troika in May 2011, introduced an ambitious plan of administrative reforms into the fiscal adjustment measures. Within this plan, and taking as inspiration similar bodies from advanced countries, Portugal created the **Recruitment and Selection Commission for Public Administration (CReSAP, as express in Spanish)** as an autonomous body independent of the Administration.

CreSAP is responsible for the introduction of meritocracy in central, regional and local government, through the management of the selection of public managers by valuing their merits. In the opinion of the doctrine, its establishment has contributed to improving the confidence and transparency of institutions and to the depoliticization of the Administration.

Its main function is to assess the curricula vitae and professional profiles of directors of public companies, and to convene and manage competitions in the case of directors of the Administration on the basis of a profile of the position provided by the governing body requesting the assessment. That is to say: there is a procedure for the selection of Directors of the Central State Administration (Directors and Subdirectors General fundamentally) based on public tenders, and a procedure (added later) for the Presidents and Directors of public companies, where a mandatory and non-binding report is issued regarding the candidates that the Government wants to designate for the business sector.

The CreSAP is composed of a President who is elected for a period of five years, and three to five permanent members who are appointed for four years. Likewise, during the selection processes they have a non-permanent member of the Ministry who intends to fill the vacancy in question (although not of the body to which it is destined), as well as a pool of between 20 and 50 experts who support the Commission in specific technical matters and intervene in competitions for senior management positions.

In the case of **selection by public competition**, once the curriculum vitae has been analysed and the self-evaluation questionnaire has been analysed, in which 12 types of ideal skills (leadership, motivation, strategic orientation, etc.) are assessed, a face-to-face interview is carried out with the six best-rated candidates, twice the number of candidates that the Commission must present to the Government. The final report, with a short-list of the three best candidates, is sent to the Government for the final decision on who should be elected. The person will hold office for five years, renewable for another five years.

In the case of the **selection of directors of public companies**, the process is different, since CreSAP evaluates the curricula vitae of the candidates sent in this case by the Government. Once the candidates have been assessed and interviewed (paying special attention to the so-called soft-skills), this body issues a "decision report" with three possible assessments: adequate; adequate with limitations and not adequate. Although this report is not binding, the Portuguese government has not so far chosen any public director on whom CreSAP has issued a negative opinion. Once selected, the executive will sign a three-year contract (as opposed to the previous five), the articulation of which must include quantifiable and measurable objectives annually

that represent an improvement in the key management indicators of each position. Once the activity has begun, the public managers are evaluated annually, taking into account the fulfilment of these objectives.

During this period CreSAP's work has been intense, as **more than 500 procedures have been completed, in which it has assessed nearly 7,000 candidates**. The average number of candidates per post was 25, and their profile ranged from current incumbents (who tend to be eligible for re-election), university professors, magistrates and other external candidates. In only 10 procedures has the post become vacant, either because there are not at least 3 candidates, or because they do not have sufficient merit.

In the case of our country, faced with purely discretionary selection procedures, there are already many voices in the field of administrative management that demand the existence of a body similar to that of CreSAP, because although in recent years greater references to merit have been introduced in our Administrative Law, the **creation of an ad-hoc body for the selection of directors of public companies would constitute a decisive step towards a change in the administrative paradigm.**

But, as we said, there have also been attempts in our country to extend meritocracy. Thus, and not going back further, Law 3/2015 regulating the exercise of the High Position established **suitability as a requirement for the appointment of high positions**, taking as a reference the criteria of merit, capacity and honourability.

This norm, which regulates the causes for which they cannot be considered suitable for the performance of a high position, clarifies that honourability must concur in the high position during the exercise of their functions, so their lack will be cause for dismissal. The previous verification that the conditions of suitability for the performance of the office are fulfilled is done by means of a responsible declaration that the candidate must subscribe providing to the **Office of Conflicts of Interest**, if so requested, the documentation that accredits the above mentioned fulfilment.

Another system in which the suitability of candidates is also analysed is the one recently regulated by the **Bank of Spain**, based on the requirements for corporate improvement of European financial institutions required by the Single Supervision Mechanism. Through this system, the suitability of the members of the administrative bodies and of the general managers or assimilated (senior managers) of the supervised institutions must be assessed prior to their registration in the Register of Senior Officials by the Bank of Spain or, depending on the size of the institution, by the European Central Bank.

The implementing regulations (Circular 2/2016 on the supervision and solvency of credit institutions) have clarified that the Bank of Spain's assessment of suitability does not replace the assessment that the institution itself must make of its candidates for senior posts. This evaluation must include an analysis of compliance with the legal requirements established in the sectorial legislation in force for the specific position to be held, and must also assess the candidate in relation to the document defining the functions, aptitudes and dedications of the members of the board drawn up by the Appointments and Remuneration Committee in compliance with the Spanish Companies Act.

The mere declaration of concurrence of the aforementioned suitability requirements, which is not accompanied by a detailed analysis of each of the requirements and their fulfilment in the specific case, shall not be considered sufficient.

Finally, the system of public tender that Law 17/2006, subsequently modified by Law 5/2017, for the independence and pluralism of RTVE has established for the selection of the members of the Board of Directors and the Chairman of the CRTVE is also novel (and undoubtedly highly controversial).

In relation to this process, which reminds us of its similarities to the Portuguese case, the evaluation report of the candidates prepared by the Committee of Experts appointed for this purpose has recently been made public, and it has assessed both the curricula vitae and the business projects of the 95 candidates presented.

The evaluation and scores of each of these projects, which have even been published in the Official State Gazette (BOE), has been uneven, with the 20 candidates who have obtained the highest marks finally being admitted provided that they have previously obtained more than 65 points (of which the training and experience are worth 70 points and the personal project presented for the improvement of RTVE 30 points).

In accordance with the provisions of the Law, once the evaluation report has been issued by the Committee of Experts, the **Consultative Appointments Committee of the Congress of Deputies and the Appointments Committee of the Senate** will be convened. The final selection of the RTVE President and Councillors is still pending a final decision.

7. SUITABILITY, RESPONSIBILITY AND SELECTION CRITERIA FOR DIRECTORS OF PUBLIC COMPANIES.

When it comes to dealing with the requirements that a Board of Directors of an effectively functioning Public Company must present (how to select its members in an appropriate manner; how far should it extend its civil and criminal liability, how to calculate the remuneration of directors and executives, etc.), a previous question arises again: should public activity really be managed through a commercial law instrument such as a Board of Directors? Or, to put it another way, is it efficient for public bodies to be managed through Boards of Directors, whose members are not always experts in the sectors on which they have to take decisions?

The answer to this question, although it can be approached from different points of view, has been partly answered in previous sections when we established a dichotomy between activities of a predominantly administrative nature, and activities of a predominantly economic nature in which business management criteria must be introduced and which, strictu sensu, must only be carried out through public companies. This being so, and reserving this denomination to those entities that meet these requirements, what are the specific and non-delegable powers of any Board of Directors, without which this body cannot consider that it acts as such?

In our opinion, these **essential functions** of any governing body are, as a minimum, the following: to determine the company's policies and strategies; to be able to understand and assess the risks faced by the company; to guarantee regulatory compliance; to establish an adequate system of Corporate Governance; and to guarantee the adequate supervision of the

Committees it has set up, as well as to supervise the management of the company and the directors as a whole.

As a fundamental part of improving corporate governance, it is necessary to adequately differentiate and balance the presence of **different types of Directors**: **Executive**, with management functions, and **Non-Executive** with supervisory functions. Within the second category, we will distinguish proprietary (or micro-dominical, as the case may be) and independent directors, which are particularly controversial in the public sphere. We should also mention the recent appearance of the so-called coordinating directors or the figure of proxy-advisors.

The procedure for selecting the members of the Boards of Directors, their method of appointment, and their system of remuneration (an aspect which, in a public entity, is subject to a large number of conditions external to the company itself) are key aspects of the system of governance. With regard to these aspects, the recent **CNMV Technical Guide 1/2019 on the Appointments and Remuneration Committee** has included a series of principles and good practices on the way in which a body of this nature can contribute to the better management of the company. The main objective of this Committee (or Committees, one for appointments and the other for remuneration) is to **ensure that the company has the best professionals in its governing bodies and senior management**. As in the case of the Audit Committees, at least two of them must be independent directors, including the Chairman.

Along the same lines, the recommendations of the **Code of Good Governance of capital companies** establish that its members should be appointed on the basis of the knowledge, aptitudes and experience appropriate to the functions they are to perform; that directors should be able to propose candidates to the Committee to fill vacancies on the Board and propose the basic conditions for senior executives; and that the remuneration policy applied and the independence of directors should be periodically verified and reviewed. To this end, this Committee, or equivalent body, should take into account the following steps and selection criteria:

- Establishment and periodic updating of a matrix of competencies that defines the aptitudes and knowledge of the candidates, and that helps to define the functions of the position, as well as the most appropriate competences, knowledge and experience.
- Evaluation of each candidate, recording in the minutes of the session the evaluation and the suitability of the candidate for the position requested.
- Description of the reasons justifying the suitability of the candidate.
- Formal acceptance by the candidate of the conditions and policies for directors and managers (legal and statutory obligations, prevalence of social interest, internal regulations, declarations of conflicts of interest, etc.).

A different matter, but closely related to the establishment of rules relating to the procedure and appointment criteria, **is the establishment of some taxed and restrictive assumptions for the resignations of the Presidents and Directors of public companies**. As in the case of appointments to senior positions in public companies, it is recommended that they be made for a certain minimum period (e.g. five years), there must also be adequate justification for any dismissals that, for extraordinary reasons, may occur before the end of the contracts.

Termination cases should be public, known, and included in the company's internal policies. Examples of similar nature may include exceptional circumstances such as: serious breaches of

legal or budgetary regulations, serious failure to comply with the company's Code of Ethics, and failure (by action or omission) to take anti-fraud and anti-corruption measures. To the extent that it responds to objective causes, substantial non-compliance with the objectives assigned to the executive agreed upon at the time of appointment may also be grounds for termination before the end of the term of office.

Cases of dismissal must be the subject of a report by the same person in charge of analysing the initial suitability of the candidates, with sufficient evaluation of the information provided by the dismissed executive. This body may be the independent entity for the selection of presidents and directors of public companies mentioned above, or even the current Appointments Committee of the Congress or Senate.

Another recommendation aligned with the Corporations Law and the Good Governance Code, which in recent years has been growing significantly, is the evaluation of the functioning of the Board of Directors by third parties, to which we have already referred when setting out the OECD recommendations. This external evaluation (recommended at least every 3 years) aims to analyse the correct functioning of the Board of Directors from the point of view of its governance: profiles of the directors, their active participation both on the Board and in the different Committees, issues dealt with, documentation and other types of aspects focused on improving the independence of the governing bodies.

With regard to the typology of responsibilities, a distinction must be made between corporate, tax, accounting and criminal liability. In order to prevent the company from being judged on criminal charges, it must demonstrate that it has established a surveillance and control system to prevent or reduce the risk of committing crimes (Corporate Compliance). As stipulated in Circular 1/2016 of the Attorney General's Office, as well as the first final judgments on this matter, it is not enough that formal compliance with the exemption requirements is justified, but it must be demonstrated that there is an authentic business ethics culture of respect for the law.

In the public field, the **new liability system is applicable to public corporations**, but with **important limitations**[7].

Finally, with respect to the existence of **Independent Directors,** it is necessary to point out that in the public sphere there is no consensus as to who should fall into this category, since in one case only those who are not considered civil servants or public employees are included under this denomination and, in other cases, it is considered that the criteria of the Regulations of the Wealth Act must be complied with[8].

[7] Article 31 quinquies CP establishes that the criminal liability of legal persons shall not be applicable to the State, territorial and institutional Public Administrations, Regulatory Bodies, Public Business Agencies and Entities, international organisations governed by public law, or those exercising sovereign or administrative public powers. On the other hand, in the case of public mercantile companies, only the penalties of fine by quotas or proportional or judicial intervention for a maximum of five years may be imposed to protect the rights of workers or creditors.

[8] Art. 140 RLPAP. Independent directors will be considered those administrators who do not provide services or who are not labour or professionally linked to the General Directorate of State Assets or to the public body that was a shareholder of the company; to the body with regulatory functions on the purpose of the activity of the company; or to the Ministry that has the guardianship of the company..

With regard to the need to extend their presence to all public companies, there are doubts, not only as to their practical usefulness, but also as to whether the impartiality and autonomy of these independent directors would actually be much greater than that of public officials. A special case of our legislation is the one established for the ICO where, with the reform of its Statutes in 2015, it was established that of its ten members four would be independent (not personnel serving the Public Sector) with the particularity of having a double vote, with a majority decision therefore in all matters related to financial operations of assets and liabilities proper to the business of the ICO.

Although the WG therefore considers that there are reasonable doubts about the necessary nature of this figure in the scope of the public company, it should be noted that there are elements to consider that the European authorities consider the presence of these independent directors to be adequate, so that it would be foreseeable that in the future their presence will be required, at least with regard to non-financial companies for the purposes of EUROSTAT. This being so, an **in-depth reflection should be carried out on whether this figure should be envisaged for all those larger public companies or, at least, those with a greater relationship with markets open to competition**, where the experience and knowledge of these independent directors could be of greater value.

8. SPECIALITIES OF AUDIT COMMITTEES OF PUBLIC COMPANIES

In recent years, the various reforms of the Corporate Law and the Good Governance Code of listed companies have meant the greatest change in decades in terms of Corporate Governance. Pioneering initiatives such as the publication in February 1998 of the Olivencia´s Code, which, inspired by the 1992 Cadbury Report in the United Kingdom, began to establish the principle of "comply or explain" in our country, and introduced as one of its newest recommendations the creation of an audit committee within the Boards of Directors.

The Olivencia´s Report was succeeded by the Aldama´s report of 2002 and, that same year, the Financial System Reform Measures Act made a "recommendation" a legal requirement for listed companies. Subsequently, as a result of the race to improve corporate governance and the defence of minority interests led by Anglo-Saxon countries, in Spain the Accounts Audit Act of 2015 extended this requirement not only to listed companies but also to Public Interest Entities, establishing precise rules on their composition, operation and responsibilities. These requirements established in the amendment of the Spanish Companies Act (Law on Capital Companies)[9] were complemented by the recommendations contained in the 2015 Good Governance Code for Listed Companies (CBGSC), which replaced the 2006 Unified Good Governance Code. At the legislative level, the Royal Decree-Law 18/2017 and Law 11/2018 on non-financial information and diversity should be highlighted, which fully transposes the European Directive into Spanish law, establishing that numerous information of an environmental and social nature (aspects such as the "salary gap"), the fight against corruption and bribery, etc., be incorporated into the management report of companies.

As the culmination, until now, of this revolution in governance, **Technical Guide 3/2017 on Audit Committees of Public Interest Entities of the CNMV** has included a set of 79 recommendations for the strengthening of Audit Committees, compliance with which must be properly assessed

[9] Articles 529 quaterdices and 529 quindecies of the Consolidated Text of the Law on Capital Companies

because there is a risk that it is considered as *lex artis* by the competent jurisdiction. The Guide affects listed companies, financial entities, companies issuing bonds or entities, or entities with more than 4,000 employees and 2,000 million turnover.

Together with a series of basic principles that should govern the behaviour of its members, the audit committee, in a collegial manner, will have responsibility for advising the board of directors and for supervising and controlling the processes for preparing and presenting financial information, for the independence of the auditor, and for the effectiveness of the internal control and risk management systems.

With regard to its composition, the audit committee shall be composed exclusively of non-executive directors appointed by the board of directors, the majority of whom must at least be independent directors and one of whom shall be appointed taking into account his knowledge and experience in auditing, accounting, or both.

But this **very remarkable development in governance in private companies** that we have witnessed in the last decade has **not found the same reflection in the public sphere**. Thus, since the introduction more than 15 years ago in the Law on Public Administration Assets of the obligation for public companies obliged to be audited to set up an Audit and Control Committee, with the composition and functions to be determined in each case, there have been no subsequent changes that have contributed to its development, beyond the development through the regulation of the law on what should be understood by independent directors. This circumstance has progressively moved away from the standards of large private capital companies to the requirements established for public companies.

However, and even formally, it is certain that, at present, in the State Institutional Public Sector it is estimated that there are around 60 Audit Committees that basically carry out specific actions to supervise the auditing of accounts. On the other hand, and despite managing greater resources and also acting through Boards of Directors, **the obligation to set up an Audit Committee has never been demanded of Public Business Entities** which, however, with the passage of time and in an unequal manner, have opted to voluntarily set up such committees.

With regard to their functions, with their start-up in 2003 in the case of state-owned commercial companies (it is not known that this requirement has been transferred to the area of territorial administration) they have historically consisted of the following: supervision of the process of drawing up the Annual Accounts and meeting with the entity's auditors; proposal for the appointment and renewal of the auditor (this aspect must be compatible with public procurement procedures); information to the Board of Directors on the qualifications detected in the audit of accounts and, if there is an internal audit department, knowledge of both the audit plan and the results of the work.

However, the evolution of the control systems and the strengthening of the corporate governance of the companies, together with the progress already pointed out by the large capital companies, have put pressure on these Committees to have begun to assume functions that in many cases until now were alien to them, and that do not always fit precisely with the functioning of the public entities whose management they must supervise.

In addition to those previously mentioned, which revolved around the supervision of financial information and the relationship with auditors, these new functions are articulated around the

supervision of risk management, to the extent that, if a possible risk materializes, there may be an equity impact that should be reflected in the accounts.

These new categories of functions of the Audit Committee that should contribute to shaping a more excellent model of control are the following:

- Oversight of the effectiveness of the entity's internal control,
- Supervision of Risk Management Systems (RMS),
- Analysis of related operations,
- Supervision of fiscal aspects (Company Taxes and any other direct or indirect taxes).
- Supervision of the functioning mechanism of the Mailbox and of the entity's Code of Ethics,
- Supervision of the company's Crime Prevention Model.
- Supervision of the operation of the regulatory compliance area.

To the foregoing must be added sufficient knowledge of the audit work carried out by the different control bodies (IGAE, TC, TCE) or Independent Authorities (Airef, CNMC, CNMV) and the responsibility to analyse, jointly with said bodies, the weaknesses of the internal control system, including in the Control Plan, to be approved by the Audit Committee, the verification activities proposed by said bodies.

As an even more developed model, the case of AENA has been analysed, where the "advanced" functions described above, which are the responsibility of the Audit Committee, have been joined to the evaluation of the company's non-financial risks through one or several specialised committees on operational, technological, legal, social, environmental, political and reputational risks.

The existence of an **Internal Audit Department** or unit is a different matter from the very existence and functions that the Audit Committee must perform, since, although it may be paradoxical, there are still entities that, despite having an Audit Committee, do not have an internal audit department integrated into the management of the company. In this regard, it is recommended that all public companies above a certain size have personnel dedicated to this task, who will act under the functional dependence of the Audit Committee. Furthermore, it is recommended that a Statute be drawn up for the Internal Audit Department, to be approved by the Board of Directors, in which the basic aspects of the effective functioning of this department are explicitly defined: objective or mission, functional and organic dependence, degree of autonomy and responsibility.

In any case, in the functions carried out by the internal audit unit or department, full coherence must be guaranteed with the control functions that the law imposes on the General Intervention of the State Administration and the other audit bodies that may exist at the State, Autonomous Community or Local level, particularly when, depending on its legal control system, the internal audit unit or department coexists with permanent financial control.

From the statistical analysis carried out on the Audit Commissions of ten of the most significant public companies (among which one at municipal level has been included), it has been observed that:

- In the 10 cases analysed, there was an Audit Committee dependent on the Board of Directors, and in 9 cases there is an internal audit department or unit that reports organically to the Chairman of the company in 67% of the cases or to other bodies (Presidential Cabinet, General Secretariat or Executive Vice-Chairmanship) in the remaining 33%.
- The number of members of the Audit Committee is 3 members in 8 cases, 4 members in 1 case and 5 members in 1 case.
- Only in 3 cases did the Audit Committee have a Regulation or Operating Rules approved by the Board of Directors of the company[10].
- The average number of annual meetings of the Audit Committee in 2018 was 4.55 times, with 2 times the Committee that met the least and 8 times the most.
- In only two cases was the Audit Committee made up mainly of non-administrative persons.
- The average number of people in the internal audit department is 5,2.

In conclusion, it is considered that, under the principles of responsibility, scepticism, continuous and constructive dialogue, and analytical capacity, the Audit Committees of Public Companies should continue to make progress in assuming these new functions, taking into account the best practices of Corporate Governance.

To this end, the **following recommendations** are made:

- The need to provide an Audit Committee and an Internal Audit unit or department (on which it will depend) for all Public Business Entities and public companies of a certain size.
- The members of the Audit Committee should be appointed taking into account their knowledge and experience in matters of taxation, accounting, internal control and risk management, and auditing.
- That the functions of the Audit Committee of all the entities of the Institutional Public Sector are updated and homogenized, providing them with greater training, specialization and involvement.
- Ensuring unrestricted access to company information and appropriate use of modern control instruments (Big Data techniques, IT analysis, etc.).
- The amount of the per diems to be received by the Directors should take into account their greater responsibility deriving from membership of the Audit Committee.
- The autonomy of the Internal Audit Department should be reinforced, making its appointment and removal directly dependent on the Audit Committee or, in its absence, directly on the Board of Directors.
- Ensure greater and better coordination of the Internal Audit area with those legally responsible for external control and with financial supervisory bodies.

[10] It should be noted that both the SEPI Group and the Patrimony Group have Instructions on the functions to be carried out by the Audit Committees of the companies within their scope.

4.- Working Group´s Members

Alberto Alonso Poza, Shareholder and Chief Financial Officer, Gas&Go**; Carlos Balmisa García-Serrano,** Director of Internal Control, CNMC**; Ignacio Corral Guadaño,** Director of the School of Public Finance**; Pedro Durá,** General Secretary, Privatization Advisory Council (CCP). Professor, Universidad Complutense de Madrid**; María Jesús Escobar,** Partner responsible for the public sector EY**; Marta Fernandez Currás,** Partner, EY Abogados**; Silvia López- Palomino, Partner,** EY Abogados**; Manuel Fresno Castro,** Comptroller-Auditor del Estado on leave of absence (WG Coordinator)**; Mario Garcés Sanagustín,** Comptroller and Auditor of the State and Inspector of the Treasury of the State on leave of absence. (WG Coordinator)**; Guillermo González de Olano,** Legal Director, Suez Agua**; Guillermo Guerra Martín,** Partner, Gómez Acebo & Pombo Abogados**; Gonzalo Iturmendi Morales,** Lawyer, Partner and Director, Bufete G. Iturmendi y Asociados, S.L.P.**; Paloma Martín Martín,** Director of Social Services and Public Sector Health, Deloitte Consulting**; David Mellado Ramírez,** Partner, PWC. State Attorney on leave of absence**; Juan José Montero Pascual,** Of Counsel, Martínez Lage, Allendesalazar & Brokelmann Abogados. Professor of Administrative Law, UNED; **José Antonio Morillo-Velarde Del Peso,** Head of the Legal Department of State Ports, Ministry of Public Works**; Cándido Pérez Serrano,** Partner responsible for Infrastructure, Government and Health, KPMG Spain**; Fernando Riaño Riaño,** Director General of Relations, ILUNION (ONCE**); Marina Serrano González,** President, Aelec. Of Counsel, Department of Litigation, Public and Regulated Sectors, Pérez-Llorca**; Carlos Vázquez Cobos,** Partner, Gómez-Acebo & Pombo Abogados**; Pablo Vázquez Vega,** Director, CUNEF; **Mercedes Vega García,** Deputy Director General of Studies and Coordination, General Intervention of the State Administration.

5.- Annex I: Sessions held

- **1st Inaugural Session: 21 November 2018.**

  Presentation of the Working Group: Cristina Jiménez Savurido, Fide´s President.

  Speakers: Manuel Fresno, State Comptroller-Auditor on leave of absence and **Mario Garcés,** State Comptroller and Auditor and State Treasury Inspector on leave of absence. Co-directors of the group.

- **2nd Session: 14 January 2019: Corporate Governance of Public Companies: proposals for improving their efficiency, good practices and possible conflicts of interest between owners and managers.**

  Speakers: Pedro Durá, Secretary General Consultative Council of Privatizations (CCP). Professor at the Complutense University of Madrid and **Jose Antonio Morillo-Velarde,** Head of the Legal Department of State Ports, Ministry of Public Works.

- **3rd Session: 12 February 2019: OECD, IMF and European Commission Guidelines on Corporate Governance of Public Enterprises: Experiences at the European Level.**

Speakers: Juan Munguira, Member of the Board of the OECD Corporate Governance Committee and **Juan José Montero,** Of Counsel de Martínez Lage, Allendesalazar & Brokelmann Abogados. Professor of Administrative Law at UNED.

- **4th Session 28 February 2019: Recruitment in Public Administration. The experience of CreSap (Commission for Recruitment and Selection of Public Administration).**

  Speaker: João Bilhim, Former President of CReSAP. Researcher of CAPP/ISCSP and GESPU/UnB. Visiting Professor at FACE/University of Brasília (UnB).

- **5th Session: 14 March 2019: Internal control systems in public companies: supervision of the Board and responsibility of management. Establishment of common internal control frameworks. Proposals for improving transparency in public companies.**

  Speaker: David Mellado, PWC Partner. State Attorney (on leave of absence).

- **6th Session: April 4, 2019: Meritocracy and procedure for the selection of the members of the Boards of Directors of Public Companies: Remuneration, suitability and legal responsibility. Existence of independent Directors and their definition. Audit, Risk Management and Appointments and Remuneration Committees in the case of Public Companies: differences and analogies with their private counterparts.**

  Speakers: Cándido Pérez Serrano, Partner in charge of Infrastructures, Governance and Health at KPMG Spain and **Manuel Fresno,** State Comptroller-Auditor on leave of absence.

- **7th Session: May 21 2019: Discussion of the document proposing conclusions.**

6.- Acknowledgements

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We are also grateful to the speakers who have participated by introducing the topics for debate and to all the members of the working group who have contributed their experience, knowledge in the matter and their personal reflections.

We would also like to highlight the participation of **João Bilhim**, Former President of CReSAP. Researcher at CAPP/ISCSP and GESPU/UnB. Visiting Professor at FACE/Universidade de Brasília (UnB), who, from Lisbon, has had an intervention to deal with Recruitment in the Public Administration and the experience of CreSap (Comissao de Recrutamento e Selecao de Administracao Pública); and **Juan Munguira**, Member of the Bureau of the Corporate Governance Committee of the OECD.

It has been months where we have been able to debate and work intensely and it has been an honour and a privilege to be able to count on everyone's contributions.

7.- FIDE

FIDE Foundation is today a **permanent meeting place** for professionals of the highest level or with a long professional career, who develop their activity in **companies, professional offices and the Public Administration.**

Fide is a legal-economic think-tank, an operational centre of knowledge in a practical state, made possible thanks to the active participation of all levels of civil society that have something to say about it: from top management of companies to law firms, from university chairs to courts of justice, from all levels of administration to professionals from different fields related to the world of Law and Business.

At Fide we have set up a series of working groups with the aim of carrying out a **continuous and profound reflection** on some of the major issues that we have considered that, due to their **urgency, need for reform or capacity for improvement**, deserve to be the object of special reflection by a group of experts. Some have already published their first conclusions, have made concrete normative proposals or have advanced an initial analysis of the situation. Others will do so throughout the year. But there is no doubt that in each group we have an **essential point of reference**. The composition of each group, with **professionals with extensive experience and in-depth knowledge of each subject**, allows us to tackle all those issues that we collectively believe merit reflection. In other cases, the debate itself reveals the complexity and distance of the positions and, therefore, the value of the work is reflected in specific summaries on the issues addressed. In any case, any professional involved in the evolution, development, application or improvement of regulation and especially of economic regulation must be familiar with these works and contribute to their development, knowledge and dissemination.

The members of these working groups are **members of Fide** and regular attendees to Fide's sessions and forums, which are closely linked to the matters dealt with in the respective areas of analysis.