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Introduction

For the economies of the Central and Eastern European (CEE) region, the decade preceding the financial crisis was a period marked by rapid growth. Foreign investors had been investing widely throughout the region, whilst local entrepreneurs were also growing their businesses quickly. The impetus for this growth and development came in part from the privatisation and deregulation of many areas of business, as well as EU membership, which helped to facilitate cross-border trade and open up new financing opportunities for local companies. Against this background of rapid growth, considerations of proper corporate governance often took a back seat in the race for market share and profit, particularly in the absence of co-ordinated pressure from investors, or any consistent drive by regulators and governments to prioritise this area.

For anyone who is familiar with the corporate governance environments that have developed in recent years in other markets, the corporate governance picture in the CEE region looks markedly different in a number of ways. The key reasons for this are the relatively short histories of the CEE countries as market economies and the absence of powerful investor groups across the region. In the case of Romania and Bulgaria, relatively recent EU accession has also meant that these jurisdictions are still in the process of adapting themselves to take account of EU-led initiatives such as the European Action Plan on Company Law and Corporate Governance, as well as relevant legislation such as the Transparency and Prospectus Directives.

More recently, of course, the global financial crisis has served to remind policy-makers and businesses in the CEE region, as elsewhere, that there is always a balance to be struck between allowing companies to operate as freely as possible from the burden of compliance, and the need to protect the interests of investors (or other stakeholders) against the abuse of power by corporate insiders. Even so, the corporate governance picture in the CEE region has not changed a great deal since the onset of the crisis, in part because the attention of both businesses and regulators has again been diverted by the need to keep individual businesses – and the wider economy – afloat, against a background of high borrowings, withdrawal of credit and foreign investment and the drying-up of the formerly lucrative construction and foreign export markets.

With the dust from the worst of the crisis having started to settle in most jurisdictions, some governments, in the Czech Republic for example, are already taking steps to introduce greater controls on business. In this context, corporate governance should form an important part of any co-ordinated drive towards longer-term financial stability.

Recent international surveys and reports have also focused the spotlight upon the importance of corporate governance in the recession and post-recession era, which has in some cases included the scrutiny of individual CEE countries. For example, the recent European Commission study on monitoring and enforcement of corporate governance practices in EC member states1 also noted that certain EC requirements relating to (for example) the existence of independent board members had been less closely followed in CEE member states with a more recent corporate governance tradition. In identifying priorities for future strengthening of corporate governance in these jurisdictions,

however, it is important to be aware of the differences between the CEE region and other markets, in terms of both the differing regional impact of the financial crisis, and the overall commercial environment.

The power of investor groups in other jurisdictions (such as the UK’s ABI or Calpers in the US) has meant that regulation of corporate governance in those jurisdictions tends to address the concerns of investors, albeit through guidelines or investor activism rather than legislation. In the CEE region there are fewer listed companies of comparable size, and certainly no equivalent of the powerful investor groups seen elsewhere. This means that regulation of corporate governance has been much more state-driven, with the consequence that it tends to address a wider constituency of interests, such as giving greater rights to employees.

Recent corporate governance initiatives introduced in response to the global recession may also need to be adapted to reflect the characteristics of commercial practice in the CEE region. The increasing crackdown on performance-related remuneration2, for example, will probably be less relevant to CEE markets, whose financial institutions and trading companies have not seemed to follow the excessive risk-taking practices and correspondent bonus culture that has characterised the US and UK markets in particular during recent years. Higher priority should be perhaps given instead to improving the monitoring and efficacy of the existing “comply or explain” mechanisms for corporate governance already (at least ostensibly) in place in CEE member states, and increasing transparency towards shareholders and the public in the absence of concerted investor pressure.

We summarise below some of the key issues that are relevant across the CEE region, and we highlight some of the areas that may be unfamiliar to investors or executives from outside the region. There then follows a quick-reference table to give an overview of the differences and similarities among the countries in the CEE region. Finally, there is a detailed section taking a more in-depth look at each country in the region. Because of the very similar position in the Czech and Slovak Republics, the detailed sections on those countries are combined, with only those areas where there are differences highlighted.

For more information on Allen & Overy and how we can help you deal with corporate governance issues in the CEE region – whether you are an investor, an executive or a regulator – please see the end of this report.

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‘Priority should be given to increasing transparency towards shareholders and the public in the absence of concerted investor pressure’
Sources of corporate governance

As noted above, markets in the CEE region largely lack the sort of investor-driven guidelines and codes of practice that are such an important source of corporate governance regulation in more mature economies. The key reference points for corporate governance in this region therefore tend to be the minimum standards prescribed by law rather than any higher standards required by investors. But this is not to say that there has not been progress in this direction. National stock exchanges in both Poland and Hungary have introduced guidelines for minimum standards of corporate governance to be expected of companies that have securities listed on their markets. In both cases, the guidelines operate on a “comply or explain” basis, allowing companies the flexibility to adopt governance structures to suit their needs whilst at the same time promoting transparency for investors.

Directors as employees

An example of the sort of specific area that can cause problems for those who are unfamiliar with local requirements is the strict interpretation of legal rules by the Czech higher courts, which prevent directors being retained under employment contracts, a practice which is nevertheless widespread in the Czech Republic. An employment agreement that purports to employ a person as a director is probably invalid. In Romania this restriction is expressly stated only with respect to joint stock companies and not for limited liability companies. This restriction has worrying consequences for both directors and companies. Directors who thought they had agreed a certain notice period in their employment agreement could find that the company can dismiss them at will. Companies that have dismissed directors could find that the directors allege that all the remuneration they have received over the years was merely as employees and claim unpaid directors’ fees. It is therefore in both parties’ interests to ensure that the documentation of their relationship complies with the legal rules. Whilst in other CEE countries it is often not possible to be employed as a director, the other jurisdictions in most cases recognise the possibility of one individual wearing more than one hat within a company – acting sometimes in the capacity of employee and sometimes as director.

Two-tier boards

As with many other continental European jurisdictions, joint stock countries in the CEE region all operate two-tier board structures with separate executive and supervisory boards. In many cases, however, the establishment of a supervisory board may be optional, especially in smaller “Ltd.” type companies. A Hungarian public company limited by shares may also operate in a one-tier board structure. Whilst there are some differences in the nature of supervisory boards in different jurisdictions, their function is essentially the same across the CEE region. The main purpose of a supervisory board is as an indirect means for shareholders to exert control over how the directors are running the company in addition to their ultimate control through the general meeting. The supervisory board will typically meet more frequently than the general meeting and will be better able to assess information provided by the company than non-expert shareholders might be. It normally has powers to review major decisions taken by the board of directors and has reporting duties to the shareholders’ general meeting.

Although supervisory board members are normally appointed by the general meeting, some jurisdictions require that employees must be allowed to elect a proportion of supervisory board members where a company has more than a certain number of employees.

3. Labour Law in Central and Eastern Europe – available at www.allenover.com
Executive remuneration

One of the areas where there is most divergence within the CEE region is in the regulation of executive remuneration. The position is probably most permissive for companies in Hungary, where there are few limits on what directors may be paid – though the obligation to disclose levels of executive remuneration was recently introduced, in line with most other member states. In Romania, directors’ remuneration must be proportional to their actual duties and the economic status of the company. By contrast, the Czech Republic is more protective of investors’ interests, with a statutory prohibition on remunerating directors whose under-performance negatively impacts the company’s financial results. Listed companies in the Czech Republic are also required to disclose overall remuneration of directors and other senior managers in their annual reports. Overall, the CEE countries are also generally less transparent in disclosing the ratio of fixed versus variable remuneration and the nature of any variable remuneration component. This may be less problematic in companies whose business model does not tend towards rewarding excessive risk-taking, but in the absence of proper disclosure mechanisms it is difficult for shareholders – or the public- to judge the company’s risk appetite and its impact on executive remuneration.

Directors’ liability

Whilst directors may be accustomed to the risk of liability to their company for breach of their duties, there are many circumstances where the scope of directors’ liability may be much wider in the CEE region than in other jurisdictions. Although a director’s primary liability is still to the company, there are also many situations where shareholders or creditors may be able to bring a claim directly against the directors, and not only in an insolvency situation. The state-driven nature of corporate governance regulation in the CEE region also means that there is a far greater importance attached to criminal sanctions for breaches of proper corporate governance. This tendency is probably most pronounced in Poland, where members of the management board can also find themselves liable for the company’s tax liabilities where enforcement against the company has been ineffective.

Examples of strict rules and severe liability in the CEE region must be set against the background in which practice does not always correspond to the legal rules. In recent years there is a perception that executives have flouted not only good corporate governance but legal rules with impunity. CEE countries have moved down the transparency indices and widely publicised wrongdoings appear to go inadequately punished or not punished at all. However, compliance with corporate governance rules is set to become increasingly important as regulatory enforcement improves and private litigation increases.

4. See the EC Study on monitoring and enforcement, p.111
Bribery and corruption

Notwithstanding the apparent deterioration in recent years of CEE countries’ ability or willingness to apprehend and prosecute wrongdoers, there is nevertheless an ever increasing global political will to prosecute bribery and corruption. Directors will need to raise awareness of the relevant rules and new legislation within their companies. The OECD Convention on Combating Bribery of Foreign Public Officials, aimed at reducing corruption in developing countries, came into force in 1999 and has been signed by a number of CEE counties including Poland, the Czech Republic and Hungary. Although the OECD has no authority to enforce the Convention, signatories have agreed to encourage sanctions against bribery in international business transactions.

The UK Bribery Act 2010, which received Royal Assent on 8 April 2010 and is expected to come into force later in the year, creates four new offences all of which will have extra-territorial effect. This means that the offences may be prosecuted if committed by a British national or corporate, or by a person who is ordinarily resident in the UK, regardless of whether or not the act or omission which forms part of the offence took place inside the UK. The four new offences are paying bribes, receiving bribes, bribery of a foreign public official and most notably failure by a commercial organisation to prevent bribery. There is however a defence from the corporate offence where the company can show that it had “adequate procedures” in place to prevent bribery. This effectively means that a company will need to ensure its anti-corruption procedures are sufficiently robust to stop any employees, agents or third parties acting on its behalf from committing bribery. A company found guilty of an offence under the Bribery Act 2010 may be liable for an unlimited fine, whilst an individual could face a prison sentence of up to 10 years.

The US Foreign Corrupt Practices Act (FCPA) prohibits the bribery of foreign public officials and imposes certain recordkeeping and internal control requirements. The anti-bribery provisions of the FCPA make it unlawful for US companies and individuals and certain non-US issuers of securities registered in the United States, as well as any third party acting on behalf of such person, to make or offer a corrupt payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. The anti-bribery provisions also apply to non-US firms and persons who take any act in furtherance of a corrupt payment while in the United States. The accounting provisions of the FCPA require any issuer listed on a US securities exchange or required to file periodic reports with the US Securities and Exchange Commission to maintain financial books and records that accurately reflect transactions and to devise and maintain an adequate system of internal controls to prevent and detect violations. The FCPA contemplates both civil and criminal penalties, which can be severe: violations of the anti-bribery provisions are subject to fines of up to USD 2 million per violation and up to five years in prison, and violations of the internal controls provisions are subject to fines of up to USD 25 million per violation and up to 20 years in prison. US law enforcement agencies vigorously enforce the FCPA, including against non-US companies and individuals. As a result, any entity that falls under the broad jurisdictional reach of the FCPA must have in place stringent compliance procedures and internal controls in order to minimize corruption risks.
Quick reference comparison table

<table>
<thead>
<tr>
<th>Poland</th>
<th>Czech Republic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sp. z o.o.</td>
<td>S.A.</td>
</tr>
<tr>
<td>Body with primary responsibility for business management</td>
<td>Management board</td>
</tr>
<tr>
<td>Supervisory board available?</td>
<td>Yes</td>
</tr>
<tr>
<td>Supervisory board obligatory?</td>
<td>Only in special cases</td>
</tr>
<tr>
<td>Can the supervisory board appoint directors if the constitutional documents permit?</td>
<td>Yes</td>
</tr>
<tr>
<td>Statutory maximum term of office for directors</td>
<td>None</td>
</tr>
<tr>
<td>Can directors have an employment agreement with the company?</td>
<td>Yes</td>
</tr>
<tr>
<td>Are there statutory restrictions on directors’ remuneration?</td>
<td>None in principle</td>
</tr>
<tr>
<td>Can directors participate in share incentive plans?</td>
<td>Yes</td>
</tr>
</tbody>
</table>

5. Although theoretically possible, due to the nature of participations in an s.r.o. it is not considered practical to remunerate executives with participation interests.
<table>
<thead>
<tr>
<th></th>
<th>Slovak Republic</th>
<th>Hungary</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>s.r.o.</strong></td>
<td>Executive(s)</td>
<td>Managing Director(s)</td>
<td>Director(s)</td>
</tr>
<tr>
<td></td>
<td>Board of directors</td>
<td>Zrt: Board of Directors or chief executive officer (CEO)</td>
<td>Director/ Board of Directors/ Management Board</td>
</tr>
<tr>
<td><strong>a.s.</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>Only in special cases</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>Only in a Zrt.</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td>None</td>
<td>None</td>
<td>2 years for the first directors</td>
</tr>
<tr>
<td></td>
<td>5 years, but can be re-elected</td>
<td>None</td>
<td>4 years for the subsequent directors possibility of re-election in all cases</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
<td>No</td>
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<td></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
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</table>
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<th>S.A.</th>
<th>Czech Republic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sp. z o.o.</td>
<td>S.A.</td>
<td>s.r.o.</td>
</tr>
<tr>
<td>Must overall directors’ remuneration be publicly disclosed?</td>
<td>No</td>
<td>Yes if listed, otherwise no</td>
</tr>
<tr>
<td>Must individual directors’ remuneration be publicly disclosed?</td>
<td>No</td>
<td>Yes if listed, otherwise no</td>
</tr>
<tr>
<td>Are constitutional or other internal limitations on directors’ authority valid against third parties?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Do different corporate governance rules apply within groups?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Is there a minimum standard of competence required for directors?</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Do directors owe any duties directly to shareholders?</td>
<td>Only in special cases</td>
<td>Only in special cases</td>
</tr>
<tr>
<td>Do directors owe any duties directly to creditors?</td>
<td>Only in special cases</td>
<td>Only in special cases</td>
</tr>
<tr>
<td>Is there any potential criminal liability for directors?</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Can directors be required to act according to the instructions of a shareholder?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
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<td>Hungary</td>
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<tr>
<td><strong>s.r.o.</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>a.s.</strong></td>
<td>Yes if listed, otherwise no</td>
<td>No</td>
</tr>
<tr>
<td><strong>Kft.</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Zrt./Nyrt.</strong></td>
<td>No (other than joint signatory right without further limitation)</td>
<td>No (other than joint signatory right without further limitation)</td>
</tr>
<tr>
<td><strong>S.R.L.</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>S.A.</strong></td>
<td>No</td>
<td>No</td>
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<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Are constitutional or other internal limitations on directors’ authority valid against third parties?</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>The provisions of the constitutive establishing that the company is represented towards third parties by several directors acting jointly are valid against third parties.</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Do different corporate governance rules apply within groups?</strong></td>
<td>No</td>
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1. **WHO GOVERNS POLISH COMPANIES?**

1.1 **Types of company**

There are several types of companies and partnerships available in Poland. This chapter deals with the two most frequently used ones: the limited liability company (Sp. z o.o.) and the joint-stock company (S.A.). The capital of an Sp. z o.o. is comprised of one or more shares, which are rights rather than securities, and which are not evidenced by share certificates. The capital of an S.A. is divided into shares, which are securities that may be evidenced with share certificates and which are potentially eligible to be listed on a regulated market.

An Sp. z o.o. is generally subject to less strict corporate governance rules than an S.A.

1.2 **Management board**

In both an Sp. z o.o. and an S.A., business management is entrusted to the management board. A management board must consist of at least one member and is subject to largely similar rules whether in an Sp. z o.o. or an S.A..

The management board manages the company's affairs and acts as its representative in dealings with third parties. It has general competence to take business decisions for the company. It can therefore take any actions which are not reserved to the supervisory board or the shareholders' meetings. Management board decisions are normally taken by an absolute majority of members present, provided that all members have been given proper notice, although the level of support required for decisions can be varied by the company's constitutional documents (Articles of Association in an Sp. z o.o. or a Statute in an S.A. – further jointly referred to as articles).

The management board has responsibility for the company's external obligations, such as dealing with public authorities and entering into contracts, and for its internal functions, such as overseeing the accounts and arranging shareholders' meetings. Subject to the limitations detailed below, the members of the management board also have the authority to carry out all legal acts on behalf of the company. Whilst management board members (directors) of companies in other jurisdictions may be divided into “executives” and “non-executives”, there is no such distinction for Polish companies. All management board members should exercise their management functions in accordance with each member's right and obligation to perform the company's duties.
1.3 Limits on the authority of the management board members

Each management board member may perform acts within the scope of the ordinary business of the company without further authorisation. A resolution of the management board is required for matters beyond the scope of the ordinary business of the company, or if any other member objects to an act before it is completed. The articles can require the management board to seek approval from the supervisory board or from shareholders for certain transactions, for example where the value exceeds certain thresholds.

Any limitations imposed on the scope of a management board member’s authority will not be binding against third parties. If a management board member acts beyond his powers, or in breach of an internal restriction, the company is still bound to perform the relevant obligation. The company might however be able to recover damages from the relevant board member.
1.4 Delegating powers

The management board members may delegate powers to act in specific matters to the company’s employees or to third parties by power of attorney. However, it is not possible to delegate the statutory functions of a board member to an attorney or alternate board member and the overall legal responsibility for the company’s business always remains with the management board.

A company may also appoint commercial proxy holders. A commercial proxy has automatic authority to act in all matters related to the company’s business, except the disposal or encumbrance of the company’s enterprise or real property (for which he must be specifically authorised). A commercial proxy is nonetheless not a board member and therefore cannot exercise the statutory powers of a board member and is not subject to the same liabilities.

1.5 Control by supervisory boards

The establishment of a supervisory board is compulsory in an S.A. and optional in an Sp. z o.o.6. The supervisory board generally supervises all areas of the company’s activities, although it cannot give binding instructions to the management board as to the running of the company’s business. Its specific duties include reviewing the company’s financial reports and the management board’s proposals for distributing profits or covering losses, as well as submitting annual written reports to the shareholders’ meeting on the findings of these reviews. The supervisory board can inspect all company documents, request reports and explanations from the management board and employees, and review the position of the company’s assets. The shareholders can grant additional responsibilities to the supervisory board in the articles, such as the right to appoint and dismiss management board members or the power to approve certain transactions contemplated by the management board. In an S.A., if the articles do not state otherwise, the supervisory board can appoint and remove management board members.

A supervisory board must have at least three members7. Members are appointed and dismissed by the shareholders’ meeting although the articles may permit shareholders to make appointments directly. There is no general right to employee representation on supervisory boards other than in certain partially-privatised companies. Independence is guaranteed by the fact that members of a company’s management board and persons employed by the company as chief accountants, legal advisers, branch managers, directors, or employees subordinated directly to one of the company’s management board members are barred from sitting on the supervisory board.

1.6 Control by shareholders

Shareholders of an Sp. z o.o. have supervisory rights, which means that they can inspect the books and documents of the company, prepare a balance sheet for their own purposes, or require the management board to provide them with explanations. Where an Sp. z o.o. has a supervisory board, the articles may exclude or limit the shareholders’ direct supervisory rights. Shareholders in an S.A. must appoint a supervisory board and therefore have no personal right to exercise a supervisory function, although they can request the management board to provide information about the company’s affairs.

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6. Although also compulsory in an Sp. Z o.o. if the share capital exceeds 500,000 PLN and the company has more than 25 shareholders.

7. Five in a listed S.A,
The shareholders’ meeting can also exercise some direct control over the management board. Certain actions by virtue of law require shareholder approval in both an Sp. z o.o. and an S.A. These include sale or lease of the whole or an organised part of the company’s enterprise, sale and purchase of real property or part of real property (even if the property is of minimal value), and (in an S.A.) issue of convertible bonds or warrants. The shareholders can also grant themselves further control rights in the articles, such as requiring the management board to seek the approval of the shareholders before performing certain actions.

In an Sp. z o.o. the shareholders’ meeting can appoint and remove members of the management board (unless it has delegated this power to the supervisory board) and members of the supervisory board. In an S.A. the shareholders’ meeting can appoint and remove supervisory board members. Only if the articles are clear on this can the shareholders’ meeting appoint and remove management board members. In other cases it can only suspend and remove them. In both Sp. z o.o. and S.A. the shareholders’ meeting has exclusive power to amend the articles and increase the company’s share capital, although in an S.A. certain powers in this respect can be delegated to the management board (within the framework of the authorised capital).

2. Duties

2.1 General duties

Duties of management board members are normally owed to the company, although section 3 below highlights some circumstances in which board members can be liable towards the company’s shareholders or creditors. In addition to various specific duties assigned by law to the management board members, they are also subject to a range of general duties. These include the duty to act with the care of a diligent business person (the standard of care will depend on specific circumstances as the law sets out only general rules), to act in the best interests of the company, not to compete with the company and to avoid acting where there are certain conflicts of interest. Management board members are also obliged to observe the provisions of the articles of the company and – unless otherwise stated in the articles – to observe any limitations imposed by a shareholders’ resolution.

2.2 Competition and enforcement of fair dealing

A management board member may not compete with the business of the company himself or as a partner or officer of a competing partnership or company. A management board member may not hold more than 10% of the shares of a competing company or have the right to appoint at least one management board member of such a company.

A management board member may not represent the company in a dispute or conclude an agreement between himself and the company. If the sole management board member is also the sole shareholder of a company, any acts between himself and the company require a notarial deed, a copy of which must be submitted to the registration court. Loans, guarantees and other credit arrangements between the company and a member of the management or supervisory board must be approved by the shareholders’ meeting.

Further restrictions can be imposed by the articles or by resolutions of the shareholders’ meeting. The specific restrictions stated above only apply whilst a management board member remains in office. To impose post-termination restrictions, it is necessary to include them in the relevant individual’s management or employment contract or to rely on the general provisions of law on unfair competition.
3. LIABILITY OF MANAGEMENT BOARD MEMBERS

The primary liabilities of management board members are to the company in most circumstances, but there are situations in which they can find they have direct liability to shareholders or creditors. If several board members are involved in a breach of duty, they will be jointly and severally liable. It is not possible to limit or exclude the liability of management board members, although there is no prohibition on the company arranging or paying the premiums for insurance for them.

3.1 Liability to the company

Any person who has participated in the establishment of a limited liability company is liable for damage intentionally caused to the company. The relevant provision of law does not expressly refer to members of the management board, but as they are normally involved with the formation of the company they are typically among those who can be liable.

Members of the management and supervisory boards and liquidators are liable to the company for damage caused as a result of their unlawful acts or breaches of the company's articles, unless such damage was not caused intentionally.

Members of the management and supervisory boards cannot avoid liability by claiming that they have merely implemented a resolution of the shareholders' meeting. Neither the management nor the supervisory board is obliged to implement a shareholders' resolution if it decides that the resolution violates the law or the company's articles. Faced with such a situation, board members are entitled to bring a court action to invalidate the shareholders' resolution. Board members are also unable to claim that the shareholders have ratified the performance of their duties at the annual meeting or that the company has renounced the claim for damages towards them.

3.2 Liability to shareholders

Shareholders do not normally have a direct claim against management board members for breach of their duties, though there are some circumstances where management board members can be directly liable to shareholders.

As noted above, the company can claim damages against the person responsible for an unlawful act or breach of the company's articles. However, if the company fails to do so within a year from the act causing damage being discovered, each shareholder may claim damages against the board members responsible for the unlawful act or breach of the company's articles.

As with claims brought by the company, board members are unable to claim that the shareholders have ratified the performance of their duties at the annual meeting or that the company has renounced the claim for damages towards them.

3.3 Liability to creditors

In certain situations management board members can find themselves directly liable to creditors of the company.

On the registration of a company or on an increase of its share capital, the management board must submit a declaration to the registration court that the contributions to cover the company's initial share capital or the increased share capital (as applicable) have been made. If the management board intentionally or negligently gives false information in this declaration its members become jointly and severally liable with the company for its obligations to its creditors. As a consequence, the creditors can recover their debts directly from members of the management board, even where such claims could be satisfied by the existing assets of the company (i.e. even where they have not necessarily suffered any damage from the acts of the management board). The liability exists for three years from the date of registration of the company or registration of the increase of its share capital.
In an Sp. z o.o. (but not in an S.A.) there is a general principle that the members of the management board are jointly and severally liable for the company's obligations towards its creditors if enforcement against the company has proved to be ineffective. They can be released from this liability if they can prove that an application for declaration of the company's bankruptcy was filed or composition proceedings were initiated at the appropriate time, or that the failure to file such application or initiate such proceedings was not due to their fault or that such failure did not cause damage to the creditors. The company does not necessarily have to be bankrupt for this liability to arise.

Members of the management board (and any other persons who are authorised to represent the company) are obliged to file an application for declaration of bankruptcy if either: (i) the company has ceased to pay its due and payable debts; or (ii) the debts of the company exceed the value of its assets even if those debts are regularly being paid. Such persons are liable for any damage caused as a result of the failure to file an application within 2 weeks from the date when grounds for such a request have arisen.

3.4 Tax liability

Members of the management board are jointly and severally liable for tax and social security arrears of the company if enforcement against the company has proved to be ineffective. They are released from this liability if they can prove that an application for declaration of the company's bankruptcy was filed or composition proceedings were initiated at the appropriate time, or that the failure to file such application or initiate such proceedings was not their fault or if they can indicate assets against which enforcement could be effected. This liability only applies to tax arrears which arise during the term of office of the particular member of the management board. Note that, unlike the similar liability to creditors discussed above, the liability for tax arrears applies in both an Sp. z o.o. and an S.A.

3.5 Criminal liability

In some circumstances members of the management board may be subject to criminal liability. A breach of law does not need to be intentional to give rise to criminal liability and for many crimes negligence will suffice, although the penalty may be less severe.

A management board member can be held liable under the Commercial Companies Code for crimes committed against the company, including acting to the detriment of the company during its incorporation or operation; announcing false information or providing such false information to members of other corporate bodies of the company, state authorities or auditors; failing to file an application for declaration of the company's bankruptcy, failing to convene the shareholders’ meeting and failing to submit relevant documents and information to the authorities. Depending on the nature of the offence, it may be sanctioned with imprisonment of up to five years, limitation of liberty or fines.

Members of the management board may be also found criminally liable for various offences under the Criminal Code. This includes a wide range of offences, such as money laundering, acting to the detriment of the company, causing damage to the company and damaging creditors by concealing or disposing of the company's assets. Criminal liability can also arise under other acts, for example for insider dealing under the Securities Act.

Polish law also recognises the concept of liability of “collective entities”. A company (or other legal person) is liable for an offence committed by its individual representatives (eg board members) if the offence resulted, or could have resulted, in any benefit to the company. The company can be fined up to 10% of its revenues from the year preceding the year in which the final and binding criminal judgement was issued against the board member. In addition to other penalties, any benefits obtained as a result of the offence committed by the board member are subject to seizure for the benefit of the State Treasury.
3.6 Failure to declare the company’s bankruptcy and other bankruptcy-related liabilities

In addition to the criminal sanctions and liability to creditors mentioned above that can arise for members of the management board if they fail to declare the company’s bankruptcy when they should, there are several other bankruptcy-related liabilities.

Members of the management board who fail to declare the company’s bankruptcy when they should may be deprived of the right to carry out a business on their own account or to hold the position of member of the management or supervisory board, representative, attorney or proxy in companies and co-operatives, foundations, associations etc, for a period of between three and ten years. This disqualification can be imposed by the court on the application of a creditor, official receiver or administrator of the bankruptcy estate as well as of the President of the Office for Competition and Consumer Protection and the Chairman of the Securities and Exchanges Commission.

The same sanction may be imposed on a member of the management board who, after declaration of the company’s bankruptcy:

- hides or destroys the company’s documents;
- hides, destroys, disposes of or encumbers the assets comprising the bankruptcy estate;
- fails to perform the duties and obligations required by the Bankruptcy Law; or
- acts in a manner that jeopardises the bankruptcy proceedings.

The court will take into consideration whether such actions were taken intentionally, negligently or unintentionally, the extent of any decrease in the value of the company and the extent of any damage incurred by creditors. If the company has previously been subject to bankruptcy proceedings, then that will also be taken into consideration.

4. TERMS OF OFFICE, TERMINATION AND REMUNERATION OF DIRECTORS

4.1 Appointment

The first management board members are usually nominated in the articles. In an Sp. z o.o. the further members of the management board are appointed and dismissed by shareholders’ resolution, unless the articles provide otherwise. In an S.A. they are appointed and dismissed by the supervisory board, unless the articles state otherwise.

The management board members must be recorded in the register of entrepreneurs of the National Court Register. Registration is merely declaratory and the management board members are authorised to perform their office as of the date of their appointment. Various documents must be submitted with the registration application, including the home address and notarised specimen signature of the board member.
4.2 Eligibility

Only individuals with full legal capacity may serve as management board members. It is not possible for a legal entity to be a management board member of another entity. There are no nationality requirements for management board members, but nationals of other EU member states need a residency permit to reside in Poland for longer than three months, and nationals of non-EU states need a visa and a work permit if they are present in Poland for more than 30 days in a calendar year.

Anyone who has been convicted by a valid and binding judgement for various criminal offences including data protection offences, unauthorised dealing in securities and money, money laundering, acting to the detriment of a company is prohibited in principle from being a management or supervisory board member until the later of five years after the judgement has become final and binding or three years after the end of the sanction imposed. If the person committed the offence unintentionally he may ask the court to lift the prohibition within three months of the moment the judgement has become final and binding.

4.3 Term of office

Terms of office are generally determined by the articles, although they can be set by resolution of the appointing body if the articles allow. There is no statutory maximum duration for appointments to the management board of an Sp. z o.o.. In an S.A. there is a maximum of five years. Re-election of management board members is possible.

4.4 Termination

Management board members can be dismissed at any time by the body that appointed them, provided such dismissal is not contrary to the provisions of the articles. In any event, management board members can always be dismissed by the shareholders.

Management board members can unilaterally resign with immediate effect. In principle, the resignation is effective when served on the company and does not depend upon acceptance by the company.

4.5 Management contracts

The management board and the company may enter into a management contract, distinct from an employment contract, to agree the specific terms of the exercise of the management position by the board member. A management contract is different from an employment contract as it should normally relate only to the performance by the board member of his statutory functions. Market practice varies as to whether board members are engaged by the company under management contracts or employment contracts – or indeed have a contract at all.

Management contracts frequently include post-termination non-compete covenants, as those applicable by law do not survive termination of the office. Unlike non-competes in employment contracts, those in management contracts are not specifically regulated.

4.6 Remuneration

All remuneration received for exercising the office of a management board member must either be provided for in his employment or management contract or separately approved by the body which appointed him. If no remuneration is specifically agreed upon, the board member is entitled to receive remuneration in the amount which is “usual” in all the circumstances of the case.

Remuneration received as a board member under a management contract and as an employee under an employment contract are no longer treated differently for tax and social security.

‘Market practice varies as to whether board members are engaged under management or employment contracts – or indeed have a contract at all’
4.7 Other incentives

There is no specific regulation of other incentives provided to management board members, and so they are subject to the general legal requirements.

In particular, it is possible for management board members to participate in share plans, either in their capacity as board members or as employees.

5. TRANSPARENCY AND RIGHTS OF SHAREHOLDERS/PUBLIC/CREDITORS TO INFORMATION

5.1 General information rights

Basic company information (registered capital, names of the management and supervisory board members, identity of a sole shareholder, scope of activity, etc.) is registered in the register of entrepreneurs of the National Court Register. Companies must also file certain documents with the register such as their articles, specimen notarised signatures of management board members, financial statements, specific declarations of the management board as to the share capital payment and other documents filed in specific situations such as mergers.

These are accessible to the public. Further information is available in the official publications Monitor Sądowy i Gospodarczy (which contains certain announcements such as the convening of the shareholders’ meeting in an S.A., or the opening of liquidation proceedings) and Monitor Polski B (which may contain the financial statements of larger companies).

Shareholders can obtain information directly from a company. In an Sp. z o.o. a shareholder may review the books, question the management board and request the preparation of a balance sheet. The shareholder may however lose or be limited in his right to question the company directly if a supervisory board has been established. In an S.A., where the existence of a supervisory board is mandatory, shareholders do not have the option to exercise direct supervisory rights, although shareholders may request information directly from the management board in the course of a shareholders’ meeting. The management board is only obliged to provide such information if it is relevant to the shareholders’ assessment of a particular matter on the agenda, and the company can refuse to provide information which could damage its interests or expose any management board member to criminal, administrative or civil liability.

Subject to the above limitations, the management board must provide a shareholder with information requested at a shareholders’ meeting by no later than two weeks after the meeting, together with written general information about the company. If a shareholder is refused information requested at the general meeting, and if this has been noted in the minutes of the meeting, he may apply to the registration court within one week after such refusal requesting that the management board provide him with such information. A shareholder may also ask the registration court to ensure that he is provided with information that has been supplied to another shareholder.
5.2 Additional obligations for listed companies

The management board of a public company must consider the likelihood of any information it intends to disclose being confidential under the Act on Public Offerings, the Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (the *Act on Public Offerings*) and the Act on Trading in Financial Instruments (the *Act on Trading in Financial Instruments*). However, the Act on Public Offerings also provides shareholders of public companies with additional information rights. At a general meeting of a public company, a shareholder or group of shareholders holding at least 5% of the votes may propose a motion calling for the appointment of a special auditor to examine or investigate a particular issue relating to the company. Any resolution in this regard should detail the scope of the investigation, the documentation the auditor should receive from the company, and the opinion of the management board regarding the resolution. If the resolution is rejected, the shareholders proposing it may still apply to the registration court within 14 days for the appointment of an auditor. The management board can request the court to take security from the applicants as a condition of the auditor’s appointment. Should the investigation reveal no legal wrongdoing, the security may be forfeited for the benefit of the company. After the investigation, the special auditor must submit a report to the company’s supervisory and management boards, and this report will also be published.

A publicly listed S.A. has additional continuing information duties towards the Polish Financial Supervision Authority (the *PFSA*). From the date the prospectus is made available to the public, the issuer is obliged to disclose to the PFSA and the Warsaw Stock Exchange (the WSE) information about all events which may materially influence the price or value of the listed shares (price-sensitive information) and certain confidential information and must produce various reports referred to below. Other than in accordance with these disclosure obligations, such information may only be disclosed to the company’s financial, economic, tax or legal advisers or parties engaged in negotiations with the company.

Under Polish law, there are certain information obligations imposed on entities holding voting rights over or under the 5%, 10%, 15%, 20%, 25%, 33%, 33 1/3 %, 50%, 75% or 90% thresholds of the total number of the voting rights in listed companies. In the case of sale or purchase of shares or other operations which increase or reduce the voting rights above or below the aforementioned thresholds, the shareholder is obliged to inform, within four business days, the concerned company, PFSA, and the capital market where the respective shares are listed.

Moreover, directors and supervisory board members of listed companies or other persons who hold management positions have the obligation to notify the PFSA and the company of any transactions executed by them or by persons related to them for their own account, whereby they acquire or dispose of any the company shares or other financial instruments related to the company.
6. **BEST PRACTICES IN PUBLIC COMPANIES**

A code of best practices in public companies was first introduced by the Warsaw Stock Exchange (the **WSE**) in 2002. The newest updated version “The Best Practices in Companies Publicly Traded on WSE” (the **Best Practices**) was introduced on 4 July 2007. The Best Practices concern the conduct of the governing bodies of the relevant companies, the individual members of those bodies and also shareholders. The aim of the Best Practices is to improve the quality of communication between companies and investors, reinforce shareholders’ rights in areas not regulated by law, and increase public companies’ transparency.

The Best Practices contain several principles recommended in company management. In particular, the company should conduct an effective and clear information policy that would guarantee security, rapidity and broad access to information. Furthermore, the recommendations state that remuneration of the bodies of the company should be set in connection with the scope of duties and liability resulting from a given function and should correspond to the size of the business enterprise and be reasonable in relation to the enterprise’s economic results.

The Best Practices also introduce a number of duties on public companies. For example, companies must maintain an internet webpage, covering all essential information, including basic corporate documents, information on the date and place of the shareholders’ meeting, and current and financial reports. The shareholders’ meeting should be convened in such a manner as to allow the participation of as many shareholders as possible.

The Best Practices state also that at least two supervisory board members should be independent, meaning that they should not have any relations with the company or any subjects that remain in vital connection with it. The supervisory board members should act with loyalty towards the company and should inform the supervisory board of any conflicts of interest.

The Best Practices require shareholders to allow media representatives to participate in the shareholders’ meetings. The shareholders’ meetings’ statute should not make it difficult for the shareholders to participate in the shareholders’ meeting or exercise their rights.
7. **Bribery and Corruption**

Provisions on corruption were introduced to the Polish Criminal Code in 2004 as part of the implementation of the Framework Decision on Combating Corruption in the Private Sector of 22 July 2003 issued by the European Council.

Under these provisions any person who, in performing a management function in a legal entity (e.g., Sp. z o.o.) carrying on business or having a key impact on decisions taken because of either his/her position or function, accepts a benefit or a promise of such in return for:

(a) conduct which could inflict material damage on this entity; or

(b) an act of unfair competition or for an inadmissible preferential act for the sake of a purchaser or customer of goods, service or other performances,

will be liable to a penalty of deprivation of freedom of up to five years.

Furthermore, any person who grants or promises to grant a benefit in the cases defined in point (a) and (b) above is also subject to the same penalty.

There are certain exclusions from liability. A perpetrator who grants or promises to grant a benefit is not liable to a penalty if the benefit or the promise of such was accepted and the perpetrator notified this to the body appointed to prosecute offences, and revealed all material circumstances of the offence before this body learned of it.

If the perpetrator of the offence causes material damage, defined as exceeding EUR 65,000, he/she will be liable to a penalty of deprivation of freedom up to eight years.

The category of persons who can be liable for corruption is broadly defined. This in particular includes directors, management board members, commercial proxies, chief accountants, supervisory board members, and liquidators.

No statutory obligations are imposed on an Sp. z o.o. or S.A. in relation to bribery and corruption offences, for example, there is no obligation on companies to maintain anti-bribery procedures.

‘Provisions on corruption were introduced in 2004, but there is no obligation on companies to maintain anti-bribery procedures’
1. WHO GOVERNS CZECH AND SLOVAK COMPANIES?

1.1 Types of company

There are several types of companies available in the Czech and Slovak Republics. This chapter deals with the two most frequently used ones: the limited liability company (s.r.o.) and the joint-stock company (a.s.). The capital of an s.r.o. is comprised of one or more “participation interests” (in Czech obchodní podíl, in Slovak obchodný podiel), which are generally subject to restrictions on transfer. The capital of an a.s. is divided into shares which are generally freely transferable and which are potentially eligible to be listed on a regulated market.

An s.r.o. is generally subject to less strict corporate governance rules than an a.s., although there are fewer differences between the types of company than is typical in many other European jurisdictions.

1.2 Directors

The business management of an s.r.o. is entrusted to one or more executives (in Czech jednatel, in Slovak konateľ). In an a.s., business management is the responsibility of the board of directors (in Czech představenstvo, in Slovak predstavenstvo). In this chapter the term “Directors” is used to refer to both the executives of an s.r.o. and the members of the board of directors of an a.s. as they are subject to largely similar rules.

The Directors have exclusive competence to take business decisions for the company. Unless otherwise specified in the company’s constitutional documents, the Directors take decisions by simple majority. Subject to the limits discussed below, the Directors also have the authority to carry out all legal acts on behalf of the company.

Whilst in other jurisdictions, Directors may be divided into “executives” and “non-executives”, according to whether they are also employed by the company, in theory at least there is no such distinction in Czech and Slovak companies. All Directors are supposed to exercise their management functions solely as statutory officers of the company, and not as employees at the same time. However, notwithstanding the legal theory, it is widespread practice for individuals to be “employed”, for example as CEO, as well as being appointed as a Director. This has implications for Directors’ remuneration and termination which are discussed further below and potentially also for Directors’ liability. Some of the review and supervisory functions performed by non-executives in other jurisdictions belong to the supervisory board (see below) in Czech and Slovak companies.
‘Notwithstanding the legal theory, it is widespread practice for individuals to be ‘employed’, as well as being appointed as a Director, which has implications for remuneration and termination’

1.3 Limits on the authority of the Directors

The Directors are required to seek approval for certain transactions. For a Czech a.s. to acquire or dispose of assets the value of which exceeds certain thresholds, other than in the ordinary course of business, the supervisory board must approve the transaction as well as the board of directors. Where the a.s. has listed shares, the approval of the general meeting is also required. Unless it has opted to have a supervisory board, no such restrictions apply to a Czech s.r.o.. In both the Czech and Slovak Republics, the Directors have to obtain the consent of the general meeting for certain matters prescribed by law or in the articles of association (e.g. prior to acquiring or disposing of a business of the company or issuing new shares).

The general meeting can also impose further restrictions on the Directors’ authority to act, but such restrictions cannot be enforced against third parties, even if made public. An act done in contravention of an internal restriction would be valid, although the company could have a claim against the Director for any resulting damages.

The company’s constitutional documents can impose restrictions on the manner in which Directors may act on behalf of the company, e.g. that two directors must act together to execute certain documents, and these restrictions can be enforced against third parties, provided they are registered in the Commercial Register.
1.4 Second level of management and other employees

The Directors may also delegate powers to act in specific matters to the company’s employees or to third parties by power of attorney. However, it is not possible under Czech and Slovak law to delegate the statutory functions of a Director to a proxy or alternate Director. Where any functions have been delegated, the overall legal responsibility for the company’s business nonetheless always remains with the Directors.

A company may appoint general proxy holders (prokurista). A prokurista has automatic authority to act in all matters related to the company’s business, except the disposal or encumbrance of real property (unless such powers are specifically granted to him). A prokurista is nonetheless not a Director and therefore cannot exercise the statutory powers of a Director and is not subject to the same liabilities.

1.5 Control by supervisory boards

The establishment of a supervisory board is optional in an s.r.o. and compulsory in an a.s. The function of a supervisory board is to monitor the actions of the Directors. Its powers are normally limited to review. Under Czech and Slovak law there are certain matters (e.g. high value transactions) for which supervisory board approval is required either by the company’s constitutional documents or by law. Except in very limited circumstances, the supervisory board does not have power to propose actions of the company on its own initiative.

The constitutional documents of an a.s. may give the supervisory board the power to appoint and remove members of the board of directors. In an s.r.o. this is not possible, even where the company has opted to have a supervisory board.

A supervisory board has a minimum of three members, with no maximum number, although under Czech law in an a.s. the number of members must be a multiple of three. The members of the supervisory board are normally appointed by the general meeting, but in an a.s. with more than 50 employees one third of the members are elected by the employees. A person who is a Director of the company may not serve on the supervisory board and vice versa.

1.6 Control by shareholders or participants

The shareholders cannot directly give orders to the Directors as to how to exercise their statutory functions of making strategic business decisions for the company. Participants or shareholders can, however, exercise some degree of control over the Directors through the general meeting.

Firstly, the general meeting has powers to appoint and remove Directors (unless it has delegated this power to the supervisory board in an a.s.) and of members of the supervisory board. Secondly, the general meeting has exclusive power to amend the constitutional documents of the company and can therefore require that certain acts of the Directors must be approved by the general meeting and/or the supervisory board. The general meeting can also require the Directors to take any lesser actions not generally within the scope of business decisions of the company reserved by law to the Directors. In a Czech s.r.o., and in both types of company in the Slovak Republic, the general meeting may also reserve any matter for its decision and may require the Directors to procure the taking of certain actions.

8. If a company has a sole participant/shareholder, the sole participant/shareholder exercises the powers of the general meeting. References to a general meeting in this chapter therefore include a sole participant/shareholder.
A qualifying minority of shareholders or participants can require the Directors to convene a general meeting to discuss specific issues. In a Slovak a.s., this requires the support of shareholders holding shares representing at least 5% of the registered capital (or such lower threshold as may be specified in the articles of association). In a Czech a.s. it requires the support of shareholders holding shares representing at least either 3% or 5% of the registered capital, depending on whether it is higher or lower than CZK 100,000,000. In an s.r.o., participants whose participations represent at least 10% of the registered capital are needed.

Both Czech and Slovak law contain a general prohibition on the abuse of both majority and minority shareholdings or participations. This is a sweeping provision, and “abuse” is an intentionally vague concept. Any legal acts conducted in breach of the prohibition will be unenforceable.

2. DUTIES

2.1 General duties

Directors’ duties are normally owed to the company, although section 3 below highlights some circumstances in which Directors can owe duties directly to investors or creditors. In addition to various specific administrative duties assigned by law to the Directors, they are also subject to a range of general duties. These include the duty to act with the care of a diligent business person, to act in the best interests of the company, to maintain loyalty to the company, not to compete with the company and to maintain confidentiality. In particular, directors must not disclose confidential information and facts to third parties if such disclosure might be detrimental to the company. The Directors are also obliged to observe rules and orders adopted by the general meeting in accordance with the law and articles of association of the company.

Unlike some jurisdictions there is a minimum level of competence expected of Directors in the Czech and Slovak Republics. The duty to act with the standard of care of a diligent business person applies to all actions and decisions taken by a Director. The duty does not require a Director to be an expert in each area of the company’s business, but he should act with the care of a diligent business person in seeking appropriate advice or assistance in such circumstances.

2.2 Competition and enforcement of fair dealing

A Director may not compete with the business of the company by engaging in an identical or similar business, either on his own account or through a company which he controls. There is also a prohibition on a Director acting as an officer of another company carrying on such business, although this has now been relaxed within corporate groups.

Directors are prohibited from acting on behalf of third parties in negotiating contracts with the company and from entering into commercial contracts with the company on their own account. It is not generally possible for exceptions to be made to these rules, even with shareholder consent, although there are some statutory exceptions. One example is loans to Directors, which are permissible if they are on arms-length terms and are approved, in a Czech a.s. by the general meeting, or in a Slovak a.s. by the supervisory board.

Further restrictions can be imposed by the company’s constitutional documents, or, in the case of an a.s., by resolution of the general meeting. The restrictions discussed above are only valid whilst the Director remains in office. If a company wants to impose post-termination restrictions on a Director, it is necessary to include them in his management contract or to rely on the general provisions of law on unfair competition.
3. **DIRECTORS’ LIABILITY**

Directors’ primary liabilities are to the company in most circumstances, but there are situations in which Directors can find they have direct liability to investors or creditors.

A concept close to the concept of shadow directors exists under Czech law; any person substantially influencing a company (whether by agreement, ownership interest or other reason) is liable to the same extent as the company’s Directors.

### 3.1 Liability to the company

Directors are normally liable to the company for damage caused by a breach of any of their duties. However, enforcement of these liabilities can be initiated by investors. Any participant in an s.r.o has standing to bring a claim against a Director on behalf of the company. Holders of 5% of the shares in a Slovak a.s. and of either 3 or 5% of the shares in a Czech a.s. (depending on the amount of the company’s registered capital) can require the supervisory board to bring a claim against a Director, and also have standing to bring a claim themselves on the company’s behalf if the supervisory board fails to do so. In either case any damages in the event of a successful claim are payable directly to the company and not to the investors who brought the claim.

Under Slovak law, creditors also have standing to bring a claim of the company against the Director, if the assets of the company are not sufficient to satisfy the creditor’s claim.

It is not possible to limit or exclude Directors’ liability, either by contract or in the company’s constitutional documents. Nor is it possible for shareholders to “ratify” breaches of duty as such – although there are various methods by which this would theoretically be possible, any waiver of the company’s rights against a Director is likely to be of no more than evidential value should future shareholders attempt to bring a claim. However, there is no prohibition on Directors’ liability insurance or on the company paying the premiums for such insurance (subject to the general rules on remuneration below). If several Directors are involved in a breach of duty, they will be jointly and severally liable. Under Czech law Directors of a controlling entity can also be liable to controlled entities in respect of failure to act with the standard of care of a diligent business person when giving orders to a controlled entity. This liability is direct if there is a controlling agreement (see 4.3 below) between the entities, or secondary in the case of a default of the controlling entity where there is no controlling agreement.

Generally, the company is required to prove that the Director breached his duties, but the burden of proof is reversed if the alleged breach lies in the Director failing to act with the standard of care of a diligent business person.

Directors of a Slovak company are not liable for damages caused to the company as a result of implementing a resolution of the company’s general meeting, provided such resolution is not contrary to the law or the company’s articles of association.

### 3.2 Liability to investors

Investors do not normally have a direct claim against Directors for breach of their duties, although as noted above they can have standing to bring a claim on behalf of the company. There are also some circumstances where Directors can be directly liable to investors. These include breach of duties in relation to a change of legal form or a merger or de-merger of the company. For example, if the Directors of Party A to a merger fail to obtain a proper valuation of the assets of Party B, they could be liable to the former investors in Party A for any resulting shortfall in their stake in the merged entity.
3.3 Liability to creditors

Directors can find themselves directly liable to creditors of the company for damages caused by their delay in filing for bankruptcy once they are aware that the company is insolvent. There can also be direct liability to creditors in respect of breaches of duty in relation to a change of legal form or a merger of the company and in certain cases concerning the process of reducing the registered capital of the company. Under Czech law the liability of Directors of controlling entities when giving orders to controlled entities also extends to the creditors of those controlled entities if the controlled entity is unable to pay them as a result of the Director’s breach.

3.4 Criminal liability

In some circumstances Directors may be subject to criminal liability. Usually a breach of law must be intentional to give rise to criminal liability, but for many crimes which are relevant to a Director’s work, negligence will suffice. Collective criminal liability is not recognised, therefore only the Directors who have personally breached the law can be prosecuted.

A Director can be liable for crimes committed against the company, such as “breach of duty in managing another entity’s assets”. A Director can also be criminally liable for acts committed by others within the company where the Director acted on its behalf or gave the order to perform the act. Under Czech law, a company as a legal entity cannot be held criminally liable.

In Slovakia, an amendment to the Criminal Code will enter into force on 1 September 2010 which introduces the possibility of imposing criminal sanctions directly against a company if a criminal offence was committed in connection with the decision-making or controlling process within such company. The idea behind the amendment is that, although a crime may be committed only by a natural person, the legal entity upon whose behalf the offender acted should bear responsibility for the crime in order to avoid the situation where no one is responsible. The sanctions against the company may be imposed in addition to sanctions against the company’s representative (i.e. a natural person), who actually committed the crime, but also if no natural person is convicted.9 Two types of sanctions may be imposed against companies: (i) confiscation of a sum of money up to EUR 1,660,000; or (ii) for certain types of crimes, confiscation of all assets of the company, if the company has acquired at least a part of its assets in connection with the criminal activity. The sanctions may be imposed also on legal successors of the company whose activities were connected with the criminal offence in question.

Acts giving rise to criminal liability of a director may include a wide range of crimes such as fraud, corruption, tax evasion, false accounting, as well as some environmental crimes such as dumping hazardous waste or causing serious environmental damage. Other crimes that could be relevant to Directors as a result of their positions are those relating to the abuse of inside information.

9. The amendment to the Criminal Code is based on a slightly peculiar concept that it may occur that even if it cannot be established who actually committed the crime, it may still be clear that the crime was committed in connection with the activities of a certain legal entity, which shall in such a case be sanctioned.
4. CORPORATE GROUPS

4.1 Regulation of groups under Czech and Slovak law

Special rules apply to corporate governance within groups of companies. Where one or more entities are subject to common control (in Slovak ovládané osoby), they form, together with the controlling entity (in Slovak ovládajúca osoba), a group (in Czech koncern). In some areas the usual corporate governance rules are relaxed within groups, but in others there are additional onerous obligations.

4.2 Intra-group transactions

Transfers between group companies of assets worth in excess of 10% of either company's registered capital are subject to independent expert valuation, and, if made during the first two (in the Slovak Republic) or three (in the Czech Republic) years of the existence of the company, approval by the general meeting. This requirement does not apply to transactions in the ordinary course of business or on a regulated market or requested by a public authority.

Furthermore, companies within a group are regarded as personally connected where one individual serves as a Director of more than one group company. Loans may only be made or security given between such companies on arms-length terms. Upstream loans and security must also be approved by the general meeting.

4.3 Controlling agreements

Under Czech law group companies can enter into controlling agreements to set out the terms of intra-group relations. There are advantages and disadvantages to doing this.

The main advantage of a controlling agreement is that Directors of the controlled company can be required to act according to the instructions of the controlling company, even where this would not be in the best interests of the controlled company, provided that it is in the interests of the group as a whole. The Directors of the controlled company remain subject to their duty to act with the care of a diligent business person. A controlling company can also cause a controlled company to take a detrimental act without a controlling agreement (eg through voting at a general meeting), although under Czech law in such cases the controlling company would be liable to compensate the controlled company for any resulting loss.

In the case of the Czech Republic, a further important issue relating to a controlling agreement is that it “lifts the veil” of limited liability to some degree, as the controlling entity is liable for losses of the controlled company if that company cannot make good the loss from its own funds. In addition, where the controlled company is not wholly-owned, the controlling agreement must provide for the controlling entity to offer to buy out the other investors in the controlled company at a fair price. There are also other formalities under Czech law associated with the conclusion of a controlling agreement, and controlling agreements are open to inspection by the public.

Where no controlling agreement is entered into, the Directors of each controlled Czech company are required to produce a report on relationships between group companies after each accounting period.
5. TERMS OF OFFICE, TERMINATION AND REMUNERATION OF DIRECTORS

5.1 Appointment

The first executives of an s.r.o. are nominated in the constitutional documents. The members of the first board of directors of an a.s. are either appointed by the first shareholders or the first supervisory board, if the articles of association give the supervisory board this power. In either type of company further Directors are appointed by the general meeting, although in an a.s. the constitutional documents may give this power to the supervisory board.

Names of the Directors must be registered in the Commercial Register (in the both Czech Republic and Slovak Republic) and Trade Register (only in the Slovak Republic). Various documents must be provided together with the registration applications, including details of the criminal record of the director whose registration is sought. Registration is merely declaratory and the Directors are authorised to perform their office as of the date of their appointment, unless otherwise stated in the appointment.

5.2 Eligibility

Only natural persons may serve as Directors – corporate Directors (one company serving as a Director of another) are not possible. Foreign nationals are equally eligible as Czech or Slovak nationals to become Directors in each country, but individuals who are neither EU nor EEA nor Swiss nationals (in the case of the Czech Republic) and neither EU nor other OECD nationals (in the case of the Slovak Republic) need a residency permit and in some cases also a work permit in order to be a Director, even if they are not in fact resident in the Czech or Slovak Republics respectively.

In the Czech Republic a person may not normally become a Director for three years following the termination of insolvency proceedings against him, or if he is subject to an unexpired conviction for certain criminal offences. Under Slovak law a person who is subject to unexpired convictions for certain financial crimes may not be appointed to the position of the Director. It is not possible for the general meeting to override this restriction.

A person who served as a Director or a member of a supervisory board of a bankrupt corporation at any time during the year prior to the filing of the bankruptcy petition against that corporation is disqualified from serving as a Director of any other Czech company for three years following the termination of the insolvency proceedings. The harshness of this provision is mitigated by the fact that the general meeting (or supervisory board) can override the disqualification and appoint the director or confirm him in office by a two-thirds majority.

5.3 Term of office

The term of office of the executives of an s.r.o. is specified in its constitutional documents and there is no legal maximum. The term of office of the members of the board of directors of an a.s. is set by the articles of association, but may not exceed five years (if the articles of association are silent, the term is deemed to be five years). Re-election of Directors is possible. Corporate governance issues can arise where Directors are engaged under employment contracts rather than management contracts. In the Slovak Republic, there is no restriction on the maximum length of notice period that can be contractually agreed in an employment agreement. Although the maximum enforceable notice period under Czech employment agreements is two months, in practice it can be very difficult to dismiss employees in the Czech Republic. Not only can dismissals be challenged in court on several grounds, but companies should also bear in mind that the standard remedy in a successful claim is re-engagement, not monetary compensation as in some other jurisdictions. This can mean that, if a Director has an employment contract with the company, he can make it very difficult (and expensive) for shareholders to dismiss him.
5.4 Termination

A Director may be removed from office at any time by the body which appointed him. Any employment relationship that the Director may also have with the company will need to be terminated separately (see above).

Directors cannot unilaterally resign with immediate effect. If a Director resigns, his office does not actually terminate until the next meeting of the body that appointed him.10 The constitutional documents of a Czech company can provide that discussion of the resignation by the body of which the Director was a member will suffice. If the Director actually announces his resignation at the meeting of the relevant appointing body, the office terminates immediately (in the case of a Slovak company) or automatically after two months if the relevant body does not agree to an earlier date (in the case of a Czech company). A Director can therefore find himself technically remaining in office – and therefore subject to the duties and liabilities of a Director – for some time after he wishes to resign, although of course in most cases it is in the company’s interest to ensure that his office is terminated as soon as possible after he announces his resignation.

Under Czech law a Director’s office terminates automatically if he ceases to fulfil the statutory criteria for performing the office.

5.5 Management contracts

The Director and the company may enter into a management contract (in Czech smlouva o výkonu funkce, in Slovak zmluva o výkone funkcie), distinct from an employment contract, to agree the specific terms of the exercise of the management position by the Director. A management contract is different from an employment contract as it relates only to the performance by the Director of his statutory functions. Management contracts must be concluded in writing and approved by the general meeting (or the supervisory board, if the supervisory board appointed the Director). Any provisions of the management contract aiming to exclude or limit the Director’s liability would be invalid. If no such agreement is entered into, the provisions of the Commercial Code will apply to the relationship between the Director and the company.

Management contracts frequently include post-termination non-compete covenants, as those applicable by law do not survive termination of the Director’s office. Unlike non-competes in employment contracts, those in management contracts are not specifically regulated. However, to be enforceable, they must be justifiable, proportionate and not “contrary to good morals”.

10. In the case of the Slovak Republic, if the relevant body does not meet for three months after receiving the Director’s resignation notice, the Director’s office terminates automatically by lapse of time as of the first day following the end of that three month period.

‘If a Director has an employment contract with the company, he can make it very difficult...for shareholders to dismiss him’
5.6 Remuneration

All remuneration received for exercising the office of a Director (i.e., Directors’ fees), other than that to which the director is entitled by virtue of law or the company’s by-laws, must either be provided for in his management contract or separately approved by the body which appointed him. If no remuneration is specifically agreed upon, the Director is entitled to receive remuneration in the amount which is “usual” in all the circumstances of the case. Under Czech law a Director may not be remunerated for performing his office if his performance has clearly contributed to the company’s adverse business results or if he has intentionally breached his legal duties in the performance of his office. If the company has posted profit in the relevant accounting period, the mandatory contribution to the reserve fund of the company has been paid and other statutory requirements have been met, the general meeting may award profit share bonuses to the Directors, but these are otherwise prohibited.

Remuneration received as a Director is different from any salary that the same individual may receive as an employee. For example, although in the Czech Republic in the case of the executive(s) of an s.r.o. the distinction is purely formalistic, for the members of the board of directors of an a.s. the two types of income are treated differently for tax and social security purposes. Although individuals may prefer to receive one type of remuneration rather than another, or to receive a combination of both types, there is some risk for companies in structuring remuneration in this manner. In our experience, there is a risk that former Directors may bring claims following termination alleging that the remuneration they have received over the years was only in their capacity as employees and claiming the statutory remuneration for the exercise of the office of Director.

5.7 Other incentives

It is possible for Directors to participate in share plans, either in their capacity as Directors or as employees. If they participate as Directors, any remuneration received under the plan would be subject to the approval of the body that appointed the director and to the prohibition on remunerating Directors who contribute to the company’s negative performance. Directors of a listed a.s. participating in a share plan should also be aware of restrictions on dealing in shares (including the exercise of options) by persons who possess price sensitive inside information.

Share plans for employees of an a.s. are specifically regulated by the Commercial Codes of both the Czech and Slovak Republics. The Czech Commercial Code permits up to 5% of the shares in the company to be issued or transferred to employees at a discount. The Slovak Commercial Code permits the general meeting to authorise a certain number of the shares in the company to be issued and transferred to employees at a discount, provided the company finances the balance of the issue price from its own resources.
6. TRANSPARENCY AND RIGHTS OF INVESTORS/PUBLIC/CREDITORS TO INFORMATION

6.1 General information rights

Basic company information, such as registered capital and names of the Directors, is registered in the Commercial Register. All companies are also required to file certain documents with the collection of documents (in Czech sbírka listin, in Slovak zbierka listín) maintained as a part of the Commercial Register, which is accessible to the public. These documents include the memorandum or articles of association, documents concerning appointment or removal of Directors, financial statements, other documents filed in specific situations such as mergers and (in the Czech Republic) also controlling agreements.

The executives in an s.r.o. have a general duty to inform the company’s participants about all matters concerning the company. Shareholders in an a.s. generally oversee the activities of the board of directors through various reports drawn up by the board, most importantly the annual report and the report on the business activities of the company and the status of its assets. Shareholders may also request explanations of matters concerning the issues on the agenda of a general meeting, or they can ask the supervisory board to investigate the actions of the board of directors. Moreover, members of Czech limited liability companies and unlimited liability companies may specifically demand information on the affairs of the company from its executive officers, and may look at the company’s documents and check the information (data) therein, or empower an auditor or a tax adviser to do so on their behalf. There is no similar right for members of a joint-stock company.

6.2 Additional obligations for listed companies

Both the Czech and Slovak Republics have implemented the EU Transparency Directive (2004/109/EC). In line with this legislation, an a.s. which has shares listed on a regulated market, and any company which has issued listed bonds, has continuing information duties. It must produce semi-annual and annual reports and financial statements, and in Slovakia, also interim management statements, or quarterly reports (if it is obliged to do so under the stock exchange rules or if it chooses to do so). Czech companies must publish these reports on the internet and deliver them to the Czech Securities Commission. Slovak companies must publish the reports either on their website, in the national press or in a generally recognised information system publishing official market prices of securities. In addition, Slovak companies have to ensure that the reports are delivered to the Slovak Stock Exchange and to the National Bank of Slovakia, which should publish them on its websites. Annual reports and financial statements are also publicly available in the collection of documents of the Commercial Register. From a corporate governance perspective, the annual report must disclose the total amount of remuneration paid to Directors and, as a separate category, other very senior managers over the accounting period. The annual report must also include information on the number of shares in the company and share options held by its Directors and information regarding any dealings in those securities by the Directors.

Listed companies are also required to publish immediately on the internet any fact material for the protection of investors. They also have to publish on the internet and deliver to the Czech Securities Commission or the Slovak Stock Exchange and the National Bank of Slovakia respectively any price sensitive (inside)\textsuperscript{11} information, unless there are valid reasons for delaying such publication.

\textsuperscript{11} Inside information in line with the Market Abuse Directive as implemented in the Slovak Act on Securities.
The Transparency Directive also translates into obligations on members holding material shareholdings in listed companies to disclose such shareholdings. This applies to any entity holding 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50% or 75% of the voting rights. This entity has to inform the Czech National Bank and the issuer of any acquisition or disposal of shares which increase or reduce its shareholding above or below the specified thresholds.

Companies issuing securities listed on a regulated market must also, for the first time in the year 2010, disclose which code of corporate governance they have adopted – if any. The companies can decide which provision they will not apply or that they will not comply with any code; the disclosure obligation is based on the comply-or-explain principle. If a company decides not to comply with a part of a code or with any code, the company has an obligation to disclose this decision and its reasons.

7. BRIBERY AND CORRUPTION

The Czech Criminal Code includes a special section dealing with bribery, covering three offences: (i) bribe-taking; (ii) bribe-giving; and (iii) indirect bribery. Bribery is understood as providing an unjust benefit in the form of an enrichment or other preferment of a person in connection with a matter of public interest or with a matter of his or another's business. Bribe-taking means that a person takes a bribe or allows another person to promise him a bribe in connection with a matter of public interest or with a matter of his or another's business, or the person asks for a bribe. Bribe-giving means that a person gives, offers or promises a bribe to another person in connection with a matter of public interest or with a matter of his or another's business. Indirect bribery is described as asking for or accepting a bribe to use his or another’s influence to affect the exercise of a public official’s powers, or for having done so. Depending on the circumstances, bribery may be punished by up to 12 years imprisonment.

Corruption can be connected with different offences under the Criminal Code, eg: violation of rules on economic competition, conspiring to defraud in bankruptcy proceedings, conspiring to defraud in a public tender, fraud in relation to a creditor, preferring a particular creditor.

Sadly, corruption is becoming increasingly prominent in Slovakia. According to the CPI (Corruption Perceptions Index) by Transparency International, the Slovak score in 2009 has fallen from 5.0 to 4.5, which is its worst result in four years and places it behind all neighbouring countries with the exception of the Ukraine.

Corruption in Slovakia is sanctioned by the Criminal Code. Both parties to the corruption (the bribe-giver and the bribe-taker) are liable and may be prosecuted. The sanctions are more serious if the corruption takes place in connection with public affairs, or if the target of the bribe was a foreign public officer, or an employee of an international judicial body or an international organisation.

A special criminal offence exists under Slovak law which covers offering or giving bribes to foreign officials in connection with the discharge of their duties for the purpose of gaining or retaining an advantage in international trade.

In spite of the general opinion that corruption is widespread in Slovakia, very few convictions have been made for this crime. For instance, the first conviction of a Slovak judge for accepting bribes only occurred in April 2010.
1. WHO GOVERS HUNGARIAN COMPANIES?

1.1 Types of company

Several types of companies are possible in Hungary. This chapter focuses mainly on the two most frequently used ones: the limited liability company (Kft.) and the private company limited by shares but also touches on certain points applicable to an Nyrt. The capital of a Kft. is comprised of quotas; these are registered interests which do not appear in material form. Quotas in a Kft. are generally subject to restrictions on transfer – the members, the company itself and other persons appointed by the members’ meeting have pre-emption rights by law unless the articles of association limits or excludes such pre-emption rights. The capital of a Zrt. or Nyrt. is divided into shares which are generally freely transferable and which are potentially eligible to be listed on a regulated market. A Kft. is generally subject to less strict corporate governance rules than a Zrt. or Nyrt.

1.2 Directors

The business management of a Kft. is entrusted to one or more managing directors who act as individuals, rather than as a body. In a Zrt. and Nyrt., business management is the responsibility of the board of directors, although it is also possible in a Zrt. to have management by a single individual as chief executive officer (CEO). In this chapter the term “Directors” is used to refer to both the executives of a Kft. and the members of the board of directors or the CEO of a Zrt or Nyrt. In both types of company, only natural persons can be Directors – it is not permitted for one legal entity to be the Director of another.

The Directors are responsible for the day-to-day management of the company. They can decide on any matter not reserved to the exclusive competence of the founder or the members. Directors must carry out their duties in person and cannot appoint alternates to take their place.

Whilst in other jurisdictions, Directors may be divided into “executives” and “non-executives”, according to whether they are also employed by the company, there is no such distinction in Hungarian companies except for Nyrts. A Director can either be an employee of the company or can hold his position based on a services/consultancy agreement.

12. There are two types of a company limited by shares in Hungary: a private company limited by shares (in Hungarian: zártkörűen működő részvénytársaság, Zrt.) and a public company limited by shares (in Hungarian: nyilvánosan működő részvénytársaság, Nyrt.). A company operates as an Nyrt. if: (i) all or some of its shares have originally been offered to the public in accordance with the requirements set out in Act CX of 2001 on the Capital Markets; or (ii) its shares, which were not originally offered to the public, have subsequently been offered for sale to the public or admitted to trading on a regulated market. A company operates as a Zrt. if: (i) its shares have not been offered to the public; or (ii) its shares, which were originally offered to the public, are no longer offered for sale to the public or have been delisted.
1.3 Limits on the authority of the Directors

Generally, a Director has the power to represent the company in all dealings with third parties and before the court and other authorities. The company’s constitutional documents can however impose restrictions on the manner in which Directors may act on behalf of the company, for example by requiring that two directors must sign together. If registered in the Register of Companies, such restrictions can be relied on against third parties. It is only possible to stipulate one means by which each Director may sign on behalf of the company – the constitutional documents cannot permit a Director to enter into certain transactions alone but require the same Director to sign for transactions above a certain threshold together with another Director.

The members can impose further restrictions on the Directors’ authority to act, but such restrictions cannot be enforced against third parties, even if made public. An act done in contravention of an internal restriction would be valid, although the company could have a claim against the Director for any resulting damage.

‘Members can impose further restrictions on the Directors’ authority to act, but such restrictions cannot be enforced against third parties, even if made public’
1.4 Company secretary and the right of representation by employees

A company’s general meeting may appoint a “company secretary” (in Hungarian: cégvezető). A company secretary is an employee who has the general right to represent the company (either individually or jointly with another employee or a Director). The company secretary remains an employee, however, and is not considered as a Director for liability purposes. Employees who would otherwise satisfy the requirements to be appointed as a Director are eligible to be appointed as company secretary. If the company has more than one place of business, it may appoint a separate company secretary to manage that part of the business. The company secretary carries out his duties independently, but on the basis of instructions from the Directors. If the company secretary questions the legality or expediency of an instruction given to him by a Director, he may refer the matter to the supervisory board (see 1.5 below).

The Directors can give employees of the company the right to represent the company in relation to specific issues or groups of issues. Such employees generally have a joint signatory right with another employee or a Director except if they are specifically given individual signatory rights by the Directors. Rights of representation given to employees or the company secretary may not be further delegated by them.

1.5 Control by supervisory boards

The establishment of a supervisory board is mandatory for an Nyrt. (except if it operates in a one-tier board system) and in certain circumstances for a Kft or a Zrt.\textsuperscript{13} It is otherwise optional for a Kft. and a Zrt. A supervisory board has between three and fifteen members, one third of whom are elected from amongst the company’s employees if the company has more than 200 full-time employees on an annual average. Otherwise, members of the supervisory board are appointed by the shareholders or quotaholders through the general meeting. Directors may not serve as members of the supervisory board and vice versa.

The main function of the supervisory board is to supervise the management of the company on behalf of the general meeting. The supervisory board can require the Directors and senior employees of the company to provide it with information and may inspect the books and documents of the company. The general meeting may not approve the financial statements without having received a written report from the supervisory board. If the supervisory board considers that the activities of the management are contrary to the law, the constitutional documents or the resolutions of the general meeting, or otherwise infringe the interests of the company or its members, it must convene and propose the agenda for an extraordinary general meeting. The supervisory board can also be assigned additional powers by the company’s constitutional documents, such as a requirement for certain transactions to be approved by it or the right to appoint and remove Directors and determine their remuneration.

Where a member of the supervisory board of a company is, for example an employee of a shareholder or another group company, he is nonetheless responsible to the general meeting of the company and cannot take instructions from his employer.

\textsuperscript{13} A supervisory board must be established if: (i) in the case of a Zrt., it is so requested by a number of shareholders representing at least 5% of the voting rights in the company; (ii) it is prescribed by law for the purposes of the protection of state-owned assets or due to special activities carried out by the company; or (iii) the company has more than 200 full-time employees on an annual average (except if it is agreed otherwise with the works council operating at the company).
1.6 Control by shareholders or quotaholders

The Directors have a duty to act independently and must not take instructions from the members of the company or from their employer. As an exception, a single member or shareholder may give written instructions to the Directors. Shareholders or quotaholders can, additionally, exercise some degree of control over the Directors through the general meeting.14

Firstly, the general meeting can appoint and remove Directors (unless it has delegated this power to the supervisory board) and members of the supervisory board. Secondly, with certain limited exceptions15, the general meeting has exclusive power to amend the constitutional documents of the company and can therefore require that the Directors need the approval of the general meeting and/or the supervisory board for certain acts.

A qualifying minority of shareholders or quotaholders can require the Directors to convene a general meeting to discuss specific issues. A shareholder or quotaholder can also request the Directors to provide them with information about the company’s affairs, or to allow them to inspect the company’s books and documents. If the Directors fail to comply with such a request, the shareholder or quotaholder can ask the Court of Registration to require the company to comply, subject to the business interests and secrets of the company.

In addition, if the shareholders’ or quotaholders’ meeting has refused a proposal that the last financial statement, or any event which has occurred during the last two years, should be examined by an independent auditor, or if no decision on such, validly initiated, proposal has been made, a qualifying minority of shareholders or quotaholders may request the court of registration to order such examination. A similar rule applies if a validly initiated proposal to enforce a claim of the company against the shareholders/quotaholders, Directors, the members of the supervisory board or the auditor has been refused or has not been voted on; in this case such claim can be enforced before the court directly by a qualifying minority of shareholders or quotaholders on behalf of the company.

2. DUTIES

2.1 General duties

A Director is generally under a duty to act in the best interests of the company at all times and to conduct the management of the company with an enhanced duty of care to act according to the standards reasonably expected of a person carrying out the functions of the relevant Director.

Each Director is personally responsible for ensuring that certain matters are reported to the Court of Registration. These matters include the company’s foundation, amendments to its constitutional documents and changes to company information recorded in the Register of Companies. The Directors are jointly and severally liable to the company for any resulting damage if the information (including the financial statement and the related business report) reported to the Court of Registration is false or inaccurate, or if they fail to file or are late in filing any of the information.

A Director must keep confidential all information obtained in the course of conducting the company’s management.

14. If a company has a sole quotaholder/shareholder, the sole quotaholder/shareholder exercises the powers of the general meeting. References to a general meeting in this chapter therefore include a sole quotaholder/shareholder.

15. The constitutional document may, however, authorise the Directors to decide on a certain limited number of changes to the constitutional document such as the name, seat, premises, branches and scope of activity of the company (with the exception of the main activity).
2.2 Competition and enforcement of fair dealing

A Director must not acquire an interest in any company that carries out an identical main (or, if the constitutional document so provides, any) activity to that of his company, although there is an exception for shares in Nyrt. The same restriction applies to being appointed as a Director of another such company, unless this is permitted by the company’s constitutional document or by the general meeting.

Neither a Director nor a close relative16 of a Director may be appointed to the supervisory board of the company of which he is a Director. Directors and their close relatives may not conclude transactions falling within the scope of the company’s main (or, if the constitutional document so provides, any) activities either in their own name or for their own benefit unless permitted by the constitutional document.

Further restrictions can be imposed by the company’s constitutional documents.

3. DIRECTORS’ LIABILITY

As a basic rule, the company is liable for damage caused to third parties by a Director acting within his sphere of competence. Directors’ primary liabilities are to the company in most circumstances.

3.1 Liability to the company

If a Director violates any law or breaches his management obligations, the constitutional document, or any resolutions of the general meeting, he will be personally liable to the company for damages. In the case of Directors with joint signing authority and the board of directors of a Zrt. or Nyrt., liability to pay damages is joint and several. If such damage is caused by a resolution of the board of directors of a Zrt. or Nyrt., any Director who was not present at the board meeting, or who voted against the resolution will not be liable.

If a Director (or, as applicable, a close relative) breaches any of the prohibitions listed in 2.2 above, the company can bring an action against the Director for indemnification within one year of the breach.

It is not possible to limit the liability of Directors by contract, since companies cannot deviate from the relevant provisions of the Companies Act. However, it is possible to obtain Directors’ liability insurance.

The 2006 Companies Act introduced the possibility of final discharge (in Hungarian: *felmentvény*). If the constitutional document provides for this, a final discharge means that the supreme body of the Company may evaluate the executive officers’ work in the year under review and, based on this evaluation, may exempt the executive officer from any claim for damages by the Company. However, if the court in a final judgment later declares that the information upon which the supreme body granted the discharge was incomplete or incorrect, the final discharge will be ineffective.

3.2 Liability to third parties

Third parties do not normally have a direct claim against Directors for breaches of duty, but there are exceptions to this rule in some limited circumstances.

If the application for registration of the company is rejected, the members must accept liability for debts arising from the undertakings of the Directors. If, due to the form of the company to be established, the liability of the members for the obligations of the company is limited and is insufficient to meet outstanding claims, the Directors of the company to be established bear unlimited, joint and several liability towards third parties.

After the termination of a company without a legal successor, indemnification claims may be brought against the former Directors by the members in respect of damage caused to third parties by the Directors. Such claims can be brought within one year after the cancellation of the company by the Court of Registration.

3.3 Criminal liability

In addition to other criminal offences, the Hungarian Criminal Code contains three specific criminal offences that may be committed by Directors:

- a Director who deceives the members of the company by: (a) disclosing or spreading false information or concealing information concerning: (i) the financial position of the company; (ii) the executive officer of the company in connection with his activity as an executive officer; or (iii) a financial instrument relating to the company; or (b) entering into a fictitious transaction in relation to a financial instrument, commits the offence of abuse of authority, which is punishable by imprisonment for up to two years, community work or a fine;¹⁷;
- a Director who illegally withdraws wholly or partly the equity of a company commits the offence of curtailment of capital, which is punishable by imprisonment for up to three years;
- a Director who takes part in the act of: (i) disguising the company so that it cannot be located at its registered office (branch office, business establishment); or (ii) the registration of a person in the public records as the authorised representative of the company whose address (customary residence) is unknown or treated as unknown commits the offence of failure to comply with the obligation to supply economic data. This is punishable by imprisonment of up to three years.

The Criminal Code also punishes intentional acts which prevent the satisfaction of creditors’ claims in the case of an insolvent debtor.

3.4 Special liability in the case of insolvency and voluntary dissolution

No Director is under any statutory obligation to file for bankruptcy or liquidation even where the company is insolvent or over indebted. However, if there is an event threatening with insolvency, Directors must perform their duties in the prior interests of the creditors rather than in the interests of the company.

¹⁷. Fines can range from HUF 3,000 (approx. EUR 12) to HUF 10,800,000 (approx. EUR 43,200).
A Director who held this position in the time period of three years before the commencement of liquidation proceedings and did not perform his duties primarily in the interest of the creditors despite the fact that he foresaw or reasonably could have foreseen that the company would not be able to pay off its debts on their maturity, can be liable for all unsettled debts at the end of the insolvency proceedings (wrongful trading rule). If the damage was caused by two or more Directors, they have joint and several liability for the damage. A Director may escape from this liability if he proves that he took all generally expected measures in order to limit the creditors’ potential losses. However, the damage to the creditors’ interests must be presumed if the Director fails to disclose and report to the Court of Registration the annual account of the company.

Directors can be held liable and can be fined up to HUF 500,000 (approx. EUR 1,700) for any non-compliance with their statutory duties in voluntary dissolution proceedings or up to HUF 1,000,000 (approx. EUR 3,300) in liquidation proceedings.

4. TERMS OF OFFICE, TERMINATION AND REMUNERATION OF DIRECTORS

4.1 Appointment

Directors are appointed by the general meeting, unless it has delegated this power to the supervisory board. A Director’s mandate takes effect on his acceptance of the appointment. A Director must give written notice of his appointment as a Director within 15 days to each other company of which he is already a Director or a member of the supervisory board.

4.2 Eligibility

Only natural persons may serve as Directors – corporate Directors (one company serving as a Director of another) are not possible. Foreign nationals are equally eligible as Hungarian nationals to become Directors, but non-EEA nationals need a residency permit and in some cases also a work permit in order to be a Director, even if they are not in fact resident in Hungary.

A person is prohibited from being a Director if:

- he has committed a criminal offence and has been sentenced to imprisonment (such a person can only be a Director after his conviction has expired);
- he is prohibited by a court order from holding the position of a Director or from conducting a particular occupation for a specified period of time (this prohibition only applies to the extent that the company carries on the same main activity as his former occupation from which he is prohibited); or
- he was a Director of a company which has been cancelled from the Register of Companies ex officio within the last calendar year before the cancellation (this prohibition applies for two years after the company’s cancellation).

4.3 Term of office

Directors may be appointed for a fixed or an indefinite term as provided for by the company’s constitutional documents. If the Director is appointed for a fixed term, this must not exceed five years, but Directors may be reappointed. If the constitutional documents do not regulate Directors’ terms of office, the Director is deemed to have been appointed for a term of five years (or the lifetime of the company, if shorter).
4.4 Termination
A Director may be removed from office with immediate effect at any time by the general meeting.

A Director may resign with immediate effect unless his resignation would endanger the company’s activities. In the latter case, he must give 60 days’ written notice. Until the effective date of the resignation, the Director must continue to participate in the making and execution of those decisions which cannot be postponed.

A Director’s office also ceases automatically on the expiry of his fixed term of appointment, or his disqualification or death.

4.5 Management contracts
The relationship between the company and a Director is usually based on an agency or consultancy contract, although Directors can also be employed.

4.6 Remuneration
A Director is entitled to receive remuneration for the performance of his duties, unless it is restricted by law. The only general legal restriction on a Director’s remuneration is that a Director may not be paid remuneration during liquidation proceedings following the onset of insolvency of the company by a final judgement.

4.7 Other incentives
It is possible for Directors to participate in share plans, either in their capacity as Directors or as employees. If they participate as Directors, any remuneration received under the plan would be subject to the approval of the general meeting.

A Director who is also an employee of the company may have employee shares issued to him. Employee shares are a separate category of shares, and their issue is restricted to 15% of the registered capital of the company.

5. TRANSPARENCY AND RIGHTS OF INVESTORS/PUBLIC/ CREDITORS TO INFORMATION

5.1 General information rights
Basic company information, such as registered capital and names of the Directors, must be notified to the Court of Registration and is registered in the Register of Companies. Companies must also file certain documents with the Court of Registration keeping the Register of Companies. These documents include the deed of foundation or articles of association, resolutions of the general meeting concerning e.g. appointment or removal of Directors, financial statements, and other documents filed in specific situations such as mergers. The Register of Companies is accessible to the public.

A company limited by shares is also required to submit to the Court of Registration the notice, attendance list and minutes of its general meeting(s) within 30 days of the meeting.
5.2 Additional obligations for listed companies

Listed companies must publish annual and half-year interim reports and audited annual reports containing the most important details regarding the company’s financial position and operations. Reports must be published in a national daily newspaper and in an electronic medium operated or recognised by the Hungarian Financial Supervisory Authority (the HFSA) or a daily newspaper published or approved by the HFSA that contains official information on the capital markets. Details of Directors’ remuneration must be disclosed, and shareholdings must also be disclosed in the annual report. Directors’ remuneration must also be approved by the general meeting of shareholders. Furthermore, if a proposal in the last financial report has been refused or no decision has been reached at a shareholders meeting or an event (for instance a decision of the managing director/shareholders) that has occurred during the last two years has been examined by an independent auditor, a shareholder or group of shareholders holding at least 5% of the votes may propose a motion calling for the competent court of registration to order an independent examination.

Besides the ordinary disclosure obligations, the company is under a general obligation to disclose and publish within one business day any information which directly or indirectly concerns the value or yield of its issued securities. In addition, there are certain information obligations imposed on entities when either the holding of their voting rights or their voting shares reaches, exceeds or falls below 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 75%, 80%, 85%, 90% and each 1% threshold above 90% up to 99% of either the total voting rights or the total number of voting shares in the respective Hungarian public company limited by shares. The starting threshold of 5% is the same as the Transparency Directive minimum requirement but the 5% increments between 30% and 50% and above 75% are super-equivalent to the Transparency Directive. Furthermore, Hungarian public companies limited by shares are permitted to impose lower or intermediate disclosure thresholds in their articles of association. A shareholder can find out whether a Hungarian issuer has imposed lower/intermediate thresholds by checking that issuer’s articles of association. In the case of the sale or purchase of shares or other operations which increase or reduce the voting rights or voting shares, above or under the aforementioned thresholds, the shareholder is obliged to inform, as soon as possible, but in any event within two calendar days the issuer and the HFSA.

More specifically, a listed company that becomes aware of any information concerning a change in its business that may directly or indirectly affect the value or yield of its securities, or that would be significant for market participants in making investment decisions, is subject to extraordinary reporting obligations. Such information must be published on the official website of the Budapest Stock Exchange (the BSE) and the company may not disclose it to third parties for a period of one hour following its dispatch to the BSE.
5.3 Corporate governance recommendations

In Spring 2004, the BSE published the “Corporate Governance Recommendations” (the Recommendations), which are guidelines for best practice in corporate governance for listed companies. The Recommendations are not in themselves mandatory, but they operate on a “comply or explain” basis. Companies listed on the BSE must issue a report on their corporate governance structure that must indicate the extent to which the company’s structures follow the Recommendations.

6. BRIBERY AND CORRUPTION

In Hungary, the battle against corruption continues. In 2003, the Hungarian Parliament approved the so-called “Glass Pocket Act,” an independent piece of legislation that required modifications to several existing laws, including amendments to the Act on Municipalities, the Act on Public Procurement, the Data Protection Act, as well as the Civil Code and the law regulating the operation of the State Audit Office. More recently, the Hungarian Parliament passed the Act on Fair Trials, which became effective on 1 April 2010. Its main purpose is to stop or at least reduce corruption and to provide an incentive to all citizens who provide information to the state authorities (for example in anti-trust cases, public procurement procedures, privatisation matters and matters involving the granting of state subsidies, the individual who provides information to the relevant authority may receive a large reward from the state). The Act also adopts the recommendations of international organisations and, amongst others, regulates “whistleblowing” at the work place. More details concerning the execution of the provisions of the Act on Fair Trials is yet to be specified by way of a related future government decree, the text of which is not publicly available.

1. WHO GOVERNS ROMANIAN COMPANIES?

1.1 Types of company

Various structural forms are available to companies and partnerships in Romania. This chapter deals with the two most frequently used ones: the limited liability company (S.R.L.) and the joint-stock company (S.A.). The capital of an S.R.L. is comprised of one or more shares (parti sociale) which are generally subject to restrictions on transfer. The capital of an S.A. is also divided into shares (actiuni) which in this case may be evidenced with share certificates, are generally freely transferable and potentially eligible to be listed on a regulated market.

An S.R.L. is generally subject to less strict corporate governance rules than an S.A.

1.2 Directors

The business management of an S.R.L. is entrusted to one or more directors – national or foreign citizens, individuals or legal entities – which act separately except as otherwise provided in the articles of association.

The business management of an S.A. can be carried out using either a one-tier or a two-tier system.

Under the one-tier administration system, an S.A. is managed by a sole director or alternatively a Board of Directors, which must have an odd number of members. There is a clear distinction between the executive and non-executive functions of the Board of Directors. The executive functions can be held by several members of the Board of Directors or they can be delegated to several managers. If a company is required by law to audit its financial statements, then must appoint a Board of Directors with at least three members.

Under the two-tier administration system, an S.A. is managed by several managing directors organised in a Management Board or a sole managing director and a Supervisory Board. A Supervisory Board must have at least three but not more than eleven members.

The shareholders’ meeting may choose either administration system when setting up the company and thereafter.

The Board of Directors and managers (if any) in the one-tier system and the Management Board in the two-tier system have exclusive competence to take business decisions for an S.A. Unless otherwise specified in the company’s constitutional documents, the Board of Directors, Management Board or Supervisory Board make decisions by simple majority.

The Board of Directors/managers (if any) in the one-tier system and Management Board in the two-tier system have responsibility both for the company’s external obligations, such as dealing with public authorities and entering into contracts, and for its internal functions, such as overseeing the accounts, and convening and arranging shareholders’ meeting.
1.3 Limits of the authority of directors

Directors may perform acts within the scope of the ordinary business of the company without further authorisation. The articles can require approval of the shareholders for certain transactions, for example where the value exceeds certain thresholds.

Any limitations imposed on the scope of the authority of the members of the Board of Directors/Management will not be binding against third parties even if publicly available, with the only exception being provisions of the articles stating that the company is represented towards third parties by several directors acting jointly. If a director or manager acts beyond his powers, or in breach of an internal restriction, the company is still bound to perform the relevant obligation, except for fraud. The company might however be able to recover damages from the director or manager that has breached the limitations.

The Board of Directors/Management Board members may delegate powers to act in specific circumstances to the company’s employees or to third parties by power of attorney if such delegation is permitted by the company’s articles. If such delegation is not expressly permitted by the company’s articles, the director is jointly liable with the ostensibly empowered person for any damage caused to the company.

‘An S.R.L. is generally subject to less strict corporate governance rules than an S.A.’
1.4 Control of supervisory boards

In an S.R.L. there is no supervisory board and the duty to supervise the directors’ activities is performed only by the shareholders’ meeting.

In an S.A. operating under the one-tier system, the managers (if any) are supervised by the Board of Directors while the Board of Directors is liable only towards the shareholders’ meeting.

Under the two-tier system the activity of the Management Board members is supervised by the Supervisory Board while the Supervisory Board is liable only towards the shareholders.

1.5 Control by shareholders or participants

The shareholders cannot give orders to any of the directors as to how to perform their statutory duties or to make strategic business decisions for the company. Instead, the shareholders exercise control over the activities of directors through the general meeting.

The general meeting appoints and removes from office the members of the Board of Directors and of the Supervisory Board. Moreover, when approving the financial statements of the company, the general meeting of the shareholders must also give details of the discharge of directors as it relates to their performance of the relevant activities over the previous year, as part of the shareholders’ ability to initiate legal actions against such directors.

Shareholders of an S.R.L. can inspect the books and documents of the company and request copies of such documents. However, if the number of shareholders exceeds 15 an S.R.L. must appoint censors and in this case the shareholders no longer have a personal right to exercise a supervisory function, although they can request that the censors provide information about the company’s activity.

In an S.A., shareholders have supervisory rights, which means that they can inspect the books and documents of the company, request copies of such documents or require the Board of Directors/Supervisory Board to provide them with explanations regarding the company’s activity.

Any shareholder of a Romanian SA has the right to notify the censors or the internal auditor of any operations that they consider have to be verified, and the censors/internal auditors will have to take such operations into consideration in their report to the general meeting of the shareholders. If notice in this respect is given by shareholder(s) representing a minimum of 5% of the company’s share capital (or any smaller quota specified by the articles of association) the censors/internal auditors are obliged to verify the notified operations. If the notice is grounded and requires urgent action, the general meeting of the shareholders must be convened by the censors or by the directors (in cases where the notice is given by the internal auditors). Otherwise, the notification will be discussed at the next general meeting of the shareholders.

Furthermore, for a Romanian S.A., transactions concluded by the Board of Directors or Management Board in the name and on behalf of the company which result in an acquisition or alienation of assets, a lease, or the change or setting up of guarantees over the assets of the company, and in each case generating expenditures exceeding 50% (or 20% for public companies) of the assets’ book value, must be approved in advance by the extraordinary general meeting of the shareholders. Shareholders can also reserve further control rights to themselves in the articles, such as requiring the managers/members of the Board of Directors or Management Board to seek shareholder approval before performing certain actions.

‘If the number of shareholders exceeds 15 an S.R.L. must appoint censors and the shareholders will lose the personal right to exercise a supervisory function’
2. **DUTIES**

2.1 **General duties**

Duties of the directors of an S.R.L. or members of the Board of Directors/Management Board in an S.A. are normally owed to the company. In addition to various specific duties assigned by law, such persons are also subject to a range of general duties. These include the duty to act with the care of a diligent business person, to act in the best interests of the company, not to compete with the company and to avoid acting where there are certain conflicts of interest. Directors and Board members are also obliged to comply with the provisions of the articles and any limitations imposed by shareholder resolution.

Directors and Board members must keep all information obtained in the course of their management duties confidential.

2.2 **Competition and enforcement of fair dealing**

In an S.A., managers or members of the Management Board cannot occupy the position of director, member of the Board of Directors/of the Management Board/of the Supervisory Board, censor or shareholder in other competitive companies or companies carrying on the same business activity without the authorisation of the relevant Board, nor may they carry out the same business or a competitive business on their own account or for a third party’s interest. Directors of an S.R.L. are subject to similar restrictions.

A natural person may not exercise the position of director and/or member of the Supervisory Board in more than five Romanian S.A companies at the same time. This prohibition is not applicable when the person nominated for the position of director in a company owns at least 25% of the share capital of the relevant company or it is a member of the Board of Directors/Supervisory Board of a company which owns shares above the 25% threshold.

In an S.R.L. if the sole director is also the sole shareholder of the company, any contracts between him and the company must be executed in written form, with the sanction for failure to observe this requirement being the invalidity of the relevant contract.

Further restrictions can be imposed by the company’s constitutional documents. The above specific restrictions only apply whilst a director/Board member remains in office. To impose post-termination restrictions, it is necessary to include them in the relevant individual’s management or employment contract or to rely on general legal restrictions governing unfair competition.

3. **DIRECTORS’ LIABILITY**

3.1 **Liability to the company**

Directors are liable towards the company for damage caused by any breach of any of their duties performed in the setting-up or functioning of the company.

Directors are jointly liable towards the company for the integrity of payments made by the shareholders, including dividends paid, for the existence and correct keeping of records in the registers of the company, for the exact performance of actions required pursuant to decisions of the shareholders and for the strict fulfilment of their duties as imposed by the law and by the articles.
However, an individual director will not be liable for damage caused by a decision of the Board of Directors/Management Board where he or she voted against such decision and informed the internal/external auditor or censors of its content.

Directors are indirectly and severally held liable towards the company for damage incurred by third parties as a result of adverse actions of the managers and personnel of the company, provided that the damage in question would not have occurred if the directors had duly exercised their supervision duties.

Members of the Board will also be held jointly liable for any unlawful act committed by their predecessors in cases where they are aware of the unlawful act but fail to inform the censors or, as the case may be, the internal auditors and financial auditors.

Directors may be discharged of their liability towards the company by the general meeting of the shareholders approving the financial statements based on the information provided to the shareholders in this context. The discharge of liability will not operate with respect to operations of directors that were not fully and correctly disclosed.

3.2 Liability to shareholders

Shareholders do not generally enjoy the right to initiate a direct claim against directors for breach of their duties.

In an S.A. as well as in an S.R.L. the shareholders’ meeting is the competent body to file a claim against a member of the Board for any damages caused to the company. However, in an S.A. shareholders owning, individually or jointly, at least 5% of the registered capital of the company have the right to file a court action in their own name but on behalf of the company, provided that the general meeting has not initiated any such claim itself or approved any such initiation on behalf of one or more other shareholders.

3.3 Liability to creditors

In certain limited situations, members of the Board can find themselves directly liable to creditors of the company.

In particular this includes the case where the company is subject to a bankruptcy procedure. Thus, the creditors’ committee may request the members of the management/directors/ supervisory Boards to cover a part of the bankrupt company’s debts if it can be proved that they have caused or exacerbated the company’s insolvency as a result of certain acts specified by the law.

3.4 Criminal liability

Both civil and criminal liability may be attached to directors for actions resulting in criminal offences. In general, a breach of law must be intentional to give rise to criminal liability, but for many offences related to directors’ duties, negligence will suffice. Such crimes are punishable with imprisonment and/or a fine.

Directors can be liable under the Company Law for criminal offences committed against the company such as acting to the detriment of the company, failing to file an application for the declaration of bankruptcy, using assets or credit of the company in bad-faith for private purposes, or failing to convene the shareholders’ meeting. They can also be liable under the Romanian criminal code for a wide range of offences such as: fraudulent administration, embezzlement, and bribery.

‘Directors may be discharged of their liability towards the company by the general meeting of the shareholders’
4. **INTRA-GROUP TRANSACTIONS**

Some of the most important restrictions on intra-group transactions relate to transfer pricing rules and characterisation of dividend payments.

Pursuant to the Romanian Fiscal Code, when establishing the amount of a tax or other public contribution due from a company, the tax authorities may disregard a transaction that lacks an appropriate corporate benefit or may modify the form of such transaction in order to reflect its true economic nature. At the same time, in case of related party transactions, the tax authorities may adjust for tax purposes the amount of the revenue or expenses of any of the parties, to the extent necessary to reflect the market price of the products or services supplied in the course of the transaction. When establishing the market price of transactions between affiliates, the most adequate of the following methods in the particular circumstances will be used: (i) price comparison; (ii) cost-plus pricing; (iii) resale price method; (iv) any other method as per the guidelines on transfer pricing issued by the OECD.

Pursuant to the Romanian Fiscal Code, if the amount paid by a Romanian legal entity for the goods and services supplied/provided by a participant (shareholder) in the relevant entity exceeds the market price for such goods or services, then the difference is treated as a dividend. Moreover, if the payment to a shareholder by a Romanian legal entity for the goods or services supplied/provided to that entity is made for the personal benefit of that shareholder of the legal entity, then such amount will also be treated as a dividend.

5. **TERMS OF OFFICE, TERMINATION AND REMUNERATION OF DIRECTORS**

5.1 **Appointment**

Directors of an S.R.L. and the members of the Board of Directors of an S.A. organised under the one-tier system are appointed by the articles or by the shareholders’ meeting. In an S.A. organised under the two-tier system the Supervisory Board members are appointed by the shareholders’ meeting, and the members of the Management Board by the Supervisory Board.

Directors in an S.R.L., members of the Board of Directors and managers (if any) in the one-tier system and members of the Management Board and Supervisory Board in the two-tier system of an S.A. must be registered with the Commercial Registry, and any directors enjoying representation powers must also submit a specimen signature. Registration is only required for opposability purposes as the Board members are authorised to perform their office as of the date of their appointment.

5.2 **Eligibility**

Only individuals or legal entities with full legal capacity may serve as Board members. Managers, under the one-tier system, and members of the Supervisory Board in the two-tier system must be individuals. However, the members of the other Boards can be either individuals or legal entities.

There is a prohibition on the nomination as Board member of any person convicted of fraudulent management, misuse of trust, forgery or use of forgeries, cheating, embezzlement, perjury, bribery or taking a bribe, as well as for other criminal offences provided by bankruptcy related legislation.

There are no nationality restrictions for managers, directors or members of the Boards. Irrespective of the type of company, shareholders are able to assume the position of director.
5.3 Term of office

The term of office of the directors of an S.R.L. is specified in its constitutional documents and there is no legal maximum term.

For an S.A., the duration of the mandate of the directors or, as the case may be, of the members of the Management Board and Supervisory Board must be established in the articles and may not exceed four years. They can be re-elected, except where the articles provide otherwise. The term of office of the first members of the Board of Directors or, as the case may be, of the Management Board/Supervisory Board may not exceed two years.

5.4 Termination

In an S.R.L. the directors can be removed from office at any time by a majority of the shareholders. Where directors have been appointed through the articles, unanimity of the shareholders is required for their removal.

In an S.A. the managers (one-tier system) and members of the Management Board (two-tier system) may be dismissed at any time by the Board of Directors and Supervisory Board, respectively. The members of the Management Board may be also dismissed by the shareholders’ meeting.

The shareholders’ meeting may dismiss the members of the Board of Directors and Supervisory Board at any time. However, if the dismissal has no reasonable ground (and only reflects the discretionary powers of the shareholders’ meeting), the Board member is entitled to ask for compensation for damage suffered.

Directors, managers or Board members may unilaterally resign from office with immediate effect. They will, however, be liable for any damage caused to the company by their resignation.

5.5 Management contracts

The relationship between the company and the members of the Board of Directors and managers in the one-tier system and the members of the Management Board in the two-tier system are usually based on a mandate or management contract. Such persons may not execute employment agreements with the company as long as they hold these positions. If they are appointed from the company's employees, their individual labour contracts will be suspended by operation of law for the entire period of their administration mandate.

No such prohibition exists for the directors of an S.R.L.

5.6 Remuneration

Board members are entitled to receive remuneration for the performance of their duties. The remuneration of the members of the Board of Directors or of the Supervisory Board is established in the articles or by a decision of the general meeting of the shareholders. The remuneration of managers in the one-tier system, and of the members of the Management Board in the two-tier system, is established, respectively, by the Board of Directors and Supervisory Board.

The remuneration set by the shareholders’ meeting or the Board of Directors/Supervisory Board must be proportional to the duties of the relevant Board members in the company as well as to the financial status of the company.

Directors’ remuneration and employees’ salaries are subject to similar tax treatment.

5.7 Other incentives

There is no specific regulation of other incentives provided to directors and so this is subject only to the general legal requirements.
6. TRANSPARENCY AND RIGHTS OF INVESTORS/PUBLIC/CREDITORS TO INFORMATION

6.1 General information rights

General company information, such as business objects, headquarters, share capital, shareholding structure, directors and censors/internal auditors, is registered with the competent Commercial Registry. Moreover, companies must file with the Commercial Registry any and all resolutions of the general meeting of the shareholders, the financial statements of the company, as well as other documentation relevant in specific situations (mergers/creation of secondary units/division). This data is publicly accessible.

Shareholders generally oversee the activities of the Board of Directors through various reports drawn up by the Board, most importantly the annual report on the company's financial statements. Moreover, documents regarding the company’s business are made available to the shareholders at the registered office of the company by the directors before each general meeting of the shareholders. Shareholders may also ask directors to provide them with any additional information needed and explanations of any matters of the agenda.

General business information may also be published on the website of the company.

6.2 Additional obligations for listed companies

Listed companies must inform the public about the allocation and payment of dividends, and the issuance of new shares, including allotment, subscription, renunciation and conversion arrangements. These companies have to draw up quarterly, half-yearly and annual reports regarding their financial status. The reports must be made available to the public electronically or on paper support or by any other means as approved by the Romanian National Securities Commission (CNVM).

Under Romanian law, there are certain information obligations imposed on shareholders holding voting rights over or under the 5%, 10%, 15%, 20%, 25%, 33%, 50%, 75% or 90% thresholds of the total number of the voting rights in listed companies. For share transactions which increase or reduce the voting rights above or below these thresholds, the shareholder is obliged, within three business days, to inform the company concerned, CNVM and the capital market on which the relevant shares are listed.

Moreover, directors of listed companies have the obligation to report to CNVM any arrangement executed by the company with its directors, employees or controlling shareholders, whose value represents the RON equivalent of EUR 50,000 or above.

Listed companies must inform the public without delay, within 48 hours, of any major new events in their field of activity which may, by virtue of their effect on the assets and liabilities, financial position or general course of business of the company, lead to substantial changes in the price of the shares.

Shareholders holding a minimum of 5% of the share capital of a listed company have the right to request to the board of directors that a special financial auditor’s report be prepared on certain specified operations. In such a case, the directors have the obligation to provide all the information and documents requested by the auditors. If the directors and/or the financial auditors do not satisfy the shareholders’ claim within 30 days, the shareholders may request the court to appoint another financial auditor or expert to prepare the report, which will be sent to the court. In such cases the external auditor’s/expert’s opinion will be made public.
7. CORPORATE GOVERNANCE CODE FOR LISTED COMPANIES

In 2008 the Bucharest Stock Exchange introduced the Code of Corporate Governance (the CCG) of the Bucharest Stock Exchange (the BSE), comprising a set of nineteen principles to be observed by companies who have issued securities listed on the BSE, which relate to the organisation, structure and operation of corporate bodies, transparency and the rights of the shareholders.

The CCG applies on a “comply or explain” basis. Issuers of securities listed on the BSE must report annually on the implementation of the CCG and give reasons for the non implementation of any principles.

Companies should use best efforts to facilitate the attendance of the shareholders at general meetings. A special section of each company’s page should be dedicated to this purpose where all the relevant information in this regard should be provided. A large number of guiding rules and recommendations have been enacted with respect to the structure and operation of the board of directors. Among other things, the CCG recommends the establishment of a nomination committee – coordinating the process of appointing new members of the board of directors and making recommendations with respect to the appointment of new members, a remuneration committee – which should elaborate a policy for the remuneration of the members of the board of directors and of the managers and an audit committee – which has the main responsibilities with respect to financial reporting. The members should act with loyalty towards the company and should avoid any situations of conflict of interest with the company and disclose any such conflicts to the board of directors.

The CCG requires companies to preserve a balance of independent and non-independent members of the board of directors. Independent members should be interpreted to mean members that do not have and have not recently had any direct or indirect relations with the company or any related parties.

‘Issuers of securities listed on the BSE must report annually on the implementation of the Corporate Governance Code’
8. BRIBERY AND CORRUPTION

The Romanian Criminal Code and Law No. 78/2000 on preventing, creating and sanctioning of corruption acts create several related offences dealing with bribery, which is defined as an action where money, gifts or other goods are given to a recipient in order to alter the behaviour of the recipient. The relevant offences are: giving bribes, taking bribes, receiving undeserved benefits and “influence peddling”. This latter offence refers to the receipt of or request for money or other benefits, or the acceptance of promises or gifts (whether directly or indirectly, for oneself or for another), committed by a person who has or appears to have influence over an employee with the aim of persuading the employee to perform or not perform an act included within the scope of the employee’s professional role or duties.

Any person can be liable for giving bribes, whereas the offence of taking bribes is limited to persons holding certain specified positions, such as officers or public officers, who are obliged to disclose any bribes offered. The applicable penalties range from three to twelve years imprisonment for taking bribes and six months to five years for giving bribes (which can be increased, respectively, to fifteen and seven years if the persons concerned have management responsibilities). Receiving undeserved benefits and influence peddling are sanctioned with imprisonment ranging from six months to five years and two to ten years respectively. Again, the maximum sentence can be increased by a further two years in both cases where the persons concerned have management responsibilities.

Liability may be avoided in cases where the offender has been coerced into giving the bribe, or where the giving of the bribe is reported by the offender to the authorities before a prosecution is brought. Companies may also be liable in cases where the relevant offences are committed by individuals for the benefit of the company, with corporate penalties including fines, dissolution of the entity, suspension of all or part of its business, disqualification from participation in future public procurement procedures and/or display or public dissemination of the conviction decision.
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