

Considerations on nullity in case of companies under Romanian law

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Abstract

The company acquires legal personality after a series of formalities required by law are fulfilled, formalities that concern the constituent acts on which it is based. For this reason, it is very important to know the legal status of the company's constitutive acts and the consequences of their irregularities. Hence, both the essential conditions and the form of the company's constitutive acts are analyzed based on the legal provisions. It is also necessary to distinguish between the nullity resulting from the unlawful drafting of these constitutive acts and the nullity of society as such. Therefore, this paper is focused on these differences, as well as on certain practical issues about nullity starting from a recent court decision handed down by the Romanian Supreme Court.

Keywords: Romanian law, company, companies' law, nullity.

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1. Introduction

The effect of a company's incorporation is that a new legal entity, a new statutory body emerges in the business area and such entity needs to comply with several requirements provided by law in order to ensure the security and stability of legal relations.

Such legal requirements cover conditions to be complied with by the company at the time of incorporation, that is formalities provided by law which must be fulfilled, as otherwise, the company may not be incorporated.

At the same time, the constitutive act(s) of incorporation based on which the company is established and which regulates (regulate) the legal relations between shareholders must be concluded as provided by law, as otherwise the company may not be legally set up.

A recent case handled by the High Court of Cassation and Justice² reveals certain difficulties that might be encountered in the judicial practice, when a company's nullity might be mistaken for the absolute nullity of a company's memorandum of association. The paper does not pretend to analyze exhaustively this topic, but rather to underline certain important aspects.

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² High Court of Cassation and Justice, Civil Division II, Decision No. 1063 of 7 June 2016.

2. A company's memorandum of association

In accordance with art. 5 of Companies' Law No. 31/1990³ (hereinafter referred to as "Law no. 31/1990"), general partnerships or limited partnerships shall be set up under a memorandum of association (company contract), whereas joint-stock companies, limited partnerships by shares or limited liability companies shall be incorporated under a memorandum of association and articles of association (statute)⁴.

According to the abovementioned law, "constitutive act" is a generic name that covers both the memorandum of association as such and the company's articles of association, all the more that the articles of association is the only instrument concluded in the case of single-member private limited liability companies, and it stands for a constitutive act within the meaning of law⁵.

3. Substantive conditions of a company's memorandum of association

In accordance with article 1179 of the Civil Code, the substantive conditions of these categories of instruments are the conditions paramount to the validity of any contract and consist of the capacity to enter a contract, a valid consent, a determined and legal object (subject matter) and a moral and legal cause.

3.1. Capacity to enter a contract

In accordance with article 6 of Law no. 31/1990, legally incapacitated persons may not be founders. Therefore, a natural person must have full legal capacity to act in order to conclude the constitutive acts⁶. An under-aged can do this through its legal guardian.

³ Republished in the Official Gazette of Romania No. 1066/2004, as amended.

⁴ For details see Ana-Maria Lupulescu, *Some Aspects Concerning the Setting up of Companies Regulated in Romania by the Law no. 31/1990 Republished*, in Cătălin-Silviu Sărau (ed.), *Contemporary Challenges in the Business Law*, ADJURIS – International Academic Publisher, Bucharest, 2016, p. 124, 125.

⁵ See Stanciu D. Cărpenaru, *Tratat de drept comercial român, conform noului Cod civil*, Universul Juridic Publishing House, Bucharest, 2012, p. 146.

⁶ Art. 37 of the Civil Code: "A person's capacity to act is that person's capacity to conclude civil legal instruments by themselves."

Art. 38 of the Civil Code (1) "A person has the full capacity to act when he/she reaches the age of majority. (2) The age of majority is 18 years."

Art. 39 of the Civil Code "(1) A minor child acquires, through marriage, the full capacity to act. (2) If the marriage is annulled, the minor who entered the marriage in good faith shall preserve his/her full capacity to act."

Art. 40 of the Civil Code "The guardianship authority may acknowledge, based on substantial grounds, that a minor who turned 16 years of age has the full capacity to act. In that respect, the opinion of the minor's parents or guardian, as well as of the family council, if applicable, will be sought."

3.2. Parties' consent

The parties' consent must be expressed with the intention to cause legal effects and should not be vitiated, but must be firm, free and informed.

Please note that a company may be set up by natural persons or by natural persons together with legal, Romanian or foreign entities.

A consent may not be affected by the vices of consent, as provided by the Civil Code. Such vices are error, duress and violence.

Therefore, *error* entails a contract's nullity when it concerns the person with whom the contract was concluded, in the case of partnerships, when that person's capacity was taken into consideration upon the conclusion of the company contract. An error regarding the object of the contract shall entail the contract's nullity when it concerns the substance of the contract's object, and not the amount of the contribution or the chances to obtaining profit.

Duress is important only when originating from the other contracting party. If it originates from one partner only, the contract shall be valid and the partner whose consent was vitiated shall claim compensations from the author of the duress, but shall be in legal relationships with the other partners.

Violence, as a vice of consent, is not common in practice, but it is also covered by the provisions of the Civil Code.

3.3. Object of the memorandum of association

In this area, the notion of object (subject matter) of a contract covers, on the one hand, the object as enshrined in the common law – in this case, jointly carrying out an activity and sharing the resulting benefits – and, on the other hand, as object of a company, the notion covers the company's activity as such, *i.e.* the production, sale or service supply activities subject to the regulations provided by article 3 of the Civil Code⁷.

The object is set out by partners in the memorandum of association and should be determined, legal and moral.

3.4. Cause of a memorandum of association

The cause is the reason that prompts the parties to enter into the contract and is therefore a psychological motivation, which explains the purpose for which the company contract was concluded.

The cause – like in any other contract – must be legal and moral and therefore should not violate public policy or accepted principles of morality. When the legal or illegal nature of a cause is established in a memorandum of association, what will be taken into consideration is real purpose of the company, not the declared and apparent purpose.

⁷ See also M. Schiaua, *Unele probleme legate de obiectul de activitate al societății comerciale*, „Dreptul”, issue no. 9/1994, p. 8 et seq.

4. Consequences of the non-compliance with a memorandum of association

In principle, in accordance with article 1246 of the Civil Code, the failure to comply with the legal provisions on substantive conditions entails the nullity of a memorandum of association.

If substantive conditions on the object and cause does not pose particular problems, the same cannot be said about the conditions on the parties' consent and capacity as basic contract conditions, as these must be related to each partner separately.

Therefore, the vice of consent in the case of a shareholder shall only impair the legal relations concerning that partner, without any consequence on the legal relation to the other shareholders⁸.

Due to the multifaceted nature of the contract, in this case, the nullity generated by the non-compliance with the conditions on consent or the parties' capacity should apply to the prejudiced legal relation only, and not to the company memorandum of association as a whole.

5. Formal conditions of a memorandum of association

In accordance with Law No. 31/1990, article 5 paragraph (6), memorandum of association shall be concluded under private signature and shall acquire a certain date when filed with the Trade Registry Office.

Exceptionally, the memorandum of association may be concluded in authentic form when the assets subscribed as social contribution include a plot of land, is the case of partnerships or limited partnerships or joint stock companies established by public subscription.

The non-compliance with the formal conditions imposed on the memorandum of association entails the company's nullity. Therefore, the condition consisting in the contract's written form, that is the authentic form, is required *ad validitatem*.

6. A company's nullity and nullities of common law

Please note that the failure to comply with the substantive conditions of the memorandum of association generates certain specific effects which are not identical to the effects of the nullity of the legal acts in the common law⁹.

⁸ See O. Căpățînă, *Societățile comerciale*, Lumina Lex Publishing House, Bucharest, 1966, p. 178.

⁹ For a labour law perspective, see R. Dimitriu, *The Romanian Law-maker's New View Regarding Nullity. Effects upon the Labour Relations*, Medimond International Proceedings, Monduzi Editore International Proceedings Division, Bologna (Italy), p. 229-234, http://www.edlearning.it/proceedings/moreinfo/20131009_index.pdf (consulted on 10.11.2017).

The Romanian Civil Code, the common law applicable in the matter, regulates the cases of a legal entity's nullity under article 196¹⁰.

To meet the imperative protection of third parties, the company's nullity regime derogates from the legal instruments' nullity regime¹¹.

In accordance with article 56 of Law No. 31/1990, the instances of a company's nullity include, but are not limited to: the memorandum of association is missing or was not concluded in authentic form, when the law provides so; all founders were incapacitated at the time of the company's incorporation; the company's object is illegal or contrary to public principles; the delegated judge's ruling regarding the company's registration is missing; the administrative legal authorization for incorporating the company is missing; the memorandum of association fail to set out the company's name, object, contributions or subscribed share capital; the legal conditions regarding the minimum, subscribed and paid in share capital were not complied with; the condition regarding the minimum number of shareholders provided by law was not complied with.

Please note that the non-compliance with the conditions on nullity causes should be assessed at the time of incorporation, and the action shall be dismissed if the nullity invoked in the application submitted to the tribunal was removed before the conclusions on the merits had been lodged.

Another specificity of the effects of a company's nullity is that they do not apply retroactively— article 198 of the Civil Code.

This is the reason why the instruments concluded on a company's behalf will continue to be valid and therefore, neither the company, nor the partners can oppose good faith third parties by invoking the company's nullity.

¹⁰ Art. 196 of the Civil Code states that:

- “(1) A legal entity's nullity may be acknowledged or, as applicable, declared by a court only when:
- a) the document of incorporation is missing or was not concluded in authentic form in certain situations provided by law;
 - b) all the founders or partners were legally incapacitated at the time of the legal entity's incorporation;
 - c) the company's object is illegal or contrary to public policy or accepted principles of morality;
 - d) the administrative authorization necessary to set up the company is missing;
 - e) the instrument of incorporation does not set out the company's name, registered office or object;
 - f) the memorandum of association does not set out the founders' or partners' contributions or the subscribed and paid in share capital;
 - g) the legal provisions on initial assets or the minimum subscribed and paid in share capital were violated;
 - h) the legal condition on the minimum number of founders or partners was not met;
 - i) other mandatory legal provisions the infringement of which entails the nullity of a legal entity's instrument of incorporation were disregarded.
- (2) The failure to comply with the provisions of paragraph (1) letters a), c)-g) shall be punished by absolute nullity”.

¹¹ See I. Schiau, T. Prescure, *Nulitatea societății comerciale*, in Dreptul, issue no. 8/2006, p. 114 et seq, C. Gheorghe, *Nulități de drept comercial*, C.H.Beck Publishing House, Bucharest, 2010; C. Gheorghe, *Nulitatea societății și nulitatea actului constitutiv*, In RDC. Issue No. 4/2006, p. 37 et seq.

The partners' responsibility regarding the liabilities of a company which ended its activity under such circumstances shall be as provided by law, *i.e.* article 3¹² of Law No. 31/1990.

In the abovementioned case, the claimants requested that the nullity of the defendant company's memorandum of association is established, on the ground that this instrument is affected by absolute nullity since the legal representatives failed to express their valid consent when the defendant company's share capital was set up.

It was held in that case that the Decision of the General Ordinary Meeting of Shareholders (GOMS) of the claimant, company A. S.A., approved the incorporation of a limited liability company – company E. S.R.L. – where the claimant owned 95% of shares, after bringing several movable and immovable assets (stables, land, store rooms, but also money and other stuff) as a contribution.

The defendant claimed to its defense that the provisions of article 56 of Law no. 31/1990 on a company's nullity are applicable, but were not invoked in this case.

The court maintained that the nullity of a company as a legal entity differs from the nullity of the memorandum of association, both in terms of legal regime, and in terms of consequences: a company's nullity can be established or declared only for the causes expressly provided by article 56 of Law No. 31/1990, while the nullity of a memorandum of association is triggered by the causes of common law.

However, in this case, the claimant company was one of the companies listed in such a way that the company's administrators could carry out acts of disposition under the general mandate, within the limit of 20% of the total assets, minus the receivables to be collected.

The alienation of such a company's assets, as in kind contribution to the incorporation of a new company, the value of which exceeds the 20% limit provided by Law no. 297/2004 on capital market¹³, article 241¹⁴ paragraph (1), lacking a valid consent which should have been expressed upon the conclusion of the instrument –

¹² Art. 3 provides that: "(1) Social obligations are guaranteed by the social patrimony. (2) Associates in the general partnership and active associates in the limited partnership or the limited partnership by shares are unlimited and jointly liable for the social obligations. The creditors of the company will first resort against it for its obligations and, unless the company pays them within 15 days from the date of the notice, they will be able to appeal against these associates. (3) Shareholders, passive associates, as well as the associates in the limited liability company are liable only to the extent of the subscribed share capital."

¹³ Published in the Official Gazette of Romania No. 571 of 29 June 2004, as amended.

¹⁴ Article 241 provides that: "(1) Acquisition, alienation, exchange or warranty of assets belonging to the fixed assets of the company, whose value exceeds, individually or cumulatively, during a financial year, 20% of the total fixed assets, less the receivables, will be concluded by the directors or the managers of the company only after the prior approval of the extraordinary general meeting of the shareholders.

(2) The rent of tangible assets over a period of more than one year, whose individual or cumulated value to the same co-contractor or persons involved or acting together exceeds 20% of the value of the total fixed assets, less the receivables at the conclusion of the legal act, as well as the associations over a period of more than one year, exceeding the same value, shall be approved in advance by the extraordinary general meeting of the shareholders. (3) In case of non-observance of the provisions of para. (1) and (2), any of the shareholders may request the court to annul the legal act concluded and to prosecute the directors for the repair of the damage caused to the company."

probably because the General Extraordinary Meeting of Shareholders did not approve the decision to contribute to the newly incorporated company's share capital, triggers the acknowledgement of the absolute nullity of the memorandum of association concluded in that way.

7. Conclusions

When settling disputes surrounding the acknowledgement of nullity in the case of companies, the nullity causes of a company are most often invoked along with the nullity causes of the memorandum of association, as regulated in the common law.

Under such circumstances, the court is obliged to differentiate between those causes and apply the appropriate legal regime to them, with the resulting consequences for the respective company's fate.

It is worth noticing the approach of the law as concerns the nullity of company, which draws attention to the observance of the legal conditions on incorporation and existence of the company, by maintaining imperative clauses, from which we cannot derogate, but which also meets the interests of third parties, and why not, the company's, by the possibility of covering the causes of nullity.

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