

**Legal nature of the management agreement
under the Bulgarian company law (critical notes)¹**

1. Introduction. The management agreement is regulated in the Bulgarian Commercial Act ("CA") respectively for the limited liability company ("LLC") in Art. 141, par. 7 CA and for the joint stock company ("JSC") in Art. 241, par. 6 and Art. 244, par. 7 CA. According to the statutory provisions cited the relations between the company and the manager, respectively the board of directors or the management board,¹ are to be regulated by management agreement concluded in written form. The management agreement with the LLC is signed on the name of the company by person authorized by the general meeting of the shareholder or by the sole shareholder of the capital. The management agreement with the non-executive members of the board of directors is to be signed by person authorized by the general meeting of the shareholder or by the sole shareholder of the capital, and the agreement with the executive members — by the chairman of the board of directors.² Upon the two-tier management system the management agreement is signed by the chairman of the supervisory board or another member of the supervisory board authorized by him.³

The present article aims to analyze the legal nature of the management agreement and to define the agreement with view to the different classifications of the types of the agreements in the contact law. In the course of the analysis are considered the arguments followed by the Bulgarian case law and the legal theory on these questions.

2. Legal nature of the management agreement in the case law of the Bulgarian courts. The Bulgarian case law provides for three different theories on the

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¹ The LLC is managed and represented by manager and the JSC — by board of directors (one-tier management system) or management board (two-tier management system). In this article I use the term "manager" as covering both the manager of the LLC and the member of the board of directors or the management board of the JSC.

² Under the CA, the one-tier management system of the JSC includes as company bodies the board of directors and the general meeting of the shareholders, and under the two-tier management system — the management board, the supervisory board and the general meeting of the shareholders. The founders are free to opt into one of these management systems upon incorporation of the company.

³ Beside Art. 241, par. 6 CA and Art. 244, par. 7 CA the management agreement of JSC is regulated also in the specific case of management agreement of medical treatment facility — according to Art. 62, par. 4 of the Medical-Treatment Facilities Act the rights and obligations of the members of the managing and supervisory bodies shall be governed by an agreement, which has to determine their remuneration, the liability for non-fulfillment of the obligations of the parties and the grounds for its termination.

nature of the management agreement. According to the first of them, the management agreement shall be defined as civil law agreement with mandate character, on the ground of which a fully capable physical person undertakes the obligation to manage and represent the LLC and the JSC.⁴ The management agreement is a *special type of mandate agreement*, because it has the general characteristics of this type of agreement. It specifies the rights and obligations of the parties, the mechanism for determination of the remuneration and the manner of its payment, the liability of the parties and the grounds for its termination.⁵

Within this group of arguments shall be placed also the view that the management agreement is a *special type of agreement, which is regulated by the civil law*. Its default leads to contractual liability.⁶ The assignment of the management of a commercial company is to be considered as *special type of civil law agreement*.⁷

According to the second theory, although the agreements for assignment of the management of commercial company are not included in the group of the absolute commercial transactions as listed in Art. 1, par. 1 CA, since by virtue of its nature the management agreement is connected with the conduction of the typical activity for the merchants, it should be concluded that these agreements are commercial agreements and the disputes related to their validity and default represent commercial disputes.⁸

The third theory represents synthesis between the first two theories, because it concludes, on one side, that the management agreement represents a special type of mandate agreement, but, on the other side states that although the agreements for assignment of the management of commercial company are not included in the group of the absolute commercial transactions as listed in Art. 1, par. 1 CA, since by virtue of its nature the management agreement is connected with the conduction of the typical activity for the merchants, it should be concluded that these agreements are commercial agreements and the disputes related to their validity and default represent commercial disputes.⁹

⁴ See Decision № 778/21.07.1999 of the Supreme Cassation Court ("SCC") under civil case № 987/98, III Civil Panel, cited in Case Law-Bulletin of the SCC of the Republic of Bulgaria, issue № 1-2/1999, p. 29; Decision № 887/24.10.2005 of the SCC under commercial case № 987/98, Commercial Department, II Panel, cited in Legal Information System „Анис 6.0“; Decision № 1784/06.11.2001 of the SCC under civil case № 395/2001, V Civil Panel, SCC, cited in Market and Law Magazine, issue № 3/2002, p. 16; Decision dated 16.01.2008 of Sofia District Court under civil case № 1107/2007, Civil Department, I Appellate Panel, cited in Legal Information System "Анис 6.0"; Decision dated 9.02.2009 of the Sofia City Court under appellate civil case № 2776/2008, cited in Legal Information System "Анис 6.0"; Decision dated 10.12.2007 of the Sofia Appellate Court under cassation civil case № 25/2007, Civil Department, I Panel, cited in Legal Information System "Анис 6.0".

⁵ See Decision № 318/01.06.2004 of the SCC under civil case № 1363/2003, II Civil Panel, Commercial Department, SCC, cited in Legal Information System "Анис 6.0".

⁶ See Decision № 557/12.04.2002 of the SCC under civil case № 1713/2001, IV Civil Panel, SCC, cited under Bulletin of the SCC, issue № 8/2002, p. 22.

⁷ See Ruling № 232/09.07.2008 of the Administrative Court — city of Veliko Tarnovo under administrative case № 467/2008, 4 Panel, cited in Legal Information System "Анис 6.0".

⁸ See Ruling № 53/20.02.2006 of the SCC under commercial case № 341/2005, II Panel, Commercial Department, SCC, cited in Legal Information System "Анис 6.0".

⁹ See Ruling № 56/27.03.2007 of the Appellate Court — city of Veliko Tarnovo under appellate private civil case № 123/2007, Civil Department, cited in Legal Information System "Анис 6.0"; Decision № 311/29.06.2004 of the District Court — city of Blagoevgrad under court case № 174/2004, cited in Legal Information System "Анис 6.0".

3. Legal nature of the management agreement in the legal theory. In the legal theory it is specified that the internal contractual relation between the members of the managing body and the company under the management agreement shall be distinguished from the organic relation arising from the election of the respective physical person or legal entity¹⁰ as manager and which subject matter is the organic rights and obligations in connection with the management and representation of the company.¹¹ The management agreement is considered as a special type of mandate agreement.¹² This characteristic allows the application of the general rules for the mandate agreement (Art. 280–292 of the Obligations and Contracts Act). The function of the internal contractual relation is to regulate the rights and obligations of the members of the managing bodies in relation to the performance of its functions.¹³

4. Management agreement as special type of civil agreement. The relevance of determination of the management agreement as commercial agreement or civil agreement is related to the due care for the performance of the obligations of the managers—care of reasonable prudent person applicable for the civil contracts or care of good merchants applicable for the commercial contracts. The opposite is also correct — i. e. in case the due care required by the debtor is care of reasonable prudent person, respectively care of good merchant, the agreement is to be defined as civil agreement, respectively commercial agreement.

As an argument favoring the understanding that the management agreement is commercial agreement could be noted that one of the parties is the company which means that from a formal point of view the agreement is unilateral relative commercial transaction. On the other side, in practical terms, there are commercial companies

¹⁰ The appointment of legal entity as member of the managing body is admissible only for the JSC (and not for the LLC) and subject to explicit permission in the statutes of the JSC — Art. 234, par. 1, second sentence CA.

¹¹ See Джидров, П., Коментар на Търговския закон. Том 3, Sofia, 1994, p. 838, 843; Братусь, С. Н., Субъекты гражданского права, Moscow, 1950, pp. 201 and the following; Таджер, В., Социалистически стопански организации, Sofia, 1980, pp. 192; Стойчев, Кр., Търговски дружества на капитала. Мениджмънт и неговата правна регламентация, Sofia, 1992, p. 59; Христов, В., За органното представителство на юридическите лица с нестопанска цел, Legal Theory Magazine, issue No 1/2004, p. 71; Рачев, Р., Трудовият договор и договорот за управление на капиталови търговски дружества. Сравнителноправна характеристика, Commercial Law Magazine, issue № 5–6/2005, p. 51 and the following; Хорозов, Г., С какъв договор се уреждат отношенията между акционерното дружество и изпълнителния му директор, когато той е и член на Съвета на директорите, Market and Law Magazine, issue № 5/2005, p. 8–10; Георгиев, Ал., Функциониране в намален състав на съвета на директорите на акционерното дружество, Commercial and Competitive Law Magazine, issue № 5/2008, p. 6–8; Reinhardt, R., Schultz, D., Gesellschaftsrecht, 2. Auflage, Tübingen, 1982, S. 201; Hüffer, U., Aktiengesetz, 7. Auflage, München, 2006, S. 423–438; Raiser, T., Veil, R., Recht der Kapitalgesellschaften, 4. Auflage, München, 2006, S. 153–158; Hauswirth, H., Befugnisse und Pflichten von Organen der Aktiengesellschaft als Gegenstand von Organstreitigkeiten vor den Zivilgerichten, Tübingen, 1997, S. 51–52.

¹² See Герджиков, О., Коментар на Търговския закон. Книга Втора. Чл. 113–157, Sofia, 2000, p. 526; Калайджиев, А., Голева, П., Марков М, Маданска, Н., Коментар на промените в Търговския закон, Sofia, 2003, pp. 53–54, 85–89; Маданска, Н., Договор за възлагане на управлението на ООД, Market and Law Magazine, issue № 7/2004, p. 8; Георгиев, Ал., op. cit., pp. 6–8.

¹³ See Герджиков, О., op. cit., p. 525; Маданска, Н., op. cit., p. 9; Ланджев, Б., Търговско право, Sofia, 2009, p. 250.

or even physical persons registered as sole merchants with the Commercial Register which main scope of business activity includes management of other companies and in such case the management agreement would be even bilateral relative commercial transaction.

According to Art. 237, par. 2 CA the members of the boards of the JSC has to perform their functions with *the care of good merchant* in the interest of the company and its shareholders. Similar, but more detailed, is the wording of the provision regulating of the due care of the directors of the public companies. The members of the managing and supervisory bodies of the public company are obliged to perform its obligations with *the care of good merchant* in a way they reasonably believe to be in the best interest of all shareholders and using only information, for which they reasonably believe it is accurate and full (Art. 116б, par. 1, point 1 of the Act on Public Offering of Securities (APOS)).

However, in my view, the management agreement shall be considered as civil law agreement, which is special type of the mandate agreement and for which the care of the good merchant is not applicable. The incorrect wording of Art. 237, par. 2 CA does not have conclusive relevance in the case. In other statutory provisions the term "due care" instead of the term "care of good merchant" is used. For instance, according to Art. 26, par. 1 of the Act on the Companies with Special Investment Purpose (ACSIP), the persons managing and representing bodies of the company with special investment purpose has to perform its duties in good faith and **with due care** for protection of the interests of the investors and to prefer the company's interest instead of its own interest.

In the legal theory it is specified that the due care of the managers represents the objective measure of the good professionals (the good managers).¹⁴ In his commentaries Angel Kalaydjiev is on the position that due care of the managers is grounded on the abstract and objective measure — the grade of care of the professional group the person belongs to — the group of the managers of commercial companies.¹⁵

I would adhere to this understanding with the following notes. The main purpose of the merchant is the realization of net profit from the commercial activity conducted and the realization of the net profit itself depends on the proper, full and accurate performance of the obligations under the concrete commercial transaction. This requires the introduction of stricter grade of the due care and respectively — more restricted options for exculpation of the debtor under the commercial transaction as compared with the debtor under the civil agreement because the merchant has to assume the commercial risk. More precisely, the care of the good merchant is the absolute minimum which the merchant has to maintain for the conducting of its activity but if he intends to ensure the prosperity of its enterprise — it has to maintain level and quality of performance which exceed to a material extent the care of the good merchant.

In comparison, the manager is assigned (and this is the content of his mandate) with the management of commercial company where third parties — the shareholders, have invested their money. The corporate structure of the LLC and the JSC

¹⁴ See Стойчев, Кр., *op.cit.*, Sofia, 1992, pp. 66–69.

¹⁵ See Калайджиев, А., Д. Ранкова, К. Кръстева-Николова, Вл. Георгиев, Цв. Бондаренко, Коментар на Закона за публичното предлагане на ценни книжа, Sofia, 2005, pp. 481–482; Калайджиев, А., Публичното дружество, Sofia, 2002, pp. 117–118.

requires their management to perform their functions in the interests of the investors which forms the content of the duty of loyalty of the managers (see Art. 237, par. 2 CA, Art. 1166, par. 1, point 1 APOS, Art. 26, par. 1 ACSIP), but, on the other side, the investors should bear the commercial risk of losses, which impacts and lowers the grade of due care of the managers.¹⁶ Accordingly, the managers shall be exculpated in case they have met the care of the good manager (which is different from the care of good merchant).

What includes the care of the good manager? As compared with the “classical” contractual obligation, where the debtor is obliged to perform its obligations only when the subject matter of the obligation is individualized to a sufficient extent (and on that ground applying the objective and abstract measure of the due care we could determine which is the proper performance in the concrete case), the activity of the managers is to be conducted in the highly dynamic market environment and the content of their obligation could not be specified in prior but becomes concrete (and always unique) dimensions in the different market and corporate situations arising before the company. In such situation the law requires from the managers the completion of certain formal procedures for adoption of their resolutions and for the conclusion of the transactions, and upon their proper completion it shall be considered that the managers have adopted the respective resolution and have concluded the respective transaction on the ground of assessment of the relevant information and upon exercise of their reasonable business judgment.

Normally, such guarantee is sufficient for the successful activity of the company and therefore it constitutes the content of the due care of the managers and the court will not analyze the content of the resolution or the transaction. On the other side, should there are any additional circumstances — upon real or potential conflict of interests between the interests of the managers (or their affiliates) and the company, the law contains additional requirements to the procedure for conclusion and the content of such transactions.¹⁷

In case as result of the decision of the managers or the transaction concluded on the name of the company it has suffered damages or loss of profit, the question is whether the managers are liable for such damages or loss profit as a result of breach

¹⁶ Inaccurate is the argument that the management agreement is commercial contract because it is connected with the conduction of the typical activity for the merchant—compare Ruling № 53/20.02.2006 of the SCC under commercial case № 341/2005, II Panel, Commercial Department, SCC, cited in Legal Information System “Анис 6.0”. The management agreement is not typical commercial transaction for the merchant but its function is only to regulate the mutual rights and obligations of the manager and the company concerning its management and representation.

¹⁷ For instance, the CA requires the agreement between the managers or their affiliates (as the term “affiliates” is defined in the CA) and the company provided that the agreement is outside the usual commercial activity of the company or is not concluded at market arm length terms to be approved in prior by the board of directors or the managing board (Art. 2406, par. 1 par. 2 CA). The violation of this rule does not trigger the invalidity of the transaction but the physical person, who has concluded the transaction and was aware or could become aware of the lack of the approval by the board of directors or the management board, is liable against the company for the damages suffered as a result of the transaction. On the other side, in certain instances the law qualifies the transaction concluded without the necessary approval directly as null—compare for instance Art. 114, par. 9 APOS in connection with Art. 114, par. 1–9 APOS.

of their duty of care. The answer is the following. The managers shall not be liable against the company for compensation, in case before the adoption of the resolution or the conclusion of the transaction, they have gathered and analyzed the necessary information, have assessed the different alternatives before the company and the advantages and the risks connected thereto and have formed on that basis their business judgment. In this case, when *ex post* the decision turned out to be inaccurate or the transaction become unprofitable for the company and this has caused damages to the company, such damages shall be borne by the company itself and the managers will not be liable for them, because these damages represent a realization of the normal market risk and they resulted from the impact of the normal market forces and the company has suffered the damages despite that the directors have met their due care.

Conversely, in case the managers have adopted the resolution or concluded the transaction without the necessary information and without any assessment of the alternative options in place they are liable against the company because they have acted negligently (since they have breached the requirements of the care of good managers).¹⁸

In addition, when the manager is fully disinterested from the activity of the company and its commercial policy, does not participate in any of the sessions of the managing bodies and in the deliberations of the resolutions, such actions shall be considered as gross negligence.

When the directors have completed formally the procedure for adoption of the resolution (and have "produced" the necessary documents evidencing the completion of the procedure) but the content of the resolution itself compromises and burdens the activity of the company we have in place willful misconduct and willful violation of the due care of the manager. In practical terms, the willful violation of the due care is combined with conflict of interest and violation of the duty of loyalty (and in this case the court will consider the content of the resolution and whether the directors have violated their duty of loyalty).

In conclusion, the management agreement is a civil law agreement and the manager has to perform his obligations with the care of good manager (and not with the care of good merchant). The content of the due care of the managers includes completion of the formal procedures for convocation of the sessions and adoption of resolutions and for conclusion of transactions on the name of the company, which guarantee that the resolutions will be adopted and the transactions will be concluded on the ground of informed assessment of all alternatives before the company and the reasonable business judgment of the managers.

5. Special legal characteristics of the management agreement. According to the different classifications of the agreements in the contract law the management agreement shall be considered as bipartite, non-gratuitous, formal and consensual agreement.

5.1. Bipartite agreement. The management agreement is bipartite agreement because any of its parties has simultaneously right and obligations. The CA is silent on the right and obligations of the parties. Thus, the agreement should contain detailed contractual regulation of the mutual rights and obligations of the parties.

¹⁸ In the same sense-compare Стойчев, Кр., *op. cit.*, pp. 66–69.

In practical terms, the management agreement includes normally the following right and obligations of the manager:

— Obligation to represent the company and to organize and manage its activity and assets in accordance with the applicable law, the Articles of Association/Statutes of the company and the management agreement for the purposes of completion of its business program of the company;

— Non-competition undertaking. The definition of the competition activity can be included by special definition in the management agreement itself. Should such definition is not provided in the agreement the definition for competition activity under Art. 142 CA, respectively Art. 237, par. 4 CA, shall be applicable. The contractual definition of the competition activity allows to be taken into account the specifics of the corporate structure and commercial activity of the concrete company;

— Confidentiality undertaking. The content of this obligation represents a prohibition to disclose confidential information of the company the managers become aware of while performing his duties as such. The interests of the company require such prohibition to be included in the agreement itself for the term of its validity and certain term thereafter (normally between three till five years). The criteria certain information to be considered as "confidential" have to be specified expressly by the agreement in order future disputes after its termination to be avoided. Generally speaking, the confidential information is any information, facts, events and decisions connected with the activity of the company, its affiliates, suppliers, shareholders as well as the information concerning third parties which disclosure could harm the interests of the company.

Upon duly performance of his obligations the manager is entitled to receive the remuneration agreed. The management agreement could provide for payment of additional remuneration to the manager to the amount of certain percentage of the net profit in order to align the interests of the management and the shareholders for stable and growing development of the company.

On the other side, the obligations of the company are related to: (i) ensuring of the necessary conditions for performance of the functions of the manager, (ii) payment of the manager's remuneration, and (iii) payment of compensation to the manager for any and all expenses incurred and damages suffered in relation to the performance of his obligations under the agreement.

5.2. Non-gratuitous agreement. In practical terms, the management agreement is normally concluded against consideration. On the other side, as noted already, the management agreement is a special type of mandate agreement. Under the general regulation of the mandate agreement in the Contracts and Obligations Act the mandate agreement is principally concluded against no consideration. Therefore, in my view and speaking mainly theoretically, the management agreement could provide also that the manager shall receive no remuneration. Such hypothesis is possible when the concrete physical person which is manager of the holding company is appointed simultaneously as manager of the daughter company — he will receive formally no remuneration from the daughter company but only from the holding company.

5.3. Formal agreement. The management agreement is a formal agreement because the CA (in Art. 141, par. 7, Art. 241, par. 6 and Art. 244, par. 7) requires written form for its conclusion and validity (the so called "ad solemnitatem form").

5.4. Consensual agreement. The management agreement is consensual because its legal effect will be in place once the parties have consented on its terms and have signed the agreement in written form.

6. Conclusion. The management agreement of LLC and JSC represents bipartite, non-gratuitous, formal and consensual agreement on the ground of which the manager is assigned with the management and representation of the company against certain remuneration. The manager shall perform his duties with the care of the reasonable manager which requires the completion of the formal procedures for convocation of the sessions and adoption of resolutions of the managing bodies and the formal requirements for conclusion of commercial transactions by the company.