

## CORPORATE GOVERNANCE IN ALBANIA–HARMONIZATION AND COMPARISON WITH EU LAW

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### Abstract

Despite all the research and studies, there is no single definition of corporate governance that can be applied to all situations and jurisdictions. The various definitions that exist today largely depend on the institution or the author, country and legal tradition. International Finance Corporation<sup>1</sup> defines corporate governance as “the structures and processes for the direction and control of companies”<sup>2</sup>. From the other part, The Organization for Economic Cooperation and Development (OECD), which in 1999 published its Principles of Corporate Governance<sup>3</sup>, offers a more detailed definition of corporate governance as a system of relationships, defined by structures and processes.

Corporate governance framework reflected and included in company law, typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of country specific circumstances, history or tradition. When a new experience accrues and business circumstances change, the content and structure of this framework needs to be adjusted<sup>4</sup>. So the companies would need to regularly and carefully monitor such adjustments and update their governance system.

The really first step on Company Law and corporate governance in Albania was made in 1929, by Civil Code (known also as Zog Civil Code<sup>5</sup>) enacted on April 1, 1929. This Code was developed under the influence of Civil Code of France. Obviously, even the German, Italian and Swiss law would inspire Albanian legislator on drafting this code. Entry into force of this code would impose the belonging of Albanian Civil Law to the Roman- Germanic family, detaching it from the eventually Ottoman belonging.

The second step on these developments was made in 1981, during the dictatorial period. This was the second Civil Code<sup>6</sup>, enacted by Law nr 6340 date 26.06.1981, and was inspired by socialist doctrine of East European Block, but also had a German pattern.

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<sup>1</sup> *International Finance Corporation –Corporate Governance Manual – Second Edition (IFC 2010)*

<sup>2</sup> *Ibid page 8*

<sup>3</sup> *OECD Principles of Corporate Governance (see [www.oecd.org](http://www.oecd.org))*

<sup>4</sup> *OECD Principles of Corporate Governance, Annotations to the OECD Principles of Corporate Governance, ensuring an effective corporate governance framework. See also [www.oecd.org](http://www.oecd.org)*

<sup>5</sup> [http://www.albarchive.gov.al/cms/front\\_content.php?idcat=192](http://www.albarchive.gov.al/cms/front_content.php?idcat=192) (accessed 11.10.2012)

<sup>6</sup> <http://www.qpz.gov.al/doc.jsp?doc=docs/Ligj%20Nr%206340%20Dat%20C3%AB%2026-06-1981.htm> (accessed 11.10.2012)

Albanian Company Law<sup>7</sup>, under which the corporate governance, has changed many times since the early 90', when dictatorial period fell and market economy entered in force. The first step on market economy period started by Law no 7638 dating 19.11.1992 "Law on Commercial Enterprises ". In 1995 we had another law "Transformation of State entities into private enterprises" by which all state enterprises have to become private ones. Later on were made many changes to the first law, that of 1992. This was made in 1995, 1996 and 2007, 2008. The process of harmonization with EU law as a result of the integration process has been difficult and not in the best way the EU economic institutions would have advice, nevertheless this process is still unfinished and full harmonization has still to come.

**Keywords:** Corporate governance, Albania, Transition, Harmonization, Comparison, EU Law.

## 1. WHAT IS CORPORATE GOVERNANCE?

The various definitions that exist today largely depend on the institution or the author, country and legal tradition. International Finance Corporation defines corporate governance as "the structures and processes for the direction and control of companies". Generally it involves the mechanisms by which a business enterprise is directed and controlled. It usually concerns mechanisms by which corporate managers are held accountable for corporate conduct and performance. Although corporate governance is distinct from and should not be confused with the topics of business management and corporate responsibility, they are related.

*"Corporate governance...involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."*

Corporate governance is also "the system by which companies are directed and controlled". It involves regulatory and market mechanisms, and the roles and relationships between a company's management, its board, its shareholders and other stakeholders, and the goals for which the corporation is governed.

Also, is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees.

Corporate governance it defines the legal and factual framework, internal (corporate bodies) and external framework (stakeholders) of the company.

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<sup>7</sup> Bachner Thomas ,Schuster Edmund-Philipp and Winner Martin (2009) *The new Albanian company law: interpreted according to its sources in European law. Center of Legal Competence , (corp. ed.) Guttenberg, Tirana, Albania. page 15*

Among other corporate governance definitions we find : “ Corporate governance is the organisation of the administration and management of companies...”<sup>8</sup> or “ Corporate governance is used to describe the system of rules and procedures employed in the conduct and control of listed companies”<sup>9</sup>.

## 2. THE NEW ALBANIAN COMPANY LAW

Albanian Company Law<sup>10</sup> regulates four types of business organisations referred as ”commercial companies” (alb. shoqeri tregtare) :

- a) General partnership (alb. shoqeri kolektive)
- b) Limited partnership (alb. shoqeri komandite)
- c) Limited liability company (alb. shoqeri me pergjegjesi te kufizuar)
- d) Joint- stock company (alb. shoqeri aksionere).

The Company Law no 9901 makes different changes to the previous one, because it was drafted by and to implement European Company Law standard, as to the process of EU integration. Regarding this, it was obligatory to fulfill the mandatory requirements of Stabilization and Association Agreement between Albania and European Union, respectively Art 70 of this agreement. This aims full approximation of *acquis-communitaire* within 10 years. Although this new law has to be in accordance with the *acquis*, in many cases this is not possible where it is obvious that the Albanian provision clearly and more intentionally deviates from European provision<sup>11</sup>. By the other part, European Directives focus mostly on joint-stock companies and less on limited liability companies and there are almost no rules on partnerships. As a result, national company laws in European Union differ widely, and the Albanian legislator enjoyed pretty much leeway when drafting the new company law. Regarding the matters that are not regulated by European law, Albanian legislator relies on German and England company law, so this mean that many interpretations will be taken by the courts of Member States where it was borrowed the rule. As a result of this we have to take into account despite EU Directives on company law also the doctrine and jurisprudence of Germany and England in various cases.

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<sup>8</sup> Recommendations of the Federation of Belgian companies, Foreword, European Commission, Internal Market Directorate General, Comparative study of corporate governance codes relevant to the EU and its members, final report and annexes 1-3, January 2002, p. 30.

<sup>9</sup> Securities Market, Commission Recommendations, Introduction, Portugal, European Commission, Internal Market Directorate General, Comparative study of corporate governance codes relevant to the EU and its members, final report and annexes 1-3, January 2002, p. 30.

<sup>10</sup> Albanian Company Law (Law no 9901 “On entrepreneurs and companies” (alb-Per tregtaret dhe shoqerite tregtare ) (changed by Law no 10476 , date 27.10.2012 )

<sup>11</sup> Bachner Thomas , Schuster Edmund-Philipp and Winner Martin, *op.cit*, p. 17-18.

The formation of a company consists of two stages that have to be completed in every case. According to Art 3<sup>12</sup>, paragraph 1 of Law 9901, Companies are founded by two or more natural persons and/or entities which agree on common economic objectives, contributions to society, as defined in its charter.

Then, again according to Art 3(2)(3)<sup>13</sup>, Companies must be registered under Section 22 of the Law No. 9723, dated 3.5.2007 "On the National Register Center" and the following sections, according to the respective form of the company and they (Companies) shall acquire legal personality on the date of their registration in the National Register Center and are liable with all their assets to liabilities arising from operations conducted.

### **3. COMPANY ORGANS AND CORPORATE GOVERNANCE**

As we all know companies are not natural persons and they cannot act as like. As a result of this they need and are dependent on natural persons to conduct their business. From the other part it is not practical that shareholders of the company conduct all the decision making process. So the question remains if the company needs a specialized management body to act on the company's behalf or this process can be done from the shareholders. Despite the fact that it is not practical and even impossible that shareholders conduct all the decision making process in the company, having a specialized management body<sup>14</sup> has its own advantages. Firstly, there are many decisions that have to be made in a short time, urgently, and holding a shareholder meeting would be very costly and takes a lot of time, so it would be better having a specialized management body making these decisions and reducing the costs of that meeting. Of course this would improve the efficiency of the company management. Having a specialized management body of the company would be efficient for large companies, those with many shareholders, but it is not so efficient regarding those small companies or even single member companies. Also, having this specialized management body, permits the company to be managed by a professional group of people.

#### **3.1 ADMINISTRATOR OF THE COMPANY**

The term administrator (well known in Albanian corporate law) is very often confused with the term manager or director (mostly known in U.S corporate law). In a typical American company, there are people that can report to the manager, then these managers reports to the directors and they report to the vice president or president (this in a more common linguistic saying). So, when it comes to make a difference between these terms due to the legal framework it becomes more difficult, since different legislations use different terms about this. In Albanian language, as in the Italian language it is used the term "administrator" (Albanian) and "amministratore",<sup>15</sup>

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<sup>12</sup> Available at:<<http://80.78.70.231/pls/kuv/f?p=201:Ligj:9901:14.04.2008> >(accessed 11.10.2012)

<sup>13</sup> *Ibid.*

<sup>14</sup> Bachner Thomas , Schuster Edmund-Philipp and Winner Martin, *op.cit*, p. 98-99

<sup>15</sup> Antonino Dimundo, *Responsibilities against directors*, Available at:<[http://www.csm.it/quaderni/quad\\_94/qua\\_94\\_18.pdf](http://www.csm.it/quaderni/quad_94/qua_94_18.pdf)> p. 1. (accessed 11.10.2012)

(Italian). According to the Italian Commercial Code of 1882<sup>16</sup>, the directors/ amministratori were qualified as “agents” of the company (Article 121) and were subject to the limits of that status entailed. They could make only transactions expressly mentioned in the articles (Art. 122), and their powers were limited. The doctrine and case law, however, under the term of that Code, had emphasized the role and power of directors, considering it the same way as judges of the company. The codification of 1942 reflects these guidelines and in the allocation of competences between management activities the shareholders and the directors of the company, gave the latter an exclusive jurisdiction. The only exceptions to this general rule are those mentioned in Art. 2364, paragraph 1, no. 4, of the Italian Civil Code, regarding the resolutions of certain acts that the statute has reserved to the meeting. They are, however, exceptions to the rule of general jurisdiction of the administrators. The extent of their powers to all acts of management included in the corporate is, in fact, clearly established by Article 2364, paragraph 1, no. 4, of the Civil Code, which provides that the meeting shall decide only on the management measures which are indicated in the deed or to be submitted by the directors, and art. 2384, Civil Code, according to which administrators provided representation may take all actions included in the corporate governance proceedings, unless the limitations resulting from the law or the articles of association. Very effectively, and briefly, it was said that administrators draw up the strategy of the business, give impetus to the whole society and fulfill what is usually called the entrepreneurial function. However, what most characterizes the powers of the director/amministratore, it is not so much their size, assigning them to a body and their institutional structure of society for actions, equipped with an autonomous competence and, beyond certain limits, imperative, as conferred by law in the public interest. Nothing comparable in short, at the powers of the representative person payable to directors when they were qualified representatives of the company<sup>17</sup>. On the other hand manager and administrator are terms quite often interchangeably used by people. There are obvious differences between a manager and an administrator, but for a vast majority of people, these two are interchangeable terms.

According to; Art. 95(1) of Albanian Company Law (ACL), the General Assembly appoint one or more natural persons as company administrators. The term, which is determined by the statute, can not be longer than five years<sup>18</sup>, with the right of renewal. Appointment of administrators produces effects upon registration in the National Registration Center. Statute may establish special rules for the appointment of administrators. As it was previously said, the administrator must be natural person, not necessarily related to the members of the company, and not even being member of the company. Being a natural person implies personal liability for the administrator. Despite that, the ACL<sup>19</sup> does not provide any special condition for being an

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<sup>16</sup> *Ibid*, p. 2.

<sup>17</sup> Galgano, *Company Law*, Bologna 1992, p. 267-268.

<sup>18</sup> Article 95(1) Law no 9901 from 14.04.2008, Available at: <<http://80.78.70.231/pls/kuv/f?p=201:Ligj:9901:14.04.2008>> (accessed 16.10.2012).

<sup>19</sup> Law no 9901 from 14.04.2008.

administrator; it can be imagine that should be a person with good reputation and knowledge on economic activities.

#### **4. ADMINISTRATION OF JOINT-STOCK COMPANIES**

The Joint-Stock Companies contrary to Limited Liability Companies, offers a better and suitable organizational framework for companies that runs large businesses and have a large number of shareholders. The main characteristic of JSC is the possibility to offer its shares to the public (in contrary to this characteristic the LLC cannot offer them to the public).

Generally, the Joint-Stock company has the following characteristics<sup>20</sup>:

- limited liability
- independent legal status and can enter into contracts in its own name
- equity capital, referred as “charter capital”, divided into shares which are freely transferable
- may issue shares and bonds.

Joint-stock companies are the only legal entities that can issue shares. These shares<sup>21</sup> may be: ordinary shares or preferred shares (such as voting preference shares, redeemable preference shares, dividend preference shares and other preference shares as determined in the charter of the company). The shareholders of a joint-stock company are normally liable for the debts and other property obligations of the company up to the amount of capital they have contributed to the company<sup>22</sup>. Until all subscribed founding shares are fully paid up, all founding shareholders are jointly responsible for the debts and other property obligations of the company up to the value of shares not yet paid for.

According to the Albanian Law, joint stock companies are trade companies, with capital divided into shares<sup>23</sup>. The founders of these companies can be natural or judicial persons, this means that other trade companies can be partners in a joint stock company. In general, a company is considered private company if it is out of the definition of a public company. According to ACL, private joint-stock companies must have a capital higher than 2 million ALL<sup>24</sup> and public joint stock companies must have a capital higher than 10 million ALL<sup>25</sup>.

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<sup>20</sup> International Finance Corporation-Corporate Governance Manual (second edition) IFC2010, p. 41.

<sup>21</sup> *Ibid*, p. 42.

<sup>22</sup> Melvin Aron Eisenberg, “The structure of Corporation Law” *Columbia Law Review*, (1989), p. 1461.

<sup>23</sup> Albanian Company Law, Art. 105.

<sup>24</sup> Albanian Lek.

<sup>25</sup> Art. 107 of ACL.

ACL offers two different set of rules for the organisation of a JSC: one-tier and two-tier structure. Speaking generally, the one-tier or unitary board system<sup>26</sup> is characterized by a single board that governs the company, and includes both executive and non-executive members. In such a setting, the supervisory body is often called the Board of Directors. This governance structure can facilitate strong leadership structures and efficient decision-making. Non-executive and independent directors, however, play a crucial role in monitoring managers and reducing agency costs. This system is typical for companies based in countries with a common law tradition, for example the U.S and U.K.

On the other hand, the two-tiered or dual system, is characterized by the existence of distinct supervisory and management bodies. The former is commonly referred to as Supervisory Board and the latter as the Executive Board. Under this system, the day-to-day management of the company is handed down to the Executive Board, which is then controlled by the Supervisory Board (which in turn is elected by the General Meeting of Shareholders). These two bodies have distinct authorities and their composition cannot be mixed, e.g. members of the Executive Board cannot sit on the Supervisory Board and vice-versa. The advantage of the two-tiered system is a clear oversight mechanism, but it has been criticized for inefficient decision-making. This system is most famously represented in Germany.

Besides the one-tier system and the two-tiered system, many countries recognize a third governance structure, the **hybrid system**<sup>27</sup>, which is essentially an amalgam of the two abovementioned models. According to this system, every joint- stock company must establish a Supervisory Board and a Board of Directors, with a possibility of organizing an Executive Board as well. Despite this, it cannot be found in Albanian Company Law any trace of this hybrid system.

Regardless of which system a country allows, the following<sup>28</sup> must be kept in mind:

- 1- Firstly, there is always a trade-off between efficiency and control. When the agency problem or conflict of interest is high, shareholders may choose the two-tier system, but must realize that a tight monitoring governance system could tie managers' hands and render business operations and decision-making inefficient. On the other hand, in the case shareholders and managers trust each other, there is better efficiency to explore more business opportunities, and the company may choose a more pro-management oriented, one-tier board system.
- 2- While all systems have many elements in common, important differences do exist and these will affect the board's authority, structure and operations, and consequently the duties and obligations of directors .<sup>29</sup>

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<sup>26</sup> Adolf A. Berle, Gardiner C. Means, *The Modern Corporation and Private Property* (Legal Classics Library, 1993) p. 338

<sup>27</sup> International Finance Corporation-Corporate Governance Manual (second edition) IFC2010 , p. 51

<sup>28</sup> *Ibid*, p. 52-53

## 5. EUROPEAN COMPANY LAW. TREATY PROVISIONS

The freedom of establishment is one of the four freedoms of Community Law. This freedom has been already part of the original Treaty of Rome, which created the European Economic Community in 1957, and now has become Article 49 of Treaty on Functioning of European Union (ex Article 43 of Treaty of Economic Community). This freedom prohibits restrictions regarding the freedom of establishment of any national of a Member States in another Member State, territory of another Member State. It prohibits restrictions on setting up agencies, branches or subsidiaries. As defined in Article 49 of TFEU:

*“Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.*

*Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.”<sup>30</sup>*

According to this article, companies or firms established according to the law of a Member State, and having their registered office, principal place of business, central administration within the European Union, are to be treated in the same way as natural persons who are nationals of a Member State.

Since the European Community was founded in 1957, there have been a series of Directives that created the minimum standards within the European Union. The basic aim of these Directives is to reduce barriers on freedom of establishment for businesses throughout the European Union, making an important process of harmonization of basic laws within EU. The object is that by harmonizing the laws all over Member States, the business will have more facilities on achieving its goals and of course creating a basic level of protection for investors in every Member State giving them more security.

Regarding the latest developments on European Union legislation about company law and corporate governance, the European Commission on 12 December 2012 issued a communication “Action Plan on European company law and corporate governance—a modern legal framework

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<sup>29</sup> *Ibid*, p. 55 (These differences are embedded in, among other things, national legislation (legal tradition) organizational theory (composition requirements and functional distribution of authorities) corporate culture and will affect the supervisory body’s authority, structure and operations).

<sup>30</sup> Treaty on Functioning of European Union, *Official Journal of the European Union*, 30.03.2010.



for more engaged shareholders and sustainable companies”<sup>31</sup> that outlines the initiatives which Commission intend to take in this area on the coming years to improve and enhance the current framework. This Action Plan announces 16 different actions and initiatives that will be taken by the Commission on the coming years, proposals for a new legislation or for soft law as recommendations or codes. This initiative will include enhancing transparency between companies and investors, encouraging long-term shareholder engagement and improving the framework for cross-border operation of companies.

## **6. HARMONISATION TO EU LAW**

Since the beginning of EU Company Law, there have been many directives being transposed in the national law of Member States. But there have been even some other states, not member states, such as Albania, that during the long way toward integration have decided to harmonise their national law with that of EU law. The legal status and registration of a company has been issues dealt with in all these states and even in the new Albanian Company Law. These rules can be found in the First Directive 68/151/EEC<sup>32</sup> that was complemented by Eleventh Directive 89/666/EEC<sup>33</sup> concerning disclosure requirements in respect of branches opened in a Member State by a company governed by the law of another state.

Other directives harmonizing the company law all over Member States were the Second Council Directive 77/91/EEC contains additional disclosure requirements for public limited liability companies on increasing and maintenance of subscribed capital, and the Twelfth Directive 89/667/EEC which requires to make possible the formation of a private limited liability company with only a single member, to all Member States. More or less these directives or parts of them are transposed in new Albanian Company Law trying to harmonize with EU law.

Regarding our matter of issue, on corporate governance the European Union policies were not interfering with the national laws of Member States until the directives of 2004 and 2007 (as we previously have mentioned). Nevertheless these directives didn't have an importance on the new Albanian Company Law, since there are not listed-companies in Albania.

## **7. CONCLUSION**

- 1- There is no single definition of corporate governance that can be applied to all situations and jurisdictions. But from many International Corporation Regulations is defined as the structure and the process for the direction of a company, or is seen as a set of

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<sup>31</sup>Available at < [http://ec.europa.eu/internal\\_market/company/modern/index\\_en.htm](http://ec.europa.eu/internal_market/company/modern/index_en.htm)>, accessed 31.01.2013

<sup>32</sup> Official Journal L 65, 14.03.1968, item 1, cf IV.2.

<sup>33</sup> Official Journal L 395, 30.12.1989, p. 36-39.

relationships between the company's management, the shareholders and other bodies of company. Corporate governance must not be confused with corporate management, because corporate governance focuses on the company's structure and its processes, at the other hand corporate management focuses on the tools required to operate the business. Corporate governance is not a onetime exercise, but rather an ongoing process.

- 2- The new Albanian Company Law regulates four types of business organisation referred as commercial company: general partnership, limited partnership, limited liability company and joint-stock company. This new company law makes different changes to the previous laws. It was meant to be drafted in implementation of European Union company law standards within the European Union integration process. But in fact this didn't happen, because in many cases the Albanian provisions clearly and more intentionally deviates from European Union provisions. On the other hand, European Directives focus mostly on Joint-Stock companies and less in Limited Liability Companies, and there are no rules on partnerships (that is one of the four types of commercial companies in Albania). At this point it would be smart accepting that Albanian legislator enjoyed pretty much lee way when drafting this new Company Law.
- 3- Companies are not natural persons; as such they need a specialized management body. The term administrator in Albanian Company Law differs from this definition in other European Union states or abroad. As a matter of fact the term administrator in Albanian Company Law corresponds to the term director in EU company law. One could realize that trying to name directors as administrators in Albanian Company Law it could be very confusing not only for researchers but even for everyday business policy makers.
- 4- The Joint-Stock company differs from Limited Liability company. It offers a better and suitable organizational framework for companies that runs large businesses and have large number of shareholders. Joint-stock companies are divided in Albanian Company Law in two organizational structures: one-tier structure and two-tier structure. The one-tier or unitary board system is characterized by a single board that governs the company, and the two-tier system is characterized by the existence of distinct bodies, supervisory and management bodies.
- 5- The freedom of establishment, as one of four freedoms of Community Law, has become part of original Treaty of Rome which created European Economic Community in 1957, and now has become Article 49 of Treaty on Functioning of European Union. The importance of this in European Union legislation is that prohibits restrictions regarding the freedom of establishment of any national of Member State in the territory of another Member State.

In accordance with this there have been implemented many Directives in European Union Member States during these years.

Albania, during the long way toward integration, has decided to harmonize the national law with that of European Law, but this has been difficult, in that Albanian legislator mostly has deviated in their provisions, intentionally or not, from European Union Law. One could realize that this came from the incapability of Albanian market to absorb European Union provisions, or from the incapability of Albanian politicians walk in the right path of European Union because of the fact this could jeopardize their economic interests.

At the other part, it cannot be said that the private sector and representatives of the companies, have become aware of the importance of corporate governance. The shareholders interest on comprehensive corporate governance principles and practices is still low. That is result of the lack of needed corporate governance cultures among their boards and management, but also of the presence of the informal sector, non registered businesses that have consequences in terms of tax evasion, labor market distortions and unfair competition.

There is no adequate efficiency and capacities of judicial system dealing with corporate governance matters, associated with limitations on the level of implementing the decisions and rule of law in general.

8. As a final result it can be suggested strengthening the structures that are responsible for the implementation of the company law.
9. Undertake measures to make the regulated market function properly, with concrete interventions.
10. A strategy-based effort to increase corporate governance culture, to make shareholders, management bodies and stakeholders aware of this kind of practices.

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- 30- Albanian Company Law(Law no 9901, date 14.04.2008 "On entrepreneurs and companies"–(alb) Per tregtaret dhe shoqerite tregtare) (changed by Law no 10476, dating 27.10.2012)
- 31- R.W.Hamilton, "Corporate Governance in America 1950-2000; Major changes but uncertain benefits", *Journal of Corporation Law* 25, No 2 (1999-2000).