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The Regulatory Criteria of Administrators' Behavior in Joint Stock Company According to Albanian Legislation

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Abstract

The administration of the company's activity is the daily preoccupation of any commercial company's administrator. But, being an independent player within the company, the administrator may also have personal interests. Transactions between an administrator with personal interests and the company always pose a potential risk to the company itself. The company law in Albania has defined the disciplinary parameters for administrators aiming to avoid the conflict of interest, as well as the prohibition of competition with the commercial company. Likewise, the law on commercial companies has enabled the shareholders of the commercial company to effectively monitor the behavior of the administrators and limit risky actions. Precisely, this control mechanism has as purpose the establishment of a good governance regime in any commercial company. The parameters for disciplining the behavior of administrators and members of the board of directors in Albanian joint stock companies are applied *mutatis mutandis* with the parameters for disciplining the behavior of administrators in limited liability companies. The parameters for disciplining behavior fall into two broad categories: avoidance of conflict of interest and prohibition of competition. In the present research paper, through a legal assessment, special attention has been paid to the legal parameters for disciplining the administrators' behaviors in the Albanian joint stock companies, aiming to analyze the legal provisions, which regulate it in this regard.

Keywords: conflict of interest, competition, administrator, joint stock company, Albania.

Jel Codes: K22, L26, O52

1. Introduction

The delegation of decision-making to the administrators clearly creates the risk of conflicts between the interests of the administrators and the interests of the shareholders. This potential conflict of interests is a consequence of the division of ownership of the company and the powers of control of the company commercial activity (Bachner, Schuster & Winner, 2009). The delegation of decision-making authority to the company's administrators may cause the risk of the administrator's temptation towards the company's assets, especially by concluding contracts with the company under particularly favorable conditions for him/her (Bachner, Schuster & Winner, 2009). In addition, administrators may also be tempted by opportunities for profit that arise during the exercise of their function, instead of using these opportunities for the company (Dine, Blecher, Hoxha & Race, 2008). For this reason, it is necessary to foresee clear disciplinary parameters in order to avoid the conflict of interest, as well as the prohibition of competition with the commercial company, which will be dealt with in this paper.

2. Conflict of interest

An important disciplinary parameter is the prevention and avoidance of cases of conflict of interest with the commercial company.[1] This limitation applies, first of all, to the administrators themselves, but also to other persons with whom the company will enter into contractual relations and for whom, the administrators have or should have known about circumstances of conflict of interest (Malltezi, 2011). Albanian Company Law provides that if the company enters into an agreement with third parties, from which the administrator or a circle of persons, who share common interests with him/her is the direct or indirect beneficiary, then the administrator is in the conditions of a conflict of interest (Malltezi, 2011). The rule defined in article 13 point 2 of Company Law is not only applied when the administrator concludes contracts or enters into other contractual relations with the commercial company, but also in the smallest actions, for example, the administrator of a supermarket chain, who buys a bottle of water in one of supermarkets (Bachner, Schuster & Winner, 2009).

[1] Article 13 and article 163 of Law No.9901 dated 14.04.2008 "On entrepreneurs and commercial companies", as amended.

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Agreements in which the parties have a conflict of interest with the company are neither illegal nor impossible. These agreements can be made fully valid simply by respecting the highest standards that the law or eventually the statute has determined, regarding transparency and decision-making control (Bachner, Schuster & Winner, 2009). This control is carried out by fulfilling the following four conditions:

(i) the administrator must declare the terms of the agreement, as well as the nature and object of the interest in this agreement;[2]

(ii) the agreement must be authorized in advance by the superior body through unanimous decision.[3]

The superior body, depending on the statute and the type of agreement, can be the Assembly of the shareholders in limited liability companies or the board of administration or the supervisory council in joint stock companies (Dine, Blecher, Hoxha & Race, 2008). In order to prevent any possible abuse of powers by the administrator, obtaining the approval of the "owners" (shareholders) in joint stock companies is not seen as practical due to the large number of shareholders. But, in this situation, the law may allow the statute to foresee the possibility of approval by the shareholders, only in companies with fewer shareholders. Or in the absence of this provision, the monitoring of the administrator's actions can be entrusted to a group of persons, who have at least no personal interest in this action (Bachner, Schuster & Winner, 2009). The purpose of this important legal guarantee is to enable risk assessment potential transactions for the company from the superior body. However, this mechanism can work only if approval is given for a particular transaction (Bachner, Schuster & Winner, 2009).

(iii) the approval given must be notified for registration in the NRC.[4]

This can be a logical solution, in particular, for small everyday actions, for example, buying food and drinks in normal quantities for personal use in community supermarkets (Bachner, Schuster & Winner, 2009). But the law does not limit the granting of general approval only to harmless actions, since it is known that the purpose of registration is to warn potential investors of the existence of general approval, so that they can make inquiries about it (Dine, Blecher, Hoxha & Race, 2008). Thus, general approval is not related with a specific action, but with the conditions for a range of permissible actions. In the absence of this definition, the purpose of Article 13 point 2 of Company Law could obviously be undermined by the indiscriminate use of undefined general approvals that are seen as pure formality (Malltezi, Rystemaj & Pelinku, 2013). A transaction made between the company and a person authorized to represent or supervise the company, without the required approval, is not binding on the company.

Whereas, in relation to the administrator, an unapproved agreement can be handled in two ways by the company:

a) in case the agreement brings benefit to the company, it can be approved by the assembly a posteriori, thus removing any doubts about its validity;

b) when the agreement is considered harmful to the interests of the company, the latter may decide not to recognize the agreement in relation to the administrator and charge the administrator with any harmful consequences of the agreement. Meanwhile, this agreement continues to produce normal effects in relation to third parties in the event that the company has failed to prove that they were in good faith (Malltezi, Rystemaj & Pelinku, 2013).

(iv) Further, the approved agreement must be published in the company's financial statements and progress reports. This publication, in addition to the terms of the agreement, must also mention the nature and object of interest of the persons involved (Malltezi, Rystemaj & Pelinku, 2013).

The purpose of this legal regulation is to protect shareholders from unfavorable agreements for the commercial company. The legislator started from the premise that since the administrator is much more informed compared to the shareholders of the commercial company, it is possible to conclude beneficial agreements for him/her (Dine, Blecher, Hoxha & Race, 2008). The creation of mechanisms for the control of these agreements when the administrator of the company is one of its partners is even more important. In such a case, the managing shareholder, as well as other shareholders, who may have a personal, financial, family relationship with the managing partner, must be excluded from voting in the meeting of the Assembly of the commercial company (Malltezi, 2011).

[2] Ibid. article 13 point 2
[3] Ibid
[4] Ibid

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Also, based on article 13 point 4 of Company Law, persons seeking approval for a transaction cannot vote on the approval of the transaction and should not be counted in the quorum. The same law extends the control mechanisms also over the agreements between the company and third parties, from which the administrator can benefit indirectly (Malltezi, 2011). The persons, who must be subject to the same control mechanism as the administrator himself, are as follows:

• Persons, who have a personal or financial relationship with the administrator;

• Persons whose relations with the administrator are such that, reasonably, they can influence his/her decision-making contrary to the interests of the company.[5]

The following persons are presumed to have one or more of the above interests with the administrator:

• husband/wife, parents, brothers or sisters of the husband/wife;[6]

• children, parents, brothers, sisters, children's children or spouse of the above persons;[7]

• persons related to the administrator: pre-born or unborn, second-degree relatives, adopter or adopted, first-degree relative of the spouse;[8]

• a person residing with the administrator.[9]

It is important to emphasize that the purpose of this control mechanism is to create a good governance regime in the commercial company, which is also applied to profitable and favorable agreements for the company, so that shareholders can be guaranteed that their interests are always in line with the activity of the commercial activity. However, the purpose of Article 13 point 3 of Company Law may not be realized if the third party proves that it does not have any significant contact with the administrator - eg. an estranged child of an administrator. This broad scope, together with the lack of any restrictions on the size or importance of actions, can cause practical problems (Bachner, Schuster & Winner, 2009).

In order to improve the protection of investors, the legislator in the last changes of the Company Law, provided that the board of administration or the supervisory council of the joint-stock company, which have approved an action, must without delay, but in any case within 72 hours, notify the General Assembly on the approval given for this action, accompanied with the respective conditions for its execution, as well as the nature and object of interest of the persons involved.[10] In the case of joint-stock companies with a public offer, this notice must be published within the above-mentioned deadline also on the company's website, regardless of other obligations for the publication of the given approval, which these companies may have. Such a provision is not included for other companies, since, in these companies, the agreements are approved in advance, directly by the other partners, who were aware about the terms of the agreement before its approval.[11] The company, within 6 months from the notification of the agreement, can request the invalidity of the agreement in court only if it proves that it is harmful to the interest of the company and the third parties were aware of the excess of competences or conflict of interests on the part of the administrator.[12] And in this case, the legislator starts from the premise that third parties are considered in good faith, unless the company can prove the opposite by showing that they have one of the above-mentioned connections with the administrator or were aware of the facts that caused the mentioned legal irregularities.

Also, the right to request the invalidity of the agreement in court can be exercised by shareholders, who represent at least 5% of the total votes in the General Assembly or less, as defined in the statute of the commercial company.[13]

[5] Article 13 point 3 of Law No.9901 dated 14.04.2008 “On entrepreneurs and commercial companies”, as amended.
[6] Ibid. article 13 point 3/a
[7] Ibid. article 13 point 3/b
[8] Ibid. article 13 point 3/c
[9] Ibid. article 13 point 3/ç
[10] Relation and tables on compatibility with ACQUIS of the draft law "On some additions and changes in law no. 9901, dt. 14.04.2008 "On merchants and commercial companies", amended, received by www.parlament.al, pg.7.
[11] Ibid
[12] Article 13 point 5 of Law No.9901 dated 14.04.2008 “On entrepreneurs and commercial companies”, as amended.
[13] Ibid article 151 point 2

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3. Prohibition of competition

The administrator or the members of the board of administration in joint stock companies cannot exercise competitive activity towards the company.[14] The following, are considered as competitive activity:

(i) employment in the function of administrator or other functions in companies that exercise commercial activity in the same economic sector;

(ii) maintaining the status of a merchant and exercising a commercial activity in the same economic sector, where he operates and the company in which the administrator is employed (Malltezi, 2011).[15]

The statute may provide that this prohibition may be repealed through a special authorization, given by the shareholders or by the General Assembly with three-fourths of the votes.[16] Also, the statute may provide that this prohibition may remain in force even after the loss of the qualities or the status mentioned in it, but not for a period longer than one year after the loss of this quality.[17]

If the administrator violates the prohibition of competition, the company can dismiss him from the duty,[18] require from the administrator to stop the competitive activity[19] or file a lawsuit for the compensation of the damage occurred.[20] The legislator offers the possibility of reconciliation between the parties by suggesting that in exchange of the lawsuit for the compensation of the damage, the administrator may:

(i) accept that the transactions carried out on his/her account are transferred to the account of the company;[21]

(ii) transfer to the company all the benefits received from performing actions on behalf of third parties;[22]

(iii) transfer to the company all credit rights, which have resulted from the performance of actions on behalf of third parties.[23]

The claim for termination of competitive activity and compensation for damages is prescribed after three years from the date of commission of such violation.[24] This provision, although it is a novelty for the Company Law, has found broad application in the judicial practice. The following illustration brings the case where a shareholder and administrator are sued by the company due to the violation of the obligation not to engage in competitive activity. Company X, with the object of activity in transporting goods and passengers, has 12 shareholders, including shareholder A, who for several years has exercised the functions of the company's administrator. After several years of activity, the company filed a lawsuit in court against shareholder A., requesting the exclusion of the latter for a number of reasons, among which the fact that shareholder A. committed unfair competition against the company, while he was a shareholder of the company and owned 50% of the shares of another company, which also had the same object of activity.[25] The court in this case emphasizes that it cannot find unfair competition, since the object of company Y, according to its basic documents published in NRC, is much wider than that of company X, including import-export of goods, wholesale and retail trade, real estate agency and etc.[26] I do agree with the reasoning of the court that the exercise of competition would have been proven with concrete facts/evidences, which demonstrate that company Y, where the partner owns 50% of the shares, carries the same economic activity, but, on the other hand, this argument is not sustainable if we consider that the law does not require the definition of the commercial object of the company activity in the statute. The companies in question could have the statutory provision on how any legal activity can be an object, but this cannot be considered as evidence that the entities are or are not competitors (Malltezi, 2011).

[14] Ibid article 17
[15] Ibid article 17 point 1
[16] Ibid article 17 point 2
[17] Ibid article 17 point 3
[18] Ibid article 17 point 4/a
[19] Ibid article 17 point 4/b
[20] Ibid article 17 point 4/c
[21] Ibid article 17 point 5/a
[22] Ibid article 17 point 5/b
[23] Ibid article 17 point 5/c
[24] Ibid article 17 point 6
[25] Decision No.6896 dt. 28.07.2009 of Tirana First Instance Court
[26] Ibid

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Although the solution that the court has given to these claims may be controversial, the decision remains important due to the fact that such a provision is the innovation of the Company Law.

4. Conclusion

This paper, following a functional approach, has analyzed and critically evaluated the parameters of discipline of the administrator's behavior in joint stock companies in Albania. Specifically, the legal analysis showed that the Albanian legislator has been focused only on giving approval to the administrator from the board of administration or the supervisory council of the joint-stock company, in order to conclude agreements or enter into other relations with the company, rather than determining the manner of action of the administrator after the notification of the existence of the conflict of interest and the consequences in terms of the conflict of interest. As regards to the prohibition of competition, the legislator conditions the repeal of this prohibition only with the approval of the shareholders of the commercial company. In the framework of the prevention of conflict of interest, in addition to giving approval for the conclusion of agreements, I do suggest that the legislator should determine that approval must be given for certain commercial relations or transactions and the administrator's method of action after notification of the existence of a conflict of interest must be conditioned on the non-participation of the administrator during the examination of the conditions and nature of the object of interest, as he/she may influence the members of these bodies of the company for his/her own interests. Also, regarding the consequences in terms of conflict of interest, the legislator may determine that the approval can be given even after the conclusion of the agreement, if it is concluded that this agreement is in the interest of the company, otherwise the approval is rejected and the administrator will be charged with the damages suffered by the company. Based on the problems encountered in practice regarding the administrator's use of the company's business opportunities for personal interests and the lack of treatment of this concept both in the legislation and in the Albanian doctrine, it is necessary to be determined that the administrator should not take advantage of the opportunities of the company for personal interests, except when the company rejects it.

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