

# American University International Law Review

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Volume 7 | Issue 3

Article 9

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1992

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### Recommended Citation

Gray, Cheryl, et al. "Romania's Evolving Legal Framework for Private Sector Development." *American University International Law Review* 7, no. 3 (1992): 617-647.

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# ROMANIA'S EVOLVING LEGAL FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT<sup>1</sup>

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As Central and Eastern European economies move from central planning and state ownership to market-driven development of private sector activity, they are undertaking comprehensive changes in the "rules of the game," otherwise known as the legal framework for economic activity. At a minimum, markets require a set of property rights<sup>2</sup> and a system of rules for exchanging those rights. Thus, the legal framework in a market economy must: (1) define the set of property rights in the system; (2) set the rules for the entry and exit of actors into and out of productive activities; and (3) establish rules for market exchange. Each of these functions typically involves numerous areas of law. In addition to basic principles articulated in constitutional law, property rights are defined in practice, in most market economies, by a wide array of laws regulating the ownership and use of real, personal, and intangible property. Company, foreign investment, and bankruptcy laws are among the subset of laws that govern entry and exit into and out of productive activities. Contract and competition law contain gen-

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1. This paper is part of a larger research project to study the evolving legal frameworks in Eastern Europe. Other studies include: Gray, *The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland*, 22 *GA. J. INT'L & COMP. L.* \_\_\_\_\_ (1992) (forthcoming) [hereinafter Gray, *The Legal Framework*]; Gray & Stiblar, *The Evolving Legal Framework for Private Sector Activity in Slovenia*; Gray & Ianachkov, *Bulgaria's Evolving Legal Framework for Private Sector Development* (forthcoming); and Atiyas, *Hungarian Legal Reform for the Private Sector* (forthcoming).

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The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors and should not be attributed in any manner to the World Bank, to its affiliated organizations, or to members of its Board of Executive Directors or the countries they represent.

2. As used in this context, the term "property rights" includes rights to real, personal, and intellectual property.

eral rules of market exchange, while specific rules of market exchange in particular sectors may be governed by more detailed sector-specific laws and regulations.

This Article analyzes the evolving legal framework for private sector development in Romania.<sup>3</sup> Due to the scarcity of documentation in this area, the study is based on interviews with lawyers, law professors, and government officials in Romania, as well as the laws that were available to the authors (in both English and Romanian) as of January 1992.<sup>4</sup> The Romanian government has worked intensively during the past two years to create a legal framework for a market economy. While problems exist with the current laws, and numerous gaps remain, the Romanian effort has been impressive in light of the short time-span and the tightly-controlled centralization of the former regime. Unlike other countries of Central and Eastern Europe, such as Poland and Hungary, where private property and private markets were suppressed but not entirely extinguished during forty years of socialism, Romania started virtually from scratch in 1990 to construct a market economy and a corresponding legal framework.

Challenges remain in both law and practice. Broad principles of private ownership, free market exchange, and equal treatment of public and private firms are well recognized and have been largely achieved, at least on paper. Yet a trend continues toward centralized, bureaucratic control — evidenced, for example, by excessive approval requirements for many activities. Moreover, implementation of economic changes in Romania will clearly take a long time — probably considerably longer than in the other reforming countries — because the institutional framework for enforcement and dispute resolution is weak or nonexistent. Developing expertise in the legal community through training and practice is crucial if the evolving legal framework is to become a guiding and binding force in everyday transactions.

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3. The paper does not address laws regarding corporatization and privatization of state-owned enterprises, areas where Romania has made significant progress in adopting a legal framework. Although very important to the development of a private market economy, these areas of law are regarded as transitional. This paper, and the larger project of which it is a part, is designed to focus on the legal framework needed for operation of a private market economy in the long-run.

4. Translations of Romanian laws are not yet published in a systematic reporter. Consequently, any inconsistency or absence of citation in this article may be explained by the transitory nature of the field itself. To the authors' knowledge, all available citations have been given.

## I. CONSTITUTIONAL LAW

The constitution is the most fundamental law in any country, defining the nature of its economy and the support to be provided to public and private sectors. A draft Romanian constitution was introduced in parliament on July 9, 1991, and was approved on November 21, 1991, after approximately two months of debate.<sup>5</sup> A constitutional commission composed of members of the two chambers of the parliament and outside constitutional experts prepared the draft.

The document is lengthy, containing 152 articles organized into seven main titles: (1) General Principles; (2) Fundamental Rights, Liberties, and Duties; (3) Public Authorities; (4) Economy and Public Finance; (5) The Constitutional Court; (6) Revising the Constitution; and (7) Final and Temporary Provisions.<sup>6</sup> Title 1 is generally non-controversial from an economic viewpoint, but has aroused strong debate from minority groups and monarchists because it declares Romania a "national state, sovereign and independent, unitary and indivisible."<sup>7</sup> Article 1 further states that the Romanian state is a republic.<sup>8</sup>

Title 2 contains many sections defining the rights and duties of citizens. The list of rights contains those that are common and expected in democratic societies, including freedom of expression, assembly, religion, movement, and freedom from arbitrary arrest and imprisonment. On the economic front, article 41 guarantees private property rights and equal protection of all private property regardless of owner.<sup>9</sup> An accompanying provision, however, leaves room for the government to restrict private property rights.<sup>10</sup> Article 41(2) explicitly forbids foreigners from owning land.<sup>11</sup> This provision, though apparently deeply rooted in history and culture, may hinder foreign involvement in the Romanian economy.<sup>12</sup>

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5. ROMANIAN CONST. (1991)

6. *Id.*

7. *Id.* at tit. I.

8. *Id.* at tit. I, art. 1.

9. *Id.* at tit. 2, art. 41.

10. *Id.* at art. 41(2).

11. *Id.*

12. Among other things, it makes secured foreign lending difficult, because foreign lenders are not able to foreclose on secured property and take possession. Instead, they must depend on local auctions in a thin market to recover value from the security interest. In practice foreign lenders forego the security and instead require local bank guarantees, which often in turn require explicit or implicit public guarantees.

The rights of 100 percent foreign-owned companies incorporated in Romania are not clear with regard to land ownership. Some government officials claim that these companies are allowed to own land, because they are not technically "foreigners" but are instead Romanian legal persons. In such a case, the prohibition would relate only to

Some rights guaranteed in the constitution could prove expensive for the government to fulfill. Article 32 guarantees the right to free education.<sup>13</sup> Economically, it is preferable to put the limited public resources into free primary and secondary education and attempt to recover costs in higher education.<sup>14</sup> Article 43 represents another potentially expensive guarantee because it requires the state to ensure a decent living standard for its citizens through economic development and social protection. Under article 43, citizens are entitled to a pension, paid maternity leave, health care in state medical facilities, unemployment relief, and other forms of social assistance.<sup>15</sup> All of these rights are granted subject to article 49, which provides that certain rights may be restricted by law only if necessary to defend national security, public order, health, morals, or the rights and freedoms of citizens.<sup>16</sup> This open-ended provision may create uncertainty by leaving a window open for arbitrary government interference in the free exercise of economic rights.

Title 3 establishes the structure of the public sector, with chapters discussing the Parliament, the President, the Government, the Public Administration, and the Judiciary.<sup>17</sup> Although not strictly economic in character, these provisions set forth the ground rules for economic policy making. The structure is designed to create a balance of power among the various branches. The executive branch ("government") designs and introduces most legislation. Both chambers of Parliament must approve<sup>18</sup> and the President must sign the legislation for it to become law.<sup>19</sup> The President appoints the Prime Minister and cabinet

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foreign individuals and would not affect foreign investment. Yet allowing foreigners to avoid this prohibition and buy unlimited amounts of Romanian land simply by incorporating in Romania would seem to undercut the rationale behind the prohibition. Another view holds that 100 percent foreign-owned firms can buy the land they need for their operations, but not other land. This view, however, does not flow naturally from any interpretation of the provision.

13. ROMANIAN CONST. art. 32.

14. This advice is typically given by the World Bank to developing countries, where the annual public cost of university students is on average 26 times that of primary school students. *See generally, World Development Report*, World Bank (1988) (noting that university students tend to be from higher-income households and are therefore more able to pay for the education). Romania should be careful to allocate its scarce public resources to the sectors with the greatest social returns, typically primary and secondary education; selective scholarships can be granted to university students unable to pay tuition themselves.

15. ROMANIAN CONST. art 43.

16. *Id.* at art. 49.

17. *Id.* at tit. 3.

18. *Id.*

19. The President may ask the Parliament to reconsider the law but may not veto it.

with the approval of Parliament.<sup>20</sup> The President may be impeached for wrongdoing by a majority vote of Parliament.<sup>21</sup>

Parliament is composed of two chambers, the Chamber of Deputies and the Senate.<sup>22</sup> Parliament supervises the government through its approval of initial ministerial appointments, its power to express no confidence or censure, and its right to request information and explanations of governmental activity.<sup>23</sup>

The power of the judiciary to oversee the constitutionality of Parliamentary acts is an area of intensive debate. The Ministry of Justice favored ex-post judicial review by the Supreme Court, as existed prior to World War II.<sup>24</sup> The constitutional drafting committee, however, favored broad powers of judicial review by a separate Constitutional Court, pursuant to title 5 of the Constitution which provides for such a court.<sup>25</sup> Under article 144, the court has the power to review the constitutionality of laws before they are promulgated.<sup>26</sup> The Parliament, however, can override a ruling of unconstitutionality by adopting the law again in the same form by at least two-thirds of the members of each chamber.<sup>27</sup> This provision seriously weakens the power of judicial review over Parliamentary acts. The court also has the power to adjudicate appeals brought before courts concerning the constitutionality of laws and rulings, thus presumably eliminating the Supreme Court's jurisdiction over constitutional questions.

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20. ROMANIAN CONST. tit. 3.

21. *Id.*

22. Romania had a bicameral parliament under its 1923 constitution, which was replaced by a unicameral system under the Ceaucescu regime. Thus, the current proposal may be considered a return to pre-socialist traditions. Under the 1923 system, each chamber of parliament had different powers and different means of selecting members. Whereas deputies were chosen by direct election, the senate had appointed as well as elected members in an effort to protect under-represented interests. In contrast, the current draft has two chambers with similar and equal powers; a law can be promulgated only after similarly-worded versions have been approved by both chambers. The draft does not specify how the members of each chamber are chosen. Given the similarities between the two chambers, some observers question the justification for the current bicameral system. M. Shafir, *Romania's New Institutions: The Draft Constitution*, 2 REP. ON E. EUR. 22 (Sept. 20, 1991).

23. ROMANIAN CONST. tit. 3.

24. The right of judicial review over the constitutionality of laws was established in 1912 and included in the 1923 Constitution.

25. ROMANIAN CONST. tit. 5.

26. The Court is to review the constitutionality of laws if requested by the President, one of the presidents of the two chambers of government, the Supreme Court, or at least 50 deputies or 25 senators. This is a preferable solution to the mandatory review, at least of "organic" laws, contained in an earlier draft of the constitution.

27. ROMANIAN CONST. art. 145. This ability of the Parliament to override the decisions of the Constitutional Court is a major change from the initial draft, which made the Court's decisions mandatory in all cases.

Title 4 addresses the economy and public finances.<sup>28</sup> Article 134 defines Romania's economy as a market economy<sup>29</sup> and orders the state to ensure free trade and to protect competition.<sup>30</sup> Under article 135 the state protects property, whether public or private.<sup>31</sup> Certain assets are reserved exclusively for public ownership and are "legally inalienable." These include underground resources of any kind, the lines of communications, air space, water resources that can produce power or can be used in the public interest, beaches, the territorial sea, the natural resources of the economic zone and the continental shelf, as well as other assets defined by the law.<sup>32</sup> While article 135 prohibits private ownership, the state can grant concessions for private sector involvement in a wide range of activities on such property, including mining and telecommunications.<sup>33</sup>

Despite the provisions indicated above that may compromise individual rights or impose difficult financial burdens on the state, the 1991 constitution is a major step forward for Romania. Overall it provides strong support for the fundamental principles of private property, free market exchange, and careful limitation of the powers of the state.

## II. RIGHTS TO REAL PROPERTY

Rights to real property have been in a state of extreme flux in Romania for the past year and there will not be much certainty for private investors until real property ownership rights become more settled and dependable. As discussed below, extensive amounts of land are being returned to former owners or given to the owners of the buildings that occupy such land. Other land and buildings are being kept under municipal control, with the possibility of leasing<sup>34</sup> and future restitution or sale. The disposition of apartment buildings and other housing now in state hands is undergoing intense debate. Apart from basic questions of ownership of real property, land registration systems require revitalization<sup>35</sup> and numerous regulatory issues such as land use zoning and building standards remain unresolved.

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28. ROMANIAN CONST. tit. 4.

29. *Id.* at art. 134.

30. *Id.*

31. *Id.* at art. 135.

32. *Id.*

33. *Id.*

34. Under Government Decree 1228 of December 1990, anything owned by the state can be leased, pursuant to the general framework for leasing in the Civil Code.

35. Prior to World War II, different parts of Romania had different systems of land registration. Transylvania followed the Austrian system of land registers classified by parcel of land, and these registers reportedly still exist. In other parts of Romania

## A. LAND

The Land Law,<sup>36</sup> passed in February 1991, defines various categories of land and gives broad outlines for their disposition. It is extremely bold and far-reaching. Regardless of whether one agrees with the principle of restitution, it is clear that land law is one area where Romania moved decisively, in advance of land reforms in other Central and Eastern European countries and the reforms in other areas of the Romanian economy.<sup>37</sup>

The bulk of the law applies to agricultural land in producer cooperatives. Prior to the 1990 revolution, cooperatives controlled approximately sixty percent of agricultural land, state farms controlled thirty percent, and the remainder was controlled by private farmers working small individual plots.<sup>38</sup> The land law provides that land controlled by agricultural cooperatives is to be returned to the original owners or their heirs, with a maximum amount of ten hectares returned to each household.<sup>39</sup> A period of thirty days, later extended to forty-five, was established for filing claims<sup>40</sup> and some 3000 local commissions were established to determine the distribution of property rights, resolve disputes, and issue property deeds.<sup>41</sup> Over six million claimants filed claims for some eight to nine million hectares. Most of the local commissions reached initial decisions during the summer of 1991, but many disputes were reportedly still outstanding as of October 1991.

Under article 36, land formerly controlled by state farms is treated differently.<sup>42</sup> This article does not provide restitution-in-kind to former

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land was registered by owner, a less desirable system because of the difficulty of tracking the disposition of individual plots. A new land register is reportedly provided for in the new Law on Cadastre.

36. Land Law No. 18 (1991).

37. Land restitution throughout Central and Eastern Europe is being driven far more by political forces than by economic ones. From an economic perspective, there is ongoing debate about the optimum size of land holdings and the wisdom of breaking up large farms into small private plots.

38. Peasant households were allowed to maintain private plots no larger than 0.15 hectares. In addition to these private holdings, about 6 percent of cooperative land was individually cultivated. T. Gabriel, *The Postcommunist Land Law*, 2 REP. ON E. EUR. 37 (1991).

39. Landless families (Article 20), families with inferior mountain land (Article 39), and cooperative employees who contributed no land (Article 18), also have the right to claim up to 10 hectares of arable land, although they cannot sell it for ten years thereafter (Article 31). Unclaimed land becomes the property of the municipality and can be leased to private parties who want to farm it (Article 30).

40. Land Law No. 18 (1991).

41. *Id.*

42. The difference in the treatment of cooperatives and state farms does not have an obvious rationale in terms of either economic rationale or economic impact.



owners. Instead, the state farms will be converted into joint stock companies, and former owners or their heirs are eligible to receive shares of these companies in proportion to their former holdings (not to exceed ten hectares).<sup>43</sup>

In addition to providing for restitution, the land law puts strict, and seemingly inconsistent, controls on the conversion of agricultural land to other uses.<sup>44</sup> Article 71 prohibits construction on some types of land, including land of "class I" and "class II" quality, land with "improvement facilities," and vineyards and orchards.<sup>45</sup> Article 72 requires steep taxes to be paid into a "Land Improvement Fund" for land to be removed from agricultural or forestry use.<sup>46</sup> Article 79 appears to require that investors, before doing any construction, physically transfer the topsoil to poor land indicated by the agricultural authorities.<sup>47</sup> These artificial restrictions on the conversion of agricultural land are vestiges of control that could cause far more economic distortions in real property use than they prevent.

Finally, the law places two further important limitations on land ownership, both of which reflect the strength of social and political concerns in opposition to the tenets of a truly free market economy. First, article 47 repeats the constitutional prohibition on the ownership of land by foreigners, although this prohibition appears limited to nonresident foreigners.<sup>48</sup> Second, article 46 provides that a family's total purchases of land cannot exceed 100 hectares (approximately 250 acres) of arable land.<sup>49</sup> Such a limit on land holdings is understandably intended to prevent the emergence of large landholdings and inequitable land distribution. In the long run, however, the law may compromise efficiency and entrepreneurship in rural areas.

Disposition of urban land is addressed in the law primarily in article 35, although in much less detail.<sup>50</sup> Land on which buildings are located is to be given to the owner of the building, whether private or municipal.<sup>51</sup> Pursuant to another law presently being drafted, state-owned enterprises may be given full ownership rights to the land on which they are situated. Previously, these enterprises had only use rights, which

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43. ROMANIAN CONST. art. 36.

44. Land Law No. 18 (1991).

45. ROMANIAN CONST. art. 71.

46. *Id.* at art. 72.

47. *Id.* at art. 79.

48. *Id.* at art. 47. The rights of foreigners who are residents in Romania are not clear under this law.

49. *Id.* at art. 46.

50. *Id.* at art. 35.

51. *Id.*

allowed a full range of uses but did not allow lease or sale. Empty land is to be returned to its original owner whenever possible. A municipal commission is being established in each town to oversee this process. As in the case of agricultural land, there are likely to be many disputes in this area.

## B. BUILDINGS

Ownership of buildings is not governed by the land law. State-owned enterprises, and a few private enterprises, generally own the buildings in which they operate. Municipalities own the rest of the commercial property within their borders. The municipality is thus a major landlord for emerging private sector businesses and has strong market power over the rental of business premises, for which rents are considered to be high. When possible, businesses rent homes or apartments from private owners and turn them into offices in lieu of renting office space from the government. Privatization of urban office buildings needs to be incorporated into the government's agenda to support private sector development.

Housing, unlike office buildings, is being privatized by the state. Many individuals own their own homes or apartments; this was possible even in the communist period,<sup>52</sup> and it has been expanded through extensive sales at very low prices, typically between one-fifth and one-tenth of "market value", under Decree-Law No. 61 of 1990. The sale of state-built housing to tenants at low cost is a generally accepted principle and is progressing rapidly.<sup>53</sup> However, the disposition of urban housing *formerly expropriated* without compensation by the state is a contentious issue, due to the conflict between former owners and current tenants. One proposed draft law gives preference to current tenants who had been resident since 1974, allowing them to buy the property and then giving the proceeds, probably far below market value, to the former owners. This proposal has many critics, however, and the issue is likely to be intensively debated in Parliament.

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52. Law No. 4 of 1973 provided for the sale of state-owned housing to tenants, with the right of use of the underlying land (up to 100 square meters of land per household in towns or 200 square meters in villages). Law No. 4 (1973). All land was the property of the state. *Id.*

53. About one-third of the housing in Romania is state-owned, and two-thirds is privately owned. In Bucharest slightly over one-half remains state-owned at present.

### III. RIGHTS TO INTELLECTUAL PROPERTY

Given its great need for western technology, as well as its desire to integrate itself into the western commercial community, Romania is moving to extend its legal protection of patents, trademarks, and copyrights. While many such protections exist in bilateral treaties with western countries, Romania is now in the process of unifying intellectual property protection within its domestic legal framework.

It is worth noting at the outset that the protection of intellectual property in developing economies is a controversial subject. Many of the same controversies also apply to countries in transition from socialism. On the positive side, intellectual property protection not only helps spur domestic invention and creation,<sup>54</sup> but it also helps to attract foreign investment, as an investor is more likely to invest in a country where property is protected. Foreign investment brings not only technology, but also employment, foreign exchange, and management talent — all urgently needed in Central and Eastern Europe.

Some observers argue, however, that intellectual property protection is essentially a one-way street, it protects industrialized countries where most inventions and creations originate at the expense of countries which must import the majority of their technology.<sup>55</sup> Under this argument, granting monopoly rights to proprietary knowledge tends to raise the price of that knowledge by giving "owners" the sole right to use or license it, and thus slowing technological and economic development in lesser-industrialized countries.<sup>56</sup> The most contentious areas tend to be patents for pharmaceuticals, where lives are often at stake, and copyrights for computer software and books. All three products are often easily copied and are crucial for economic development. Despite the debate on intellectual property protection, many developing economies and many economies in transition from socialism, including Romania, are moving to adopt western-style intellectual property laws.<sup>57</sup>

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54. In addition to spurring invention by eliminating the "free rider" problem and thus increasing the economic returns to basic research, another economic rationale for patent law is to prevent socially-wasteful over-investment in research. See generally R. Posner, *Law and Economics* (1986) (discussing the "free rider" problem).

55. *Strengthening Protection of Intellectual Property in Developing Countries*, World Bank Discussion Paper 112 (W. Siebeck ed. Dec. 1990).

56. Only one percent of existing patents are held by nationals of developing countries. OECD, *ECONOMIC ARGUMENTS FOR PROTECTING INTELLECTUAL PROPERTY RIGHTS EFFECTIVELY* 21 (1989).

57. In some cases this is being done under threat of retaliatory practices from industrialized countries.

## A. PATENTS

Until October, 1991, the Romanian Law on Inventions and Innovations (No. 62) of 1974 provided the basic framework for patent rights.<sup>58</sup> In keeping with standard western patent law, Law 62 stated that holders of patents enjoy the exclusive right to exploit their inventions, unless they expressly permit others to do so.<sup>59</sup> During the socialist period, however, patent law had little meaning in the domestic economy. State control over the economy was pervasive and inventors worked within the state apparatus. Inventors were granted credit for their inventions in the form of a "Certificate of Invention," a one-time cash award calculated generally as a percentage of the savings achieved by the design<sup>60</sup> or a percentage of the net return on the investment. Ownership rights to the invention, in the form of "Letters Patent," were granted in the name of the socialist organization upon whose behalf or within whose contractual relation the invention was created.<sup>61</sup> This left the exclusive right to utilize the invention with the Romanian state.<sup>62</sup> As a result, there is no experience with the enforcement of private patents. This will present a significant challenge to Romania's new intellectual property regime.

Parliament passed a new patent law in late October 1991.<sup>63</sup> Generally, the law provides patent protection similar to that found in industrialized countries. The law removed the above-mentioned restrictions, with the basic protections remaining. The law retains two controversial provisions: a compulsory license provision<sup>64</sup> and a provision that the state has the right to appropriate patents if deemed to be in the "national interest."<sup>65</sup>

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58. See Eminescu, *Patent Law and Practice, Trademark Law and Practice, and Copyright Law and Practice* in DIGEST OF INTELLECTUAL PROPERTY LAWS OF THE WORLD (1990) (providing an excellent report on intellectual property law in socialist Romania).

59. Law No. 62 (1991).

60. This is in keeping with the definition under Romanian law, that a patent is the technical solution to a social or economic problem. This includes a description of the problem and how the patent will solve it.

61. This should not be confused with the "compulsory license" discussed below.

62. Under the 1974 law, patents for Romanian inventions in certain industries — including nuclear materials, chemicals, pharmaceuticals, medical products, disinfectants, food, animal/plant breeding, and silk worms — could be issued only to state organizations, although the manufacturing processes for these products could be the subject of private patents. Eminescu, *supra* note 58.

63. Interview with George Sommerfield, Pennie & Edmonds, in Washington, D.C. (Oct. 29, 1991).

64. *Id.*

65. *Id.*

A compulsory license allows the state to issue rights of use to third parties, with compensation, if a patent registered in Romania has been unjustifiably unutilized or underutilized for four years.<sup>66</sup> The policy behind compulsory licensing is that countries granting monopoly rights in intellectual property deserve the use of those inventions in return. In practical terms, however, compulsory licenses are often ineffective without the cooperation of the patentee, due to the necessary technological expertise which the patentee possesses. Moreover, in many cases there may be no third party interested in obtaining a license to the patent. Thus, the compulsory license provision may not significantly reduce the protection of patents registered in Romania. Rather, it provides the government with a tool to prod the holder of an unused patent when a potential licensee meets resistance to any efforts to negotiate a licensing arrangement.

More controversial is the appropriation provision, which compromises the basic security of property rights. Compensation for expropriated patents is guaranteed by the patent law.<sup>67</sup> Despite this guarantee, however, the appropriation provision creates uncertainty as to the past and present value of a patent, making sale and leasing arrangements risky. Furthermore, "national interest" is not defined. In light of Romania's far-reaching need for western technology, "national interest" could indeed include all technical innovations in the country. Thus, this far-reaching power of the state could seriously encroach upon the integrity of the patent law's protections.

Romania is a signatory to the Paris Convention for the Protection of Industrial Property (1883),<sup>68</sup> the major international treaty protecting patents and trademarks. The two most important rights granted by the treaty are national treatment of foreigners<sup>69</sup> and right of priority in registration.<sup>70</sup> The right to national treatment obligates countries to treat foreigners as they would their own nationals under their own

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66. The concept of compulsory licenses is well-known throughout the world. The Paris Convention, discussed below, allows for the issuance of compulsory licenses (Art. 5(a)), and the patent laws of many countries provide for them.

67. The Constitution also provides for compensation in the event of state expropriation.

68. Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 25 Stat. 1372, T.S. No. 379 [hereinafter Paris Convention], as revised by Act of Brussels, Dec. 14, 1900, 32 Stat. 1936, T.S. No. 411; Act of Washington, June 2, 1911, 37 Stat. 1645, T.S. No. 579; Act of the Hague, Nov. 6, 1925, 47 Stat. 1789, T.S. No. 834; Act of London, June 2, 1934, 53 Stat. 1748, T.S. No. 941; Act of Lisbon, Oct. 31, 1958, 13 U.S.T. 1, T.I.A.S. No. 4931; Act of Stockholm, July 14, 1967, 21 U.S.T. 1629, T.I.A.S. No. 1583.

69. *Id.*

70. *Id.*

laws.<sup>71</sup> The right of priority gives the holder of a patent one year to file for patent protection in other member countries without losing priority rights over other potential claimants to the invention.<sup>72</sup> The criteria for patentability, however, is still a question of domestic law. Thus, the Paris Convention will do little to protect patents without a Romanian law that provides reliable substantive patent rights.

All patents must be registered in the Romanian State Office for Inventions and Marks (OSIM) and are valid for twenty years.<sup>73</sup> OSIM's main responsibility in approving patent applications is to determine the novelty of the claimed invention. OSIM's decisions may be reviewed by the OSIM Appeals Commission, and the Commission's decisions in turn may be appealed to the Civil Division of the Municipal Court of Bucharest. Such appeals may only address whether the decision of the OSIM Appeals Commission complied with Law No. 62, not whether the Commission properly assessed the novelty of the patent.

Foreign patents must be registered by the Bureau for Foreign Patents and Inventions (Rominvent) of the Romanian Chamber of Commerce in order to enjoy the protections articulated in Romania's new patent law. In registering with Rominvent, the foreign patent holder also grants the power-of-attorney to his or her Rominvent representative.<sup>74</sup> This is an area that could be opened up to allow broader participation by Romanian lawyers.

## B. TRADEMARKS

Romanian trademarks are adequately protected, at least on paper, by Law No. 28 of 1967 on Brands, Trade & Service Marks, as amended in 1977.<sup>75</sup> The law grants exclusive rights of use and transfer. Trademarks are defined as distinctive signs used by enterprises for distinguishing their products, works, or services from those of other enterprises.<sup>76</sup> Trademark protection lasts initially for ten years and is renew-

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71. *Id.*

72. *Id.*

73. Under the 1974 law, this period was only 15 years, which could be extended. No such extension is possible under the new law.

74. Granting power-of-attorney to local counsel is normal when registering patents in other countries, as local counsel are usually the only ones authorized to register patents. The extent of the power-of-attorney is usually spelled out in the contract of services between the patent holder and local counsel.

75. Eminescu, *supra* note 58.

76. Examples include words, letters, graphics and numbers, in combination with certain colors, as well as wrappings and sound recordings. Signs must have a distinctive character to become trademarks.

able. Like patents, trademarks are protected upon registration at the OSIM.<sup>77</sup>

The Paris Convention grants national treatment and right of priority to trademark owners. Right of priority lasts six months for trademarks, in contrast to one year for patents.<sup>78</sup> The Paris Convention does, however, provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks, apparently without requiring that the mark be registered in other member countries.<sup>79</sup>

Romania is also a signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks.<sup>80</sup> The Madrid Agreement protects both trademarks and service marks by allowing members of signatory countries to register their trademarks with the International Bureau of the World Intellectual Property Organization (WIPO) in Geneva.<sup>81</sup> The mark must first be registered in the country of origin,<sup>82</sup> whose rules of administration apply for registration with WIPO. The effect of WIPO registration is that the trademark is protected in all signatory countries. Upon notification of the registration of a trademark, national administrations may still be authorized by national law to declare that certain trademark protection cannot be granted in that territory. Thus, like the Paris Convention, the Madrid Agreement depends ultimately on domestic law in protecting substantive rights.

### C. COPYRIGHT

The primary source of Romania's domestic copyright law is Decree No. 321 of June 21, 1956, as amended in 1957 and 1968.<sup>83</sup> This decree deals primarily with literary works, but it also has potential application to the commercial sphere, particularly for computer software. It grants the holder rights of public recognition as the author of a work, exclusive exploitation of the work, and alienation of exploitation rights. The protection of these rights exists for the life of the author and the

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77. As in the case of patents, foreign trademarks must be registered through Rominvent.

78. Paris Convention, *supra* note 68.

79. *Id.*

80. Madrid Agreement Concerning the International Registration of Marks, 1967.

81. *Id.*

82. *Id.*

83. Eminescu, *supra* note 58.

spouse, plus fifty years for direct descendants and fifteen years for other heirs.<sup>84</sup>

At the international level, Romania is a signatory to the Berne Convention for the Protection of Literary and Artistic Works.<sup>85</sup> The most recent revision of the Berne Convention is the Paris text of 1971, which extends the period of protection from twenty-five to fifty years.<sup>86</sup> The Convention traditionally includes computer software, which is the most controversial subject of international copyright protection.<sup>87</sup> Under the Berne Convention, no formalities are required to protect a work in other member countries.<sup>88</sup> Protection in the country of origin may depend on registration, but international protection does not require central registration. Rather, works are subject to protection upon creation.

A new copyright law is presently before Parliament but is expected to be subject to long debate, due to the conflict over computer software. Under the Berne Convention, retroactive protection of copyrights is possible, meaning infringers of protected works may incur liability for past illegal use. The Berne Convention, however, has no enforcement mechanism. Claimants may bring infringement cases before the International Court of Justice, but such action is rare.

Enforcement capacity is an issue in all of the areas of intellectual property law discussed above. Although a registration procedure exists, it remains questionable whether a holder of intellectual property rights can actually protect these rights if another person infringes upon them. In the socialist state this was not much of an issue, because almost all rights were held by the state. As the private sector and foreign investment grow, however, enforcement will emerge as a critical issue. Giving true meaning to these rights will require strengthening the registration agencies and the courts to ensure that infringements can be identified, halted, and punished where appropriate.

#### IV. COMPANY LAW

Romania has made much progress in the area of company law, moving from no recognition of private business to passing market-oriented

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84. The discrepancy in duration depending on the nature of the relation is peculiar to Romanian law.

85. Berne Convention for the Protection of Literary and Artistic Works, Sept. 6, 1886, 828 U.N.T.S. 221, *reprinted in* 1 Basic Documents Int'l Econ. L. (CCH) 711 (1990).

86. *Id.*

87. *Id.* Berne allows countries to deny protection of certain works through domestic legislation, even if they are covered by Berne.

88. *Id.*



company law in about twelve months. The first law that allowed individual private initiative was Decree-Law No. 54 of 1990.<sup>89</sup> This law provided for four types of organizations: small enterprises, business partnerships,<sup>90</sup> family associations, and sole proprietorships.<sup>91</sup> While the law represented a very important development in the transition to a market economy, the framework is quite restrictive because the government retains much control over private business activities.<sup>92</sup>

Law 54 was largely supplanted in November 1990 by Law 31, the Companies Act, which provides for all types of company organization typical of continental legal systems.<sup>93</sup> These include the general partnership, the limited partnership, the limited partnership by shares, the limited liability company, and the joint stock company.<sup>94</sup> However, the law is quite disorganized, ambiguous, and has numerous problematic provisions, as discussed below.

#### A. CHARACTERISTICS OF A JOINT STOCK COMPANY

The Romanian joint stock company resembles the French S.A. (*Societe Anonyme*), the German AG (*Aktiengesellschaft*), and the Anglo-American public corporation. Extensive information and procedural requirements are imposed on this form of company in order to protect large numbers of anonymous investors. The joint stock company is an important company form in all mature market economies and is likely to become important in Romania in the future as state-owned enterprises are privatized and as small private firms grow. At present, however, the form is hardly used, and almost all companies to date have been established as partnerships or limited liability companies.

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89. Decree-Law No. 54 (1990).

90. The direct translation of this form is "lucrative association".

91. Decree-Law No. 54 (1990).

92. For example, a small enterprise could employ no more than twenty wage-earners and a business partnership could have no more than ten partners. Sole proprietorships were intended primarily to cover individuals conducting trade or services. Each firm had to obtain a licence from the mayor's office, submit its budget to "local financial bodies," and publish its balance sheet twice a year in the Official Gazette "after being checked by the financial authorities." In order to obtain inputs of raw materials and energy, firms had to work with state authorities to gain access to central allocation mechanisms.

93. The new law requires that small enterprises and "lucrative associations" set up under Decree-Law 54 reorganize themselves into one of the new company forms within six months. Decree-Law 54 is still in force with respect to the other two types of firms, family associations and sole proprietorships.

94. The pre-war Romanian company law closely followed the Italian law of 1881 and other continental models.

### 1. *Minimum Requirements*

Under the Romanian law, at least five founders are necessary to establish a joint stock company.<sup>95</sup> The founders can be residents or non-residents, legal or natural persons. Minimum capital of one million lei (approximately US \$4,000) is required.<sup>96</sup> This may include the value of in-kind contributions, which are to be evaluated by experts appointed at the founding meeting.<sup>97</sup> Both registered and bearer shares are allowed, with bearer shares to be paid in full.<sup>98</sup> Registered capital cannot be increased before all shares issued previously are paid in full.<sup>99</sup> Not all capital must be paid up front, but at least thirty percent of subscribed capital must be deposited upon the founding of the company.<sup>100</sup> A prospectus is required if stock is to be offered for public sale.<sup>101</sup>

The law requires that the subject of activity of every company, as well as every shareholder, be listed in the founding contract.<sup>102</sup> The requirement that subjects of activity be listed could be problematic if the categorization of possible subjects were narrow, because it would restrict the ability of firms to diversify in response to market signals. The Romanian system is not severely restrictive. It provides five broad subject areas from which firms can choose one or more.<sup>103</sup> Listing every shareholder may not be difficult now, given that most private companies are still very small, but it will become difficult if shares become widely held and traded through the process of privatization or private sector growth. Some Romanian lawyers interpret this provision to require that only founding members be listed.

The contract and the statutes (bylaws) for establishing the company must be approved at the first general meeting of shareholders.<sup>104</sup> Voting rules in this meeting depart from the normal pattern in which voting rights are proportionate to share ownership. At the first general meeting every listed shareholder<sup>105</sup> has one vote regardless of the num-

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95. Although not clearly stated, it appears from article 212 that the State may be a single shareholder.

96. Law No. 31 (1991).

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. While the company law does not explicitly delineate these categories, they have been identified by lawyers in Romania as the recognized categories of corporate activity.

104. Law No. 31 (1991).

105. This presumably does not include the holders of bearer shares unless they are specifically listed. It also does not include shareholders who fail to deposit their shares

ber of shares held, with a quorum of fifty percent of the subscribers, rather than shares, and a simple majority voting rule.<sup>106</sup> Because experts are appointed at the first meeting to evaluate in-kind contributions,<sup>107</sup> investors making such contributions are not allowed to vote on issues concerning such contributions.<sup>108</sup> These voting rules appear to give minority shareholders disproportionate and highly unusual influence in setting the general rules for the operation of the company. The first meeting establishes many important policies, and such a system of one person-one vote dilutes the incentive of shareholders to invest enough to acquire a majority stake in a company.

## 2. *Corporate Governance*

Romanian law provides for a sole administrator or a board of administration to be chosen at the general meeting of shareholders.<sup>109</sup> The board may delegate some of its powers to a managing committee, thus creating a two-tier structure of governance.<sup>110</sup> The president of the board of administration is required also to be the director of the managing committee.<sup>111</sup> This requirement is problematic in that it focuses much power, essentially the roles of Board Chairman and CEO, in one person. While this focus of power may be reasonable in some cases, it is not necessarily the best solution. Three or more auditors elected at the general meeting provide regular oversight of company operation.<sup>112</sup> One must be an accountant, and the majority must be Romanian citizens.<sup>113</sup>

## 3. *Voting Rights*

Article 67 establishes a general one share-one vote rule, except at the first general meeting as discussed above.<sup>114</sup> The company contract or statute, however, can limit the number of votes of shareholders owning

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five days before the meeting in the place specified by the statutes, a very cumbersome procedure.

106. Law No. 31 (1991).

107. *Id.*

108. *Id.*

109. The sole administrator or the president and at least half the members of the board of administrators must be Romanian citizens, unless the company contract or statutes provide otherwise. The Foreign Investment law provides that foreigners can be employed by a company only in such positions or as experts.

110. Law No. 31 (1991).

111. *Id.*

112. *Id.*

113. *Id.*

114. ROMANIAN CONST. art. 67.

more than one share, and thus voting rights can be weighted in specific cases to favor certain shareholders.<sup>115</sup> Furthermore, a super-majority can be required for decisionmaking at the general meeting.<sup>116</sup> The possibility for weighted voting rights and super-majority voting rules is likely to be particularly important for foreign investors in the medium to long-term, because it allows majority Romanian ownership to be combined with foreign control or veto power over key corporate policies.

#### B. CHARACTERISTICS OF A LIMITED LIABILITY COMPANY

The Romanian limited liability company follows the form used throughout continental Europe, such as that of the French S.A.R.L. (*Société à responsabilité limitée*) or the German GmbH (*Gesellschaft mit beschränkter Haftung*). It combines some of the benefits of the joint stock company with the relatively simpler procedural requirements of the general partnership, and is particularly well-suited to small and medium-sized firms with only a few owners. This form is the most widely used to date and will probably continue to be the favored form for most domestic and foreign investment.

The limited liability company differs from the joint stock company in several ways. A limited liability company can be owned by only one person or "associate" and can have a maximum of fifty associates.<sup>117</sup> Minimum required capital is only 100,000 lei (about \$400).<sup>118</sup> Because of the more personal nature of the expected interrelationships among owners, no prospectus is required to set up the company and a limited liability company cannot issue bonds — which are generally offered to the public and, in the case of the joint stock company, require a prospectus.<sup>119</sup> All associates must have access to the books of the company at all times, and they may perform the duties of auditors if no auditors are appointed by the General Meeting.<sup>120</sup> Shares of individual associates cannot be transferred to persons outside the company unless approved by associates representing at least three-quarters of the regis-

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115. This is an inefficient means of giving more voting power to certain shareholders, because it ties voting rights to the specific shareholder rather than to the share. A share's voting rights can change merely through transfer to another shareholder. A preferable way, possible in the company laws of many other jurisdictions, is to allow some shares to have more than one vote.

116. Law No. 31 (1991).

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* An auditor is required only if there are more than 15 associates.

tered capital.<sup>121</sup> Although most decisions at the General Meeting only require an absolute majority of associates and registered shares, unanimity is required to alter the company contract or statute.<sup>122</sup> A one-share, one-vote rule is mandated, in contrast to the more flexible voting rules of the joint stock company.<sup>123</sup>

The corporate governance of a limited liability company differs from that of a joint stock company. A limited liability company is to be managed by one or more administrators appointed by the company contract, in the case of the first administrator, or by the general meeting of associates.<sup>124</sup> Neither a board of directors nor a two-tiered structure of corporate governance is required.

### C. CHARACTERISTICS OF THE THREE PARTNERSHIP FORMS

The law provides for three partnership forms — the general partnership, the “sleeping” (or “limited”) partnership, and the sleeping partnership limited by shares.<sup>125</sup> In the general partnership, all partners have unlimited joint and several liability with regard to the partnership’s obligations, and all are entitled to participate in the management of the business, unless otherwise provided in the partnership contract.<sup>126</sup> This form is most suitable for small enterprises with a few active participants. In the sleeping partnerships, by contrast, only the active partners, who serve as the administrators, have unlimited liability,<sup>127</sup> while the liability of the sleeping partners is limited to their capital contribution. These forms are more suitable for larger undertakings where a few active participants are seeking capital from passive investors. The sleeping partnership limited by shares most closely resembles the joint stock company in its formal requirements which include minimum capital, prospectus requirements for public subscription of shares or bonds, founding and general meeting requirements, procedures for valuation of in-kind capital, auditing requirements, and recordkeeping.<sup>128</sup> Because of this formality, the form appears unlikely to be used much in practice.

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121. Law No. 31 (1991).

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* There is also a civil partnership form, governed by the Civil Code, which is intended to cover simple initiatives among a few equally involved individuals.

126. *Id.*

127. *Id.*

128. *Id.*

## D. PROCEDURES FOR SETTING UP A COMPANY

The procedures required to set up a company, whether in a joint stock or a limited liability form, appear somewhat cumbersome to the outside observer. Seven basic steps are required:

- (1) Foreign joint ventures must first obtain approval from the *Romanian Agency for Development* (see discussion under "Foreign Investment" below). Romanian companies skip this step.
- (2) The *public notary* must approve the company contract and statute. Although the official cost is low (1000 lei), the approval process takes time because the number of notaries is limited.<sup>129</sup>
- (3) The company must apply to the district *court* for a judicial decision granting authorization to set up the company. This appears to be a formality — of some 15,000 applicants, all have been approved. Yet it can take up to three weeks to get the decision from the court.
- (4) Meanwhile, the court requires consultative advice from the *Chamber of Commerce*, which checks for any criminal record and passes judgment on the "moral character" of the applicant. This is at best another formality that requires several days and another small outlay of money — 200 lei for Romanians, \$20 for foreigners. This requirement could, however, become an outlet for unjustified discretionary refusals of applications.
- (5) After receiving court approval, the judicial decision must be published in the *Official Gazette*, requiring more time.
- (6) The new company must then be officially registered with the *registry of companies*. While this costs only 1000-2000 lei for Romanian companies, foreign investors are charged \$500 plus \$100 for each extra activity, up to a maximum of \$900. This step confers legal personality.
- (7) The new company must register with *fiscal authorities*.<sup>130</sup>

This procedure may not place much burden on large investors, Romanian or foreign, who can hire Romanians at low wages to stand in line and run back and forth from office to office completing forms and seeking signatures of approval. Furthermore, large firms are not bothered by the "gifts" that, although perhaps not necessary, reportedly speed up the process. They also may not mind the one or two month waiting period that these procedures entail. Small entrepreneurs, however, undoubtedly find these procedures daunting and expensive. To promote local private sector development, Romania would do well to streamline the process. Steps six and seven appear to be the only truly necessary steps.<sup>131</sup>

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129. Notaries are still all state-employees, although pursuant to a new law private notaries will be allowed soon.

130. Law No. 31 (1991).

131. Step 2, approval by the public notary, is potentially useful as a check to insure that the law has been followed in setting up the company. However, in practice notaries are not always well-trained, and the approval requirement can become one more time-

## V. FOREIGN INVESTMENT

Law 35 on Foreign Investments was adopted in April 1991.<sup>132</sup> It replaced Decree-Law No. 96, which was issued in March 1990 as a first effort to provide a framework for foreign participation in the economy.<sup>133</sup> Unlike Decree No. 96, which provided for individual negotiation of the terms of each joint venture, the new law establishes clear procedures, requirements, and incentives that apply across-the-board to all foreign investors.<sup>134</sup> Although still problematic in certain areas, the law does appear to be perceived favorably by foreigners, and thus it generally sends the right signal — that private investment with foreign participation is desired and welcome.<sup>135</sup>

### A. FORM AND OWNERSHIP

The law applies broadly to virtually any participation by a foreigner in the Romanian economy.<sup>136</sup> Foreigners are permitted to set up branches or wholly-owned subsidiaries, as well as joint ventures with Romanian partners.<sup>137</sup> These types of foreign investments are subject to the general rules and corporate forms set out in the company law. Article 1 extends the law to cover licensing, management contracts, and even acquisition of property by a foreigner in Romania.<sup>138</sup> Portfolio investment is also included, even if it is merely the purchase of one share of stock by a foreigner.<sup>139</sup>

### B. THE APPROVAL PROCESS

Foreign investment in Romania requires approval from the Romanian Development Agency (RDA).<sup>140</sup> If the foreign investor is not notified within thirty days of the RDA's decision, the request for investment is deemed granted.<sup>141</sup> It is not clear what purpose the mandatory screening process serves, aside from facilitating data collec-

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consuming bureaucratic bottleneck. Notaries can even have a negative impact if they insist that companies follow certain narrow rules with which they happen to be familiar.

132. Law No. 35 (1991).

133. The first recognition of foreign joint ventures was in Decree 424 of 1972, although this decree was virtually unused in practice.

134. Law No. 35 (1991).

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

tion on foreign involvement in the economy.<sup>142</sup> Article 20 provides that the RDA screen the reliability of the investor, the field and the legal form of the investment, and the amount of capital to be invested.<sup>143</sup> Yet the law does not specify any closed sectors, minimum capital requirements, or other criteria, other than what is provided in the Company Law, to bring objectivity to the screening process. Furthermore, in light of the broad coverage of the law, its strict application would require approval for property or shares purchased by a foreigner.

Both the broad coverage and the lack of objective criteria could lead the screening process to become either cursory, and thus unnecessary, or arbitrary. The experience of foreign investors to date suggests that the approval process is rapid and no longer imposes a major burden on investors. After some time, the government may want to review again the role of the RDA and the efficacy of mandatory screening, as opposed to more targeted intervention.

### C. PROFIT REPATRIATION

Although profits in convertible currency could always be repatriated without limit, the law limits the repatriation of lei profits in any one year to a maximum of fifteen percent of registered capital, in convertible currency or in kind, contributed by the foreign partner.<sup>144</sup> Until recently, lei profits for repatriation had to be exchanged for foreign currency at the auction rate of exchange, although initial capital was valued at the lower official rate. These two rates varied until recently because of the official dual exchange rate system. The government recently unified the exchange rate, making the conversion of lei profits less costly to the investor.

Unfortunately, at the same time the government unified the exchange rate it also tightened access by the private sector to foreign exchange by requiring that all foreign exchange, other than a firm's equity participation, be surrendered to the government at the official exchange rate.<sup>145</sup> Foreign currency bank accounts appear to be no longer permitted, except in specially-approved cases or as needed to hold equity contributions. Thus, not only do foreign investors face lim-

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142. Both Poland and Hungary, for example, recently abolished their mandatory approval requirements.

143. Law No. 35, art. 20 (1991).

144. Law No. 35 (1991).

145. Decree No. 763 (November 19, 1991). The official rate is still managed and remains somewhat lower than the parallel ("black market") rate. Although the lei was supposedly made convertible with the exchange rate unification, foreign exchange continues to be rationed in the official exchange market through enforced waiting periods.



its on the repatriation of lei profits, but they may also face difficulty retaining their foreign currency earnings under these new regulations.<sup>146</sup> Further, the regulation also interferes with foreign lending. If companies are not able to hold onto and use the amounts borrowed, they will not as readily gain access to foreign exchange to pay back the debts.

These limits on profit remittance and on foreign currency accounts are the most restrictive in Central and Eastern Europe.<sup>147</sup> These limits are difficult to enforce in practice given the vagaries of capital valuation and transfer pricing. Romania would be wise to reevaluate these policies considering the potential benefits foreign involvement can bring the economy and the difficulty of enforcing such limits in practice.

#### D. TAX INCENTIVES

Law 35 grants generous customs and tax incentives to foreign investment.<sup>148</sup> In the customs area, foreign investors are exempt from payment of customs duties on all imported capital equipment<sup>149</sup> and are exempt from duties on raw materials for two years.<sup>150</sup> Not only do these exemptions create room for abuse, through the importation of non-essential goods for resale, but they are unfairly discriminatory against domestic entrepreneurs. The discrimination occurs if similar exemptions do not exist for domestic firms. As an alternative, Romania could lower its tariffs on certain capital goods and raw materials for all investors, or it could adopt a duty-drawback system specifically for exports.<sup>151</sup>

In addition to customs exemptions, the law offers tax holidays of two to five years, depending on the sector of activity.<sup>152</sup> After the holiday period expires, taxes are reduced by fifty percent if the profits are reinvested in Romania,<sup>153</sup> or by twenty-five percent if the firm meets certain criteria as to import, export, research and development, domestic

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146. Because of their newness, the actual impact of these new rules is still unclear.

147. See Gray, *The Legal Framework*, *supra* note 1 (noting that most other Eastern European countries have recently eliminated limits on profit repatriation).

148. Law No. 35 (1991).

149. *Id.*

150. *Id.*

151. The latter option, however, may be too difficult to administer for some time.

152. Five year tax holidays are available for investments in industry, agriculture, and construction. Tax holidays are three years for investments in exploration and exploitation of natural resources, communications, and transportation, and two years for investments in trade, tourism, banking, and insurance.

153. Law No. 35 (1991).

procurement, or job creation.<sup>154</sup> Although the current domestic tax situation is clearly in need of reform,<sup>155</sup> granting tax holidays for foreign investment only makes it more difficult to develop a reasonable and productive revenue system. A preferable approach, increasingly followed around the world, would be to adopt a broad-based tax system that applies reasonable rates equally to foreign and domestic investors. If incentives are to be given, investment credits will be more targeted and less subject to abuse than tax holidays.

## VI. CONTRACTS

The legal framework for private contracts is contained primarily in the Romanian Civil Code which dates from 1864 and was amended in 1913 and 1920. The Civil Code is modeled closely on the French Napoleonic Code. As such, it provides a basic framework for property rights and private contracts. Unlike most of its neighbors, including Poland and Hungary, Romania never amended its Civil Code after World War II to incorporate socialist conceptions of property and give primacy to state contracts. Thus, it was not necessary to re-amend the Code after the 1990 revolution.

The Civil Code is supplemented by the provisions of the Commercial Code still in force,<sup>156</sup> including some specific provisions on commercial obligations. Two other laws in the commercial area include the Law on Promissory Notes, which follows the model of the Geneva Convention in this area, and the Law on Bills of Exchange, both adopted in 1935. These laws were never abolished and can still be used. However, Romanians have little practical experience working with decentralized private business transactions and there is not a body of judicial interpretation to answer the many questions that arise in everyday commerce. These will require time to develop.

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154. *Id.*

155. The entire Romanian tax regime is in flux. A tax on profits passed in 1991 imposed steeply progressive tax rates on business profits (up to a top marginal rate of 77% on profits over 1 billion lei). However, domestic firms received tax holidays under this law that were only slightly less generous than the holidays given foreign investors under the foreign investment law. *Romania: Framework for Foreign Direct Investment*, Foreign Investment Advisory Service (FIAS), World Bank, 1991. Therefore, it is unlikely that many domestic private firms paid any tax at all. A new company income tax with a far lower general rate of 45 percent (or 30 percent on profits up to 1 million lei) was just approved, and further tax reforms are planned for 1992. In any case, it is unlikely that the government's administrative machinery has the capacity to enforce and collect taxes on the newly-emerging private sector. Extensive technical assistance (and time and experience) will be needed.

156. Most of the Commercial Code — the provisions dealing with company forms — has been replaced by Law No. 31, the Company Law. Law No. 31 (1991).

## VII. BANKRUPTCY

In all likelihood, many Romanian firms will fail and have to close as the economy moves toward a free market. A well-functioning system of bankruptcy law and practice is therefore, a critical part of the legal framework.<sup>157</sup> The only bankruptcy procedure existing in Romania is that contained in the Commercial Code of 1887. The Code follows the pattern of other commercial codes of that period, especially that of France and Italy. When adopted, it was considered to be state-of-the-art, and was subsequently used as a model for bankruptcy legislation in several neighboring countries. The Code's bankruptcy procedure was widely used before World War II. Although not applied during the socialist period from 1945 to 1989, it was never formally abrogated.

The Code provides for liquidation proceedings under the direct administration of a judge. Romania's scheme is unique in appointing judges directly to administer the bankruptcy (article 730) rather than private receivers. This solution seems problematic because it ties up judges in long cases and prevents the emergence of a specialized profession of receivers. Because the judge's remuneration is not related to the size of the company's assets, as is typical in the case of receivers, the rule also tends to lessen the administrator's incentive to preserve the assets and speedily resolve the bankruptcy case.<sup>158</sup>

Under the law, bankruptcy cases can be brought by debtors, creditors, or the court. As an alternative to bankruptcy, the law also provides a "mutual agreement" procedure through which debtors and creditors can agree to restructure the debt obligations and thus keep the debtor in business. The procedure can be initiated only by the debtor, and any agreement must be accepted by creditors representing at least three-quarters of outstanding debt and approved by the court.

The government has prepared a new, modern Bankruptcy Law to supplant these provisions of the old Commercial Code.<sup>159</sup> The new

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157. Bankruptcy law works best in private sector cases, when there is a true conflict of interest between debtors and creditors. It does not work as well for the closure of state-owned firms, particularly with regard to debts from state-owned banks, because a true conflict of interest is often lacking. It is our belief that bankruptcy law should be designed primarily with the newly-emerging private sector in mind, both to regulate forced closures of firms and to structure relations between debtors and creditors more generally. Perhaps other reorganization and liquidation procedures should be used for public sector firms.

158. This may be one reason why the percentage of assets actually recovered in pre-war bankruptcies in Romania was typically lower than that in neighboring countries.

159. As with the old Commercial Code, the new draft applies only to commercial companies, essentially those covered by the new company law.

draft is comprehensive and well-organized. It covers not only bankruptcy per se, but also reorganization under bankruptcy protection<sup>160</sup> as well as the mutual agreement procedure.<sup>161</sup> While similar to modern bankruptcy laws in other European jurisdictions, it retains the Romanian concept of judge-receiver. The new law is expected to be in place in 1992.

### VIII. ANTI-MONOPOLY LAW

The Romanian Parliament has not yet adopted an antimonopoly law, although the government recognizes the importance of such a law and plans to introduce a draft law in the near future. General principles of competition are contained in Law No. 15 on the Restructuring of State Economic Units (1990),<sup>162</sup> and in Law No. 13 on Unfair Competition (1991).<sup>163</sup> These laws do not, however, provide an in-depth definition of anti-competitive monopoly behavior, nor do they specify the sanctions to be applied or establish specialized administrative machinery for enforcement. In the Eastern European environment, where few people are familiar with markets and where the general court system has little experience with commercial matters, it is unlikely that anti-monopoly legislation will have much impact. Only through the use of specialized enforcement machinery will any impact be felt.

The government's slow approach to anti-monopoly legislation, as compared to other areas of legal reform, appears to be due in part to a fear of overcontrol — a fear that administrative officials would use any such law to impede rather than facilitate private sector development. This is an understandable fear in this environment; even industrial countries continually debate the proper scope for administrative inter-

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160. Bankruptcy cases can be initiated by the debtor, the creditor, or the court. Only creditors, however, can initiate bankruptcy in the case of state-owned enterprises. Upon initiation of a case, the management of the company is turned over to an administrator appointed by the court. The judge-receiver and administrator then work together to decide whether reorganization or closure is preferable.

161. Only the debtor can initiate a mutual agreement procedure, and any proposed agreement to reduce indebtedness must be approved by the court and must satisfy at least 50 percent of the creditors' claims.

162. Law No. 15 provides some basic protections against monopoly behavior. Law No. 15 (1991). Specifically, Article 36 forbids agreements among companies to set prices or unfair contract terms; to limit production, sales, technological development, or investment; to allocate input or sales markets; to discriminate among purchasers, or to impose unrelated conditions on contracting partners. *Id.* at art. 36. It also generally forbids monopoly behavior of firms with a dominant position. *Id.* Article 37 provides that regular courts are competent to decide cases brought under Article 36. *Id.* at art. 37.

163. Law No. 13 (1991).

vention, and many Western economists believe that traditional antitrust enforcement has been detrimental to competition. Technical assistance from industrialized market economies could be useful in training Romanian officials in methods of antitrust analysis and enforcement.<sup>164</sup>

## IX. JUDICIAL INSTITUTIONS

No judicial institutions in Romania, including courts, arbitration panels, lawyers, or law schools, are fully prepared to take on the challenges inherent in their roles in a market economy. Large-scale efforts at institutional development are needed. This is one area where foreign technical assistance, if properly designed, can have a large positive impact.

### A. COURTS

Under the socialist system, courts were not involved in commercial areas. All commercial legal work was done under the old regime by lawyers within state-owned enterprises and disputes were worked out in specialized arbitration institutions established for that purpose. As Romania continues to move toward a market economy, courts will soon be expected to handle a multitude of new responsibilities in commercial areas: including contract disputes, bankruptcies, real property disputes, intellectual property issues, and so forth.

A draft law recently introduced in Parliament proposes a new court system composed of four types of courts: local, district, appeal, and the Supreme Court.<sup>165</sup> With the exception of local courts, each one would have four sections: civil, criminal, administrative, and commercial. The draft law attempts to increase the independence of the judiciary by granting life tenure for all judges, after a transition period,<sup>166</sup> and subordinate public prosecutors to the Ministry of Justice, rather than

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164. Numerous sources of expertise—including the U.S. Federal Trade Commission, the U.S. Department of Justice, the OECD, and the European Community—are available and are giving such technical assistance to other Central and Eastern European countries.

165. Small cases would begin at the local courts and larger matters at the district courts, with two levels of appeal for each. The first level of appeal could reconsider issues of both fact and law, while the second level of appeal would concern only matters of law. Military courts would, under draft amendments to the Criminal Procedures law, be restricted to cases involving military staff and military rules, rather than also having competence to decide criminal cases against state security allegedly committed by civilians. This draft may have to be reconciled with the draft constitution, which disallows special courts except in special circumstances, such as times of war.

166. Lay judges, common in socialist legal systems, were eliminated from the panels of judges in July, 1991.

maintaining their separate and independent status in the previous regime. Massive training and assistance will be needed to equip the courts to handle the expanded responsibilities in a professional and reasonably predictable manner.<sup>167</sup> Without competence and experience in the court system, private commerce is unlikely to thrive.

### B. ARBITRATION

Arbitration is a useful alternative to court litigation and is sanctioned by the Code of Civil Procedure.<sup>168</sup> The Romanian Chamber of Commerce has long sponsored a service to arbitrate questions arising from foreign trade. Recently this arbitration service has expanded its area of responsibility to include domestic commerce. With support, assistance, and publicity, this and other arbitration panels have the potential to develop into viable and important alternatives to the more cumbersome court system.

### C. LAWYERS

Although there are several thousand lawyers in Romania, very few are trained in commercial matters, and their profession is still centrally controlled. The profession is divided into two branches — “private” lawyers or “advocats” and legal advisors within state enterprises or “jurisconsults.” All private lawyers, though nominally independent professionals under a new law passed in 1990, are still required to belong to the Lawyers Union. Clients pay the bar the legal fees pursuant to a pre-set schedule and the Union withholds its own fees and taxes before paying the remainder to the lawyer. Lawyers are not yet permitted to open up private law firms. This presents a clear case of cartelization, led by the Lawyers Union, that inhibits private entrepreneurship and limits the availability of legal services critical to private sector development. The legal profession should be opened up to independent practi-

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167. The Romanian Ministry of Justice has already begun to organize a program of judicial training. Romanian experts — those formerly involved in international commercial law or inter-enterprise disputes — have been called upon to teach commercial law to judges and lawyers, as well as staff of the Ministry of Justice. The Ministry has sponsored regional conferences and training seminars that incorporate both economic theory and case studies of foreign and Romanian commercial disputes. Finally, foreign professors are being invited to lecture at law faculties and participate in workshops with Romanian lawyers and judges. Expanded efforts in all of these areas are needed.

168. This type of arbitration should be differentiated from the old system of state arbitration of disputes among state-owned enterprises, which has been abolished. See generally, Gray, *The Legal Framework*, *supra* note 1.

tioners immediately so that a cadre of independent legal advisors can develop.

#### D. LEGAL EDUCATION

The basic principles of contract law as found in the Civil Code have always been taught in Romanian law schools and market-oriented commercial transactions have generally been taught in the context of international trade. Thus, a base exists on which to reorient the legal curriculum to a market economy. Although traditionally lasting four years, an extra year was recently added to the legal curriculum on a temporary basis to allow for the teaching of Romania's new commercial legislation, including the company, foreign investment, and tax laws.

The law school at the University of Bucharest has exchange programs with a number of universities in Western Europe, including the Universities of London, Hamburg, and Florence. These programs should help to supplement the education of both students and professors during this period of transition. In order to launch this new educational program successfully at home, however, supplies such as documentation, books, and computers are needed.

A number of private law schools are now appearing in Romania. They cost much more than state education, approximately 30,000 - 50,000 lei per year as compared with 1,000 lei at the University of Bucharest, and are not officially "recognized" by the government. Despite their lack of recognition, the private law schools expand educational opportunities and may improve the overall quality of education by increasing competition.

#### CONCLUSION

As is evident from the discussion throughout this Article, the Romanian government has worked hard over the past two years to develop a legal framework within which the private sector can develop. Many new laws have been passed by the Parliament, and many more are being drafted and debated. However, both the administrative and judicial machinery for implementing those laws and the publicity apparatus for educating the public about them is lagging behind. Laws by themselves are only paper; the legal framework will "come to life" only when the legal and administrative institutions can enforce the laws and readily resolve the disputes that they inevitably spur, and when the public accepts that the laws are indeed binding. Furthermore, the laws are by necessity general frameworks only. Their content needs more detailed regulation and practice in individual cases. Developing this

body of regulation and practice inevitably takes time. Borrowing concepts from industrialized market economies, assisted by legal exchange programs and legal technical assistance from abroad, could help to expedite the process.