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## APPLICABILITY OF THE FINANCIAL ASSISTANCE PROHIBITION FOR LIMITED LIABILITY COMPANIES UNDER ROMANIAN LAW

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The Romanian mergers & acquisitions market has been targeted more and more lately by leveraged buy-outs (LBOs), a type of business better known in the western jurisdictions. Usually, this kind of share deals are performed with the aid of money borrowed from financial entities, to be later reimbursed from the gains obtained after the closing of the transaction. A major issue raised by this type of acquisition transactions is the security package that can be duly created by the buyers in favour of the financing banks. Most of the buyers intend to use the shares and the assets of the company which will be acquired in order to secure the acquisition loan itself. This transactional structure, however, may pose a big set of issues under Romanian law.

According to the Romanian companies' law no. 31/1990 (the „**Company Law**”), article 106, and in line with the European legislation (i.e. 2012/30/EU Directive), „*a company may not grant advances or loans, nor may it grant security for the purpose of the subscription or acquisition of its own shares by a third party*”, while according to article 107 of the same law „*the creation of security interests over its own shares by a company, either directly, or through third parties acting in their own name but on behalf of the company, is considered acquisition*” for the purpose of article 106.

This prohibition is currently known by the practitioners under the name of financial assistance and is expressly regulated under Romanian law only for joint stock companies (in Romanian, *societati pe actiuni*) (JSCs) while for other types of companies (such as limited liability companies) there is no express provision in this respect.

Although the prohibition is expressly regulated only for joint stock companies, the Romanian market practitioners have had a long-standing debate on whether such prohibition is applicable to limited liability companies (in Romanian, *societati cu raspundere limitata*) (LLCs) as well and if so, to what extent. The main argument in favour of applying this prohibition by analogy is that if a third party becomes a shareholder in a company by using that company's own assets this would unduly increase the respective company's debts in the detriment of its pre-existing creditors. Adding to this the fact that there is no express permission for financial assistance to LLCs and that a limited liability company's creditors should reasonably benefit from the same protection as those of a joint stock company, the Romanian market practitioners and scholars did not reach a unanimous conclusion on this dilemma. This aspect remains unsolved also in the jurisprudence of the Romanian courts of law which, to our knowledge, contains no case law on this matter.

This legislative uncertainty is also maintained by the fact that, in some cases, the Company Law expressly states for specific articles and paragraphs from the joint stock companies' corporate organisation rules whether they also apply *mutantibus mutantibus* to LLCs or not. Article 106 above, however, was left out, so that there is no express regulation on whether it applies to LLCs or not.

There are also strong arguments under Romanian law that this prohibition should not be considered applicable to LLCs.

Article 106 of the Company Law was implemented in its current form following the transposition of the 2006/68/CE Directive, which was repealed and replaced by the 2012/30/EU Directive. The European legislation states that it specifically refers to joint stock companies (in Romanian *societati comerciale pe actiuni*), this type of companies being the object of the entire European legislative act. Furthermore, the European lawmaker was not extremely prohibitive even in respect to JSCs, as it permitted for the EU member states to allow such financial assistance operations in their legislations subject to the fulfilment of certain conditions, mainly related to the equal and unbiased treatment of the minority shareholders and the combatting of market abuse.

On the same note, under the general principles of law, any prohibition is considered to be of strict interpretation and it cannot be applied extensively. Based on this principle, the majority of the Romanian courts, including the Supreme Court of Justice, have ruled that the joint stock companies' rules included in the Company Law should only apply to JSCs and not be extended to limited liability companies. An example of such argumentation is decision number 3471/2008 of the Supreme Court of Justice according to which the applicability of the specific rules provided for the joint stock companies are of strict interpretation and they cannot be applied to LLCs or other types of companies unless the law provides so expressly.

However, a more recent decision of the same court has a different approach on this matter, considering that since the law has expressly excluded a number of provisions from the Company Law, which therefore only apply to joint stock companies and are not applicable to limited liability companies, it means that the rest of the joint stock companies regulations (which may include article 106 above) is also applicable to limited liability companies, by means of analogy. It should be noted, however, that this decision of the Supreme Court only refers to the rules of corporate organization of a joint stock company and respectively, of a limited liability company, and not to prohibitions and limitations imposed by the law for these companies.

The consequences of breaching the financial assistance prohibition are both of commercial and criminal nature. The Company Law does not provide an express sanction for infringement of the prohibition, however, the general opinion in legal literature is that the sanction should be the absolute nullity (in Romanian, *nulitate absoluta*) of the security, guarantee, loan or any other document which is in breach. Certain authors also question the validity of the relevant share sale-purchase agreement as well. Absolute nullity may be invoked by any interested party (in some views these could only be the relevant company whose shares are being acquired and its creditors) and it empties the relevant agreements of any legal effects (as if the agreement was never concluded by the parties) with the natural consequence that the parties must return the proceeds/assets they might have received pursuant to such null agreements.

From a criminal law point of view, according to article 273, letter c) of the Company Law, the administrator, the manager, the executive director or the legal representative of the company who grants loans or advances on the company's shares or creates security interests in unlawful circumstances may be sentenced to imprisonment between 3 months up to 2 years or be sanctioned with a fine.

The general view of legal authors is that a breach of the above prohibition would qualify as a criminal offence but it should apply only to JSCs on the grounds that the text specifically refers to "*actiuni*" (shares in JSCs) and not "*parti sociale*", (shares in LLCs) and the application of criminal law is of strict interpretation and cannot be extended by analogy to other situations than those expressly provided by law.

In order to reach a conclusion and taking into consideration all of the above, it seems that the majority of the case law and views of legal authors under Romanian law are in favour of a strict

applicability of the financial assistance prohibition to JSCs only. However, given the divergent and inconclusive case law and potential contrary arguments that may be brought against this view we cannot rule out the possibility that a court of law may find the prohibition applicable to LLCs as well. What we know for sure is that this matter continues to be an open subject for the corporate legislation and case law in Romania and a sour subject for LBO transactions on the Romanian market.

