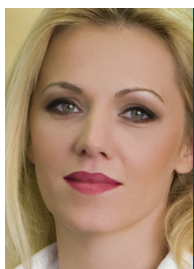


## Alternative management systems in Romania



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UNTIL RECENTLY, ROMANIA KNEW ONLY one system of management – the unitary system, where the management is formed by only the sole director/board of directors – applicable, with certain differences, to both joint stock companies (JSCs) and limited liability companies (LLCs). Following the World Bank's 2004 Report on the Observance of Standards and Codes, which indicated deficiencies in the existing company legislation, changes brought to Romanian corporate law from 2006 sought to adapt it to the Organisation for Economic Co-operation and Development's corporate governance principles, as well as to EU principles.<sup>1</sup>

### INTRODUCING THE DUAL SYSTEM

One of the novelties introduced by the reforms is that JSCs can now choose between the existing unitary system and the newly introduced dual system of administration, where the management is formed of the supervisory board and the directorate.

Although relatively new, the dual system has already been adopted by major companies in Romania, especially banks (eg Raiffeisen, Bancpost and BCR) and insurance companies (Agras Vienna Insurance Group), as well as investment and asset management companies (such as Fondul Proprietatea and OTP Asset Management).

### CHARACTERISTICS OF THE TWO ALTERNATIVE MANAGEMENT SYSTEMS

A summary of the two systems now available to JSCs may highlight the following main features:

#### Unitary system

- Within the unitary system the directors are appointed by the general assembly of the shareholders. Only exceptionally, in the case of vacancies, are provisory directors appointed by the board itself.
- The company's directors may not be its employees. Existing labour agreements at the time of accepting the mandate are therefore automatically terminated or suspended.
- The board of directors has to be non-executive in its majority if it delegates powers to managers. The executive directors manage the company either directly or by delegating some of their powers to managers, provided that the exclusive powers set forth by law or by the general assembly are retained (eg only directors may draft the annual management report, organise the meetings of the shareholders and implement the resolutions taken thereby). The delegation of powers to managers is not mandatory, except for audited companies.<sup>2</sup> Managers are appointed by the directors from among themselves (as executive members) or company personnel.
- It is mandatory that a number of directors work as a collegial body, namely the board of directors, the power to represent the company belonging to its president. Other powers may be allocated to one or more directors, concurrently or jointly. It is highly recommended that the limits and conditions to the directors' powers be clearly set forth in the articles of association.

Due to its relative permeability, with non-executive and executive powers separated at an individual level rather than at the level of corporate bodies, the unitary system remains more suitable for smaller companies or companies with a smaller number of shareholders, who act concertedly and exercise a more direct and relatively constant supervision on the company.

#### Dual system

The dual system allocates more clearly the executive and non-executive powers to various corporate bodies. It therefore proves more suited to companies with a dissipated and numerous shareholding, including listed companies, as the supervisory board's role is to ensure cohesion among the various interests of the shareholders and of the stakeholders (creditors, employees and other third parties interested in the company's profitability).

- All members of the supervisory board (appointed by the general assembly) are non-executive officers of the company, while the members of the directorate (or the sole director), appointed by the supervisory board, are executive officers.
- Following from this separation of powers, the supervisory board may not be involved in the company's management, except where its approval of certain operations is required by the articles of association. Instead it is called to control and supervise the management activity carried out by the directors, verify compliance with the law and report to the general assembly.
- The company is represented by its directors, working as a rule together within the collegial body of the directorate.

#### Common requirements

Beyond the differences summarised briefly above, a number of common requirements apply to members of the board (be it the supervisory board in the dual system or the board of directors in the unitary system), mainly as a reflection of the corporate governance principles in the matter of management structures that apply to both systems. Certain duties and obligations belong to all members of the management bodies, including executive directors, non-executive directors, supervisory directors and managers.

Among the purposes of corporate governance are the effective monitoring

of the company management by the board (whether supervisory or board of directors) and the consolidation of the board's liability towards the company and its shareholders.

- Deriving from these goals, as well as from other specific corporate governance principles, the board (supervisory/board of directors) monitors the efficiency of the company's management, by way of verifying the executive directors'/ managers' reports and further reporting to the shareholders.
- In both systems, to ensure the board's capacity to make business decisions based on objective assessments and thus ensure a balance between the interests of the shareholders and those of the stakeholders, while always serving the company's interests, the directors must all act on a fully informed basis, in good faith, and with due diligence and care.
- Romanian law provides independence and professionalism criteria for the directors (supervisory/board of directors). These criteria are governed by the principle 'substance rather than form', which is close to the 'comply or explain' principle.<sup>3</sup>
- The members of the board must be ensured actual and timely access to relevant and accurate information.
- Further, the members are obliged to disclose previous mandates upon taking over their position and concomitant mandates are limited.

**DIRECTORS' DUTIES**

All the members of a company's management bodies (ie members of the board of directors and/or the supervisory board, the executive directors and the managers) have fiduciary duties, with three main components:

- First, they have an obligation to act diligently, the standard requiring that,

when making a business decision, they must be reasonably entitled to believe they are acting in the interests of the company and based on adequate information.

- Secondly, they have a loyalty duty towards the company. This is generally assessed in connection with the lack of a direct or indirect interest regarding a certain business decision (a principle correctly applied by obliging the management members to declare their contrary interests and abstain from voting, by forbidding loans to management members in excess of the legal limits and by imposing a non-competing obligation), with the equitable treatment of all shareholders, the monitoring of transactions with affiliates and also by establishing principles regarding the manner in which the members are remunerated.
- Third, all management members must observe their confidentiality duty.

**LIMITED LIABILITY COMPANIES**

Finally, since the option between the unitary system and the dual system is available only for JSCs, a few words may be necessary with regard to the management system within LLCs.

It should be noted that LLCs represent, together with the JSCs, the most frequent choice of incorporation in Romania, as, similarly to the JSCs, they offer shareholders a limitation on their liability to the value of the shares they have contributed. The management structure in LLCs is a laxer form of the unitary system (where, among other characteristics, the directors may form a board of directors, seen as a collegial body, or may act separately, with similar or different powers, including the power of representation, depending on the choice expressed by the shareholders in the articles of association).

**CONSIDERATIONS FOR COMPANIES AND INVESTORS**

Each of the two management systems available for JSCs has its benefits and the choice is usually determined by the size of the company and the number of its shareholders. As explained, if the shareholders are numerous, meet rarely and are located outside Romania the dual system is recommended, as the supervisory board acts as a control body over the executives. Conversely, in smaller companies, the unitary system may be preferred, as fewer people need to be involved and there is a more direct relationship between the executives and the shareholders.

**NOTES**

- 1) As reflected in 'Modernising company law and enhancing corporate governance in the European Union – a plan to move forward', communicated by the European Commission to the European Council and Parliament in 2003, as well as in the 15 February 2005 'Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board'.
- 2) According to the Romanian Ministry of Finance Order No 1752/2005, audited companies are those that meet two of the following criteria: total assets in excess of €3.65m; net turnover in excess of €7.3m; average number of personnel in excess of 50; listed company.
- 3) 'Substance rather than form' (according to the 2005 Recommendation, above) means that the determination of what constitutes independence should principally be an issue for the (supervisory) board itself to determine and, in applying the independence criteria, the (supervisory) board should focus on substance (the absence of any material conflict of interest) rather than formalistic criteria. The principle 'comply or explain' obliges companies to justify any deviation from corporate governance codes. Since Romania does not have a corporate governance code, the principles apply in the determination, on a case-by-case basis, of the independence of the non-executive directors and members of the supervisory board, taking into account the non-exhaustive list of criteria provided by the law.