

# THE LEGAL REGIME OF THE MORTGAGE OVER THE SHARES AND SOCIAL PARTS IN THE CURRENT BUSINESS ENVIRONMENT

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## Abstract

*The present study aims to scrutinize the main legal traits of the mortgage over the shares (from a joint-stock company) and social parts (from a limited liability company) with focus on the modalities of establishment, the publicity, the real benefits for lender, the special situations related to the foreclosure process.*

*Also, one of the envisaged objective is to critically analyze the last amendments brought to the Romanian specific legislation and to submit proposals for amelioration aiming to better serve the business needs, on one hand, and to strengthen the legal security on the other hand.*

**Keywords:** *Shares, Social Parts, Security Agreement, Joint-Stock Companies, Limited Liability Companies*

## 1. Introduction

### 1.1. Which is the area/domain covered by the theme of the present study?

The main objective of the present study is to present the legal regime of the movable mortgage over the shares (belonging to the joint-stock company) and social parts (related to the limited liability company) and to critically assess the important legal traits, the modalities of setting-up, the significant clauses contained by the security agreements, the benefits for the contracting parties, the contrastive analysis of the current legal framework and the foregoing legal framework, the corporate decision-making process regarding the approval by the shareholders of such guaranties, the publicity of the security agreements and some relevant situations deriving from the foreclosure operations.

The mortgage over the shares and social parts are currently used by the Romanian credit institutions to secure the repayment obligation towards a creditor.

In general terms, the movable mortgage is an institution specific to the civil law; prior to the entering into force of the new Civil Code (01.10.2011), the settlement of such guaranties was governed by the former VI<sup>th</sup> Title from the

Law no. 99/1999 on some measures for the acceleration of the economic reform that was a special law in comparison with the former Civil Code that represented the general law; furthermore, the special law had priority - in terms of its application - towards the general law. *So, the first covered area is the civil law.*

Bearing in mind that the guaranties are set over the shares and social parts that are linked to the trade professionals (joint-stock companies and limited liability companies) *the second covered area is the commercial law.*

It is important to be highlighted that pursuant to the current doctrine, the commercial law represents a deriving domain of the civil law. In other words, there is no contradiction between the two legal areas (the civil law and the commercial law)<sup>1</sup>.

### 1.2. Why is the studied matter important?

The importance of the study mainly consists in:

- a) making a global analysis of the legal regime of the mortgage over the shares and social parts with focus on practical issues;
- b) augmenting the importance and the efficacy of such guaranties both in lending operations performed by the credit institutions and ordinary borrowing operations (which are not performed by the credit institutions, as defined by the law but they are performed by other companies);
- c) the proposals to amend the legislation in force.

The pursued objectives of the study are:

- a) to fortify the legal regime of such guaranties with the scope to be used on a higher scale in the current activity;
- b) to point out the effective benefits versus disadvantages;
- c) to highlight the way the corporative will is formed aiming to establish such guaranties and the potential sanctions.

### 1.3. How does the author intend to answer to this matter?

The main modalities that will be used to furnish the needed answers are:

- a) the contrastive legal analysis of the relevant former legislation and also the analysis of the current legislation;
- b) the research of the relevant practice in the field;
- c) the investigation of the relevant doctrine.

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<sup>1</sup> Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5<sup>th</sup> edition, updated, 2016), 24.

The research will be made through using mainly the comparative method, the historical-teleological method and the logical method.

#### 1.4. What is the relation between the paper and the already existent specialized literature?

The existing doctrine has not extensively and specifically analyzed the following aspects:

- a) the main clauses recommended to be inserted within the security agreements;
- b) the corporate approvals regarding the establishment of the mortgage over the shares and social parts plus the potential sanctions;
- c) some particular aspects concerning the criminal responsibility with regard to the guaranteeing operations occurring between the companies, pursuant to the Law no.31/1990 On Companies, further amended and completed;
- d) some relevant aspects coming from the foreclosure process.

Taking into consideration the above, the present study aims to complement the existing specialized literature, providing new arguments and/or solutions desirably to be widely used by all the legal professionals (experts, professors, students, practitioners etc.).

## 2. The shares. Concept. Traits. Legal nature.

**2.1.** In accordance with the Article 91 from the Law no. 31/1990, the share capital is represented by the shares issued by the joint-stock company; taking into consideration the modality of transfer, the shares may be nominative shares or shares at bearer. The type of the share will be determined by the constitutive deed; on the contrary, the shares will be nominative. The nominative shares may be issued in material form (on paper medium) or in dematerialized form when they are registered in the shareholders' registry.

A joint-stock company is set-up by minimum 2 shareholders who contribute to the formation of the share capital (in amount of minimum RON 90,000) aiming to develop a commercial activity; the shareholders are liable up to the limit of their contribution to the share capital.

**2.2.** The commercial doctrine provided different definitions for the concept of share, as follows:

- a) a share bears three meanings: i) each fraction of the share capital; ii) the totality of the rights and obligations that derives from the bylaws for shareholders; iii) the title by which the shareholders exert their rights and these rights are transferred to the third parties<sup>2</sup>;
- b) a share has the following meanings: i) an equal

part of the share capital; ii) a credit title ascertaining the rights and obligations deriving from the capacity of shareholder; iii) the document which comprises the shareholder's right<sup>3</sup>;

- c) a share is a representative title of the shareholder's contribution, representing a fraction of the share capital which confers to the holder the capacity of shareholder<sup>4</sup>.

**2.3.** Following the above-mentioned definitions, the main legal traits of the shares are:

- a) the shares are fractions of the share capital having a certain nominal value. Based on the Article 93 from the Law no.31/1990, the nominal value of a share cannot be smaller than RON 0,1 ;
- b) the shares must have the same value. As a consequence, the holders of the shares have equal rights fact that create the needed prerequisites for the decision-making process in the general shareholders meeting. The Law no.31/1990 enables to be issued-under the conditions of the constitutive deed- shares which confer different right to the holders (Article 94, 2<sup>nd</sup> paragraph from the Law no.31/1990).

The lawmaker has in view the preferential shares with precedent dividend without right of vote that grant to the holder: i) the right to a precedent dividend charged on the distributable benefit of the financial exercise before any other charge; ii) the rights conferred to the shareholders having ordinary shares, inclusively the right to take part in the general shareholders meeting except for the right of vote (Article 95, 1<sup>st</sup> paragraph from the Law no. 31/1990).

- c) the shares are indivisible, as provided by the Article 102, 1st paragraph from the Law no. 31/1990.

This legal provision has an imperative nature, the pursued scope being to overcome the intention to excessively divide the shares into many other shares.

The law does not ban to exist more co-owners of one share but they are responsible to appoint a proxy aiming to exert the related rights or to pay the due contributions.

- d) the shares are negotiable titles. As moment as the shares represent the equivalent of the shareholder's contribution to the share capital, it means that the share comprises a certain value. Bearing such value, the shares may be alienated to the third parties as stipulated by the law. The shares held by the companies listed

<sup>2</sup> Cesare Vivante, *Traite de Droit Commercial. Les sociétés commerciales* (Paris: V.Giard & E. Briere Libraires-Editeurs, vol.II, 1911), 271.

<sup>3</sup> I.L.Georgescu *Romanian Commercial Law* (Bucharest: All Beck Publishing House, vol.2, 2002), 606.

<sup>4</sup> Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5<sup>th</sup> edition, updated, 2016), 323.

with the Stock Exchange may be alienated under the conditions governing the regulated markets.

**2.4.** With regard to the legal nature of the share there are some relevant opinions as follows:

- a) based on an opinion, the share does not display all the traits attributable to the titles of credit meaning the integration of the law, the autonomy and the literalness; a share holds only the first trait namely the integration of the law<sup>5</sup>;
- b) in compliance with another author, a share of capital represents an uncertain receivable against the company for a quota from the social fund in the final moment of liquidation<sup>6</sup>;
- c) the shares are special titles, called corporative titles, company titles or titles of participation. Also, the shares are not autonomous titles towards the legal document they derive; the shares come from the bylaws. Moreover, in case of transmittal, the acquirer becomes the holder of a deriving right<sup>7</sup>;
- d) based on the new Civil Code, a share is a movable, in principle, incorporeal good, indivisible good which represents a special form of the parts of interests issued by the societies as regulated by the Civil Code.

A share tradable on the capital market is an incorporeal, fungible good. On the other hand, a share to bearer issued in material form by a company not listed to the Stock Exchange is a corporeal and non-fungible good<sup>8</sup>.

**2.5.** The shares grant to the holders the following rights:

- a) the right to take part in the general shareholders meeting personally or by proxy;
- b) the right of vote. Any paid share confers the right to a single vote if otherwise is not stipulated by the constitutive deed (Article 101 from the Law no.31/1990). The shareholders may vote proportionally with the held shares. ;
- c) the right to information with regard to the activity of the company. In this respect, the administrators, the members of the Directorate have the obligation to make available to the shareholders and to any other petitioners the information regarding the structure of the shareholding etc. (Article 178, 1st paragraph from the Law no.31/1990);
- d) the right to cash the dividends. The dividends are paid proportionally with the participation to the share capital if otherwise is not stipulated in the

constitutive deed (Article 67, 2<sup>nd</sup> paragraph from the Law no/31/1990);

- e) the right to the amount deriving from the winding-up of the company.

**2.6.** The aspects highlighted to the po.2.1-2.6 are also applicable to the company limited by shares (*Rom. societate in comandita pe actiuni* ).

### **3. The social parts. Concept. Traits. Legal nature**

**3.1.** The social parts form the share capital of the limited liability company.

A limited liability company has the following characteristics in the light of the Law no. 31/1990:

- a) it is established by one or many persons (associates) based on the trust;
- b) the associates contribute with some goods with the scope to perform a commercial activity and to share the attained profit;
- c) the associates are liable up to the limit of their contribution to the share capital;
- d) the share capital is of minimum RON 200.

**3.2.** The legal traits of the social parts are similar, in general, with the characteristics of the shares.

So, with regard to the social parts:

- a) they are fractions of the share capital;
- b) they must have the same value (minimum RON 10);
- c) they are indivisible;
- d) they may be not represented by negotiable titles;
- e) the number of the social parts distributed to each associate is proportional with its contribution to the share capital;
- f) the social parts may be alienated to the third parties under the restrictive conditions stipulated by the Article 202 from the Law no.31/1990 meaning only if the associates representing  $\frac{3}{4}$  from the share capital approve such operation.

**3.3.** The social parts confer the associates the following rights:

- a) the right to take part in the general associates meeting;
- b) the right to vote;
- c) the right to information with regard to the activity of the company;
- d) the right to cash the dividends. The dividends are paid proportionally with the participation to the share capital if otherwise is not stipulated in the constitutive deed (Article 67, 2<sup>nd</sup> paragraph from the Law no/31/1990);

<sup>5</sup> I.L.Georgescu *Romanian Commercial Law* (Bucharest: All Beck Publishing House, vol.2, 2002), 612.

<sup>6</sup> D.D.Gerota *The general theory of the commercial obligations towards the technique of the civil obligations* (Bucharest: Imprimeria Nationala, 1932), 163.

<sup>7</sup> Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5<sup>th</sup> edition, updated, 2016), 325.

<sup>8</sup> Stanciu D.Carpenaru, Gheorghe Piperea, Sorin David *The Law Of The Companies. Commentary On Articles* (Bucharest: C.H. Beck Publishing House, 5th edition, 2014), 323.

- e) the right to the amount deriving from the winding-up of the company.

#### **4. Establishment of the security over the shares and social parts. Overview of the former and current legislation.**

**4.1.** Prior to entering into force of the New Civil Code (01.10.2011), the establishment of the guaranty over the shares and social parts was governed by the former VI th Title from the Law no.99/1999 on some measures for the acceleration of the economic reform. Such guaranty was settled through a real movable guarantee agreement. For priority rank issues, the agreement was enrolled in the Electronic Archive. Regarding the real movable guarantee over the shares, one of the legal requirements (introduced by the Law no.441/2006) was to enroll also the agreement in the shareholders' register kept by the company. A similar requirement existed also for the real movable guarantee over the social parts.

**4.2.** In respect to the current legislation, the modality by which is settled such guaranty is the movable mortgage [Article 2389, letter d) from the Civil Code]. There were maintained the legal provisions based on which the mortgage agreement over shares and social parts must be enrolled in the Electronic Archive and in the registers kept by the company. With regard to the shares belonging to the joint-stock companies listed with the Stock Exchange, the mortgage must be enrolled with the special accounts open on behalf of the settlor with the system held by the Central Depository (Article 96 from the Regulation no.13/2005 on the authorization and operation of the Central Depository, houses of compensation and central counterparts, issued by the Securities National Commission, further amended and completed).

#### **5. Relevant clauses recommended to be inserted in the movable mortgages agreements**

**5.1.** The settlor of the movable mortgage has the liberty to use, to administrate and to dispose by the mortgaged asset having the duty not to harm the creditor's rights (Article 2373 from the Civil Code).

It means that the mortgage right enrolled with the first rank in the Electronic Archive survives to any operation of sale of the mortgaged asset made by the settlor.

**5.2.** The settlor may not destroy, harm the mortgaged asset and also the settlor may not substantially diminish the value of the mortgaged asset only if such destruction, deterioration or diminishing of the value occurs during the normal use of the asset or in case of necessity (Article 2374 from the Civil Code).

In brief, this article imposes the general undertaking for the settlor to be diligent and to maintain the value of the mortgaged asset, except for the situations already stipulated.

**5.3.** The mortgage is extended over the fruits and products of the mortgaged asset and also over all the assets received by the settlor as effect of an operation of administration or disposition regarding the mortgaged asset. It is considered product of the mortgaged asset any asset that supersedes the mortgaged asset or the asset in which the value of the mortgaged asset is incorporated (Article 2392 from the Civil Code).

The main conclusion is that the mortgage covers also the right to cash the dividends stemming from the shares and social parts.

**5.4.** The creditor has the right to inspect the mortgaged asset without harming the activity of the settlor (Article 2394 from the Civil Code).

With regard to the shares and social parts, the meaning of the aforesaid article consists in the fact that the creditor is entitled to require and to receive any documents and/or information regarding the status of the mortgaged asset.

**5.5.** The mortgage agreement must contain a sufficiently precise depiction of the mortgaged asset.

In respect to the shares, the mortgage agreement comprises the type of the shares, the number of shares, the form of issuance, the value of the shares, and the numbering of the shares (if any).

Concerning the social parts, the mortgage agreement contains the number of the social parts, the value of the social parts and the numbering of the social parts (if any).

In general, the enrollment of the mortgage agreement both in the Electronic Archive and in the registers held by the companies also contain the interdictions of alienation and encumbrance.

#### **6. Some special legal requirements regarding the approval of the guaranties over the shares and social parts**

**6.1.** In respect to the shares, if there is needed a resolution issued by the general shareholders meeting, the creditor must pay a special attention to the formalities of convening the shareholders.

The convening of the shareholders must comprise the whole agenda of the shareholders meeting that will be held with an explicit depiction of all the items included on the agenda (the depiction of the guaranties, the object of the guaranties, the amount of the credit, the financing bank etc.).

The general rule is that the convening must be published in the Official Gazette of Romania, the IV th Part and in one of the widely spread newspapers from the locality where is the registered office of the company or from the nearest locality. The term for the convening of the general shareholders meeting may be not smaller than 30 days from the date when the convening was published in the Official Gazette of Romania, the IV Part (Article 117, 2<sup>nd</sup> and 3<sup>rd</sup> paragraphs from the Law no. 31/1990).

It is very important to be strictly followed the aforesaid conditions (especially the term of 30 days) because on the contrary the sanction is the absolute annulment of the resolution of the general shareholders meeting that ensues the cancelation of the mortgage over the shares.

The 4<sup>th</sup> paragraph of the Article 117 from the Law no.31/1990 establishes a derogation concerning the convening formalities as follows: if all the shares are nominative, the convening may be done through the recommended letter or, if the constitutive deed enables, through the letter sent via e-mail having the electronic signature incorporated, attached or logically associated at the shareholder's address mentioned with the shareholders' registry with 30 days prior to the date when the meeting will be held.

We stress that with regard to the convening formalities the general rule (publication of the convening in the Official Gazette of Romania, the IV<sup>th</sup> Part and in one newspaper as mentioned above) is applied on a higher scale in comparison with the derogatory rule established by the Article 117, 4<sup>th</sup> paragraph from the Law no.31/1990.

The convening formalities must not be performed when all the shareholders are present and there is the unanimous approval of the guaranties (Article 121 from the Law no. 31/1990).

Also it is important to be pointed out that the guaranties over the shares may be approved by the Board of Administrators/the Directorate if the value of the mortgaged asset is up to the half of the accounting value of the assets at the date when the legal document is signed (Article 153<sup>22</sup> from the Law no.31/1990); on the contrary, the approval comes from the extraordinary general shareholders meeting.

In respect to the shares held by the companies listed to the Stock Exchange, the mortgage over the shares is approved by the Administrators/Directors if the value of the mortgaged asset does not exceed, individually or cumulatively, during the tenor of a financial exercise, 20% of the total value of the fixed assets, except for the receivables (Article 90 from the Law no.24/2017 on the issuers of the financial instruments and market operations); on the contrary, the approval comes from the extraordinary general shareholders meeting.

**6.2.** With regard to the social parts, the mortgage is legally approved by the associates representing  $\frac{3}{4}$  of the share capital (Article 202, 2<sup>nd</sup> and 5<sup>th</sup> paragraphs from the Law no. 31/1990).

The convening of the general associates meeting is made in the form stipulated by the constitutive deed and, in lack of a special provision, the convening will be made by recommended letter sent with 10 days before containing also the agenda of the general associates meeting (Article 195, 3<sup>rd</sup> paragraph from the Law no.31/1990).

## 7. Novelties regarding the foreclosure process

**7.1.** The creditors of the associate may exert their rights – during the duration of the company- only:

- a) on the part from the benefits due to the associate based on the balance sheet;
- b) on the part that would be due to the associate after the winding up of the company.

The novelty consists in the fact that the social parts, according to the Article 66, 2<sup>nd</sup> paragraph from the Law no.31/1990 :

- a) may form the object of the garnishment and **seizure** started by the aforesaid creditors during the duration of the company;
- b) may be **sold** by the same creditors.

As effect, the Law no.31/990 (by the Article 66, 2<sup>nd</sup> and 3<sup>rd</sup> paragraphs) has finally validated the existing practice, meaning the mortgage legally established over the shares and social parts may be foreclosed based on the law. The former doctrine expressed the opinion in conformity to which the social parts may be not foreclosed<sup>9</sup> and may be not form the object of a guaranty because of the *intuitu personae* trait of the social part; we highlight that the most of the practitioners did not follow it because it could mainly trigger a blockage of the business. Subsequently, the Administrators/the members of the Directorate are obliged to make available to the creditor/ foreclosure body, upon their request, the financial situations and any other documents or the information needed to assess the shares and the social parts and also to facilitate their taking-over.

The publicity of the seizure and garnishment it will be made upon the request of the foreclosure body without being applicable the provisions of the Article 71 from the Emergency Government Ordinance no. 116/2009, as provided by the Article 66<sup>1</sup> from the Law no. 31/1990.

## 8. Special situations. Overview

**8.1.** A distinct attention must be paid to the guaranties furnished by and between joint-stock companies members of the same group.

We have in mind the provisions of the Article 144<sup>4</sup>, 1<sup>st</sup> paragraph from the Law no. 31/1990 which expressly bans the crediting by the company of its administrators through some specific operations as: i)granting the loans to the Administrators;ii)granting financial benefits to the Administrators at the date or after the date when the company concluded with the Administrators operations of delivery of goods, services or performance of works;iii)direct or indirect guaranteeing, in whole or in part, of any loans granted to the Administrators, concomitantly or after the granting of the loan;i)direct or indirect guaranteeing, in whole or in part, of the performance by the Administrators of any

<sup>9</sup> Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5<sup>th</sup> edition, updated, 2016), 377.

other personal obligations of those towards third parties;ii)direct or indirect guaranteeing, in whole or in part, of a claim that has as object a loan granted by a third party to the Administrators or other personal service of the Administrators.

The provisions of the aforesaid Article 144<sup>4</sup>, 1<sup>st</sup> paragraph will apply to the operations where are interested the spouse, the relatives or in-laws up to the fourth degree inclusively of the Administrator; also if the operation regards a company where one of the persons abovementioned is Administrator or holds, alone or together with one of the abovementioned persons, a participation of at least 20% of the subscribed capital. In case of breaching this provision (Article 144<sup>4</sup> 2<sup>nd</sup> paragraph from the Law no. 31/1990), the potential sanction is the absolute annulment of the guaranty.

**8.2.** In the process of setting-up the guaranties must be followed inclusively the provisions of the Article 272, 1<sup>st</sup> paragraph, letters b) and c) from the Law no. 31/1990 which stipulates the criminal responsibility (imprisonment from 6 months to 3 years or fine) of the founder, administrator, general manager, director, member of the supervisory council/directorate or legal representative of the company who:uses in bad faith, the assets or the credit, enjoyed by the company, for a purpose contrary to the interests of the company or in his benefit or favors another company in which he has interests, directly or indirectly;borrows in any form, directly or through an intermediary, from the company that he administers, from a company controlled by this company or from the company which controls the company which he manages, the borrowed amount being higher than EUR 5,000 or makes one of these companies to provide any guarantee for his own debts.

Besides the criminal responsibility, the guaranty becomes null.

**8.3.** Besides the abovementioned with the points 8.1 and 8.2 any guarantee provided by a company must be justified by an economic interest taking into consideration inclusively the principle of the speciality of the capacity of use applicable to the company.

## 9. Conclusions

### 9.1. Main outcomes of the study

The main outcomes of the present study are:

### References

- Cesare Vivante, *Traite de Droit Commercial. Les societees commerciales* (Paris: V.Giard & E. Briere Libraires-Editeurs, vol.II, 1911), 271;
- D.D.Gerota *The general theory of the commercial obligations towards the technique of the civil obligations* (Bucharest: Imprimeria Nationala, 1932), 163;
- I.L.Georgescu *Romanian Commercial Law* (Bucharest: All Beck Publishing House, vol.2, 2002), 606, 612;
- Stanciu D.Carpenaru, Gheorghe Piperea, Sorin David *The Law Of The Companies. Commentary On Articles* (Bucharest: C.H. Beck Publishing House, 5th edition, 2014), 323;
- Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5<sup>th</sup> edition, updated, 2016), 24, 323, 325.

- a) global presentation of the mortgage over the shares and social parts with focus on the legal traits of the shares and social parts, on the rights granted to the shareholders and associates, on the clauses advised to be inserted in the mortgage agreement, on the foreclosure process;
- b) analysis of the relevant foregoing legislation and current legislation;
- c) presentation of some relevant precedent formalities that may have major impact on the validity of the mortgage agreement;
- d) overview of some relevant aspects regarding the criminal responsibility that may have major impact on the validity of the mortgage agreement;
- e) proposal to be eliminated the enrollment of the movable mortgage over the shares and social parts from the registries held by company having in mind that the enrollment in the Electronic Archive is public being available to any diligent person;
- f) proposal to be amended the Law no.31/1990 meaning to be expressly stipulated : (i) if the Article 144<sup>4</sup> regards only the joint-stock companies or not.

If not, to be expressly mentioned which are the envisaged persons; (ii) if the Article 144<sup>4</sup> and the Article 272 regard also the companies as active/qualified subject of the infractions.

### 9.2. Expected impact of the outcomes

The main expected impact consists in the followings:

- a) to raise the awareness in respect to all the issues highlighted in the present study for all the cases when a mortgage over the shares and social parts is settled;
- b) to become effective the recommendations mentioned with the po. 9.1, letters e) and f) from the present study.

### 9.3. Suggestions further research

Please see the recommendations mentioned with the po. 9.1, letters e) and f) from the present study.