
Seizing the opportunity for effective legal reform in Albania

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Well designed company law helps protect investors and, thus, encourage investment. Positive reforms to company law help improve a country's business environment and stimulate the economy.

In Albania, the road to reform was bumpy at first. “We adopted our first company law¹ in November 1992, a couple of months after the transition to a market economy started,” explained a government official. The 1992 law was essentially a simplified version of France and Germany's company laws. As a result, the legislation wasn't tailored to fit the realities faced by Albanian companies. Certain provisions were too advanced for the Albanian business structures while others were inadequate. For example, the law referred to publicly-listed companies when a stock exchange was not yet viable in Albania.

Due to the law's inadequacies, the process of incorporating a company was overly complicated, minority investors were not protected and companies were not required to produce financial information.

In 2006 going into 2007—nearly 15 years after the adoption of the first company law—Albania's government, legal and business communities all felt the need for a new commercial legal framework. It was time to seize the opportunity to reform effectively. This time, Albania's government proceeded carefully, consulted with international experts and local stakeholders—and finally, in 2008, passed a company law designed to make a difference in the long term.

Albanian investors' difficulties (pre-2008)

In 2006, the European Bank of Reconstruction and Development² (EBRD) published an evaluation of Albania's commercial legislation. The study revealed several problems. First of all, financial information was difficult to access. Second, there was little to do to break through corporations' lack of transparency, especially when controlling shareholders refused to collaborate with minority shareholders. Furthermore, the absence of case law hampered legal proceedings. The study also found that company information, when available, was generally unreliable and that statutory auditors were often unable to act independently.

Moreover, in 2007, *Doing Business* ranked Albania as one of the countries with the weakest minority investors protections in the world, due to cases of self-dealing—i.e., the use by company insiders of corporate assets for personal gain.

Self-dealing was a problem for 3 main reasons:

- 1) Inadequate approval and disclosure requirements in cases of related-party transactions;
- 2) Weak legal instruments for minority investors to defend their rights before the courts;
- 3) The lack of access to evidence to prove directors' misconduct.

It was clearly time for change. “We wanted to change this reality and improve our laws in order to become more competitive in the region,” said a government official involved in the process of reform after 2007’s poor showing in the *Doing Business* report. “Many international organizations were ready to help. We had both internal and international support. Now the challenge was to start the reform process,” the official explained.

Growing momentum for reform

Around the same time, there was another push for reform. In June 2006, Albania signed the Stabilization and Association Agreement (SAA) with the European Union (EU). As a result, Albania is considered a potential candidate for EU accession.

As was the case for many candidate countries, Albania benefited from funding in order to jumpstart reform in areas relevant to EU membership. It needed to prepare itself for the incorporation of the existing body of law which is called in EU jargon the *acquis communautaire* (or *European acquis*)³ into its domestic legal framework. The body of the European *acquis* deals with issues as diverse as telecommunication, agriculture, immigration, commercial law and corporate governance.

This was a great push for reform. With all the excitement of a potential EU accession, Albania’s government, parliament, private sector and donors were very active and ready to encourage and facilitate any reform processes that could expedite access to the EU common market.

The drafting team and their steps to reform

The government—mainly the Ministry of Economy, Trade and Energy—and the donor community—the EU, German Development Agency (GTZ) and the United States Development Agency (USAID)—agreed that reforming 1992’s company law was critical for Albania. GTZ appointed two experts⁴ to draft the new law.

There were several important considerations for the experts:

- The new law's harmonization with EU company law and standards;
- The new law's compliance with EU corporate governance directives;
- The fulfillment of the EU's SAA recommendations for Albania;
- The internal harmonization of the law with the existing realities of the Albanian civil and commercial laws.

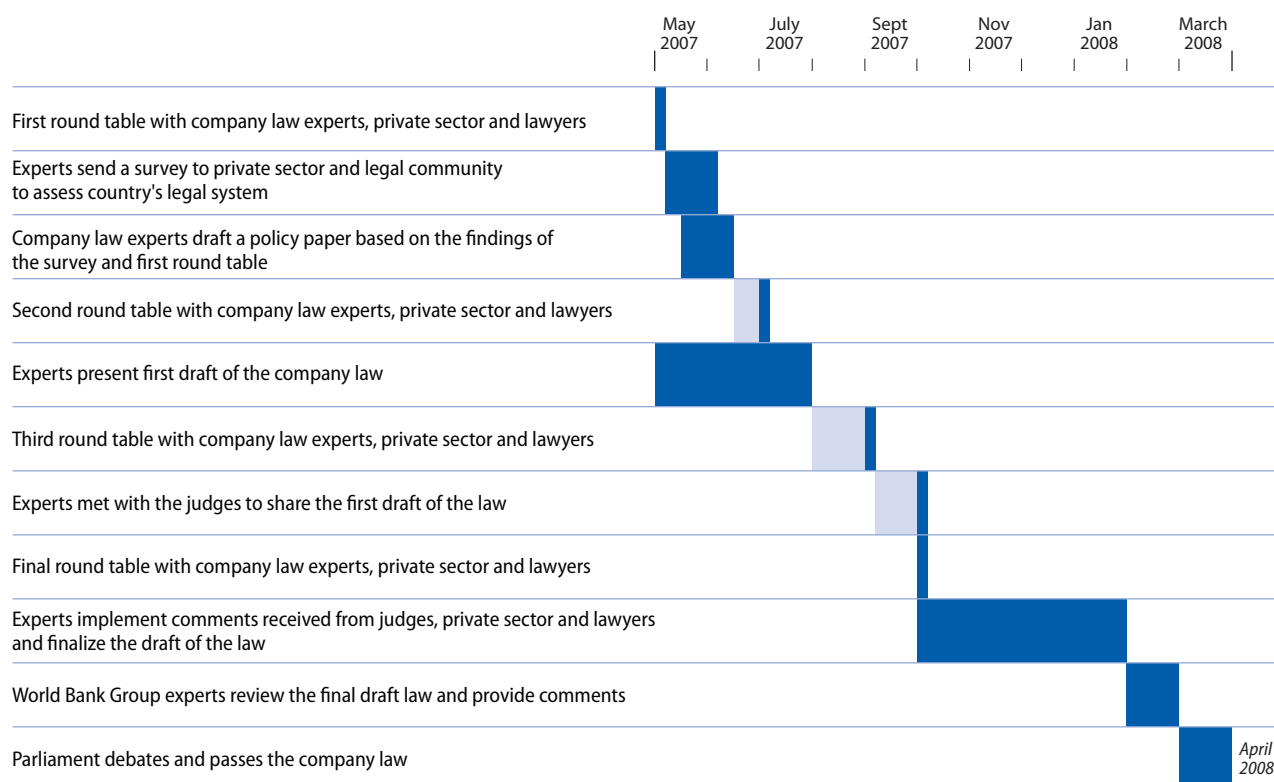
The experts organized their first roundtable discussion with stakeholders on May 8, 2007 (figure 1). Participants at the roundtable included members of the Albanian business and legal communities, as well as international donor agencies.

Inspired by the discussions during the roundtables, the experts created a survey that was discussed with the relevant ministries and then disseminated to the participants. The purpose of this survey was to identify priority areas for

FIGURE 1

Protecting investors reform in Albania

Source: Doing Business database.



reform from the perspective of the participants. Among their higher priorities, stakeholders chose: 1) minority investor protections, 2) clarification of director responsibilities, and 3) obligations in the governance of single-member companies. All three areas would help protect investors in Albania going forward. Then, by the end of May 2007, the experts drafted a policy paper based on the results of the survey.

From June 14th to 19th, 2007, experts carried out a second roundtable to discuss the final version of their policy paper on the company law reform. They also presented the potential new structure of the law.

The first draft of the new company law was completed ahead of schedule on July 16, 2007. It was promptly sent to GTZ for translation and distribution. From September 11th to 16th of the same year, experts organized a third roundtable to discuss the details of the draft now titled “Law on Entrepreneurs and Companies” (hereinafter referred to as “the new law”) with Albanian and foreign legal and business communities. The suggestions that came out of this meeting included ways to harmonize the draft new law with the existing Albanian legislation—such as the criminal and civil code—by cross-referencing several legal provisions.

In addition, the experts agreed to hold a special roundtable with Albanian judges in October 2007. At this meeting, procedural and implementation issues—including the harmonization of the draft new law’s terminology with the country’s other pieces of legislation—were discussed. Subsequently, experts organized a final meeting with private-sector lawyers in order to ensure that the correct terminology was used. This final step helped ease the new law’s implementation in the Albanian system.

Meetings were also held with the Ministry of Finance’s Legislation Department because another team was drafting a new Securities Law around the same time. Ensuring a coherent and uniform approach to both legislations was very important for their individual and joint successes.

Benchmarking a draft of the new law

In February 2008, a draft of the new law was delivered for approval to Albania’s Parliament. At this time, the government was interested in knowing the likely impact of the new law on Albania’s *Doing Business* rank. As it turned out, the new law had direct implications for the *Doing Business* “protecting investors” indicator. Therefore, the government requested the World Bank’s Foreign Investment Advisory Services (FIAS) Doing Business Reform Unit to review the draft new law and to provide a diagnostic of the new legislation.

The *Doing Business* Reform Unit reviewed the draft and informed that the new law would indeed help improve Albania's ranking in the "protecting investors" indicator. The draft contained important improvements. For example, it defined and clarified director duties and made it easier to sue directors in cases of self-dealing. However, access to corporate information was still extremely limited and disclosure obligations were not sufficiently rigorous. As a result, Albania's ranking would not have improved significantly.

The *Doing Business* Reform Unit recommended modifications to the new law regarding disclosure and access to corporate information. Albania's government was informed that if the Parliament were to incorporate the World Bank recommendations, the country be ranked among the top 20 best performers in the "protecting investors" indicator.

The government implemented the modifications and presented the ranking simulations to the Parliament in March 2008. After consideration by the Council of Ministers and the Parliament, the proposal was unanimously enacted on 14 April as Law No. 9901 "On Entrepreneurs and Companies."

What does the new law do?

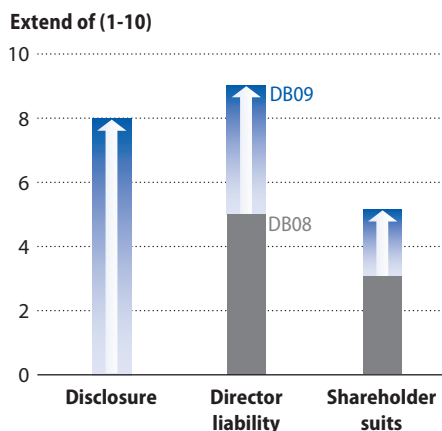
The new law regulates against directors' self-dealing by (figure 2):

- Clearly defining the duties of company board of directors and management;
- Requiring extensive disclosures for related-party transactions;
- Requiring disinterested shareholders' approval of large related-party transactions;
- Expanding access to corporate information.

Previous legislation gave board members, directors and shareholders broad and imprecise responsibilities. In contrast, the new legislation presents distinct duties for a company's management and board of directors and, thus, better protects investors.

FIGURE 2

Protecting investors in Albania: Big improvements



Source: *Doing Business* database.

Specifically, under the new law, directors have the obligation to fulfill their duties in good faith and place the best interests of the company above their own personal interests. Directors also have the obligation to disclose to shareholders all information necessary to make informed decisions. The new law also forbids directors and individuals with decision-making authority over the company from diverting to themselves or to other persons a business opportunity that belongs to the corporation—without a legitimate cause. Moreover, they cannot favor a shareholder or group of shareholders at the expense of others. Nor can they vote on issues in which they have a conflict of interest.

Regarding disclosure, interested parties now have to comply with precise transparency requirements. As soon as directors learn that they have interests in a certain transaction, they must disclose in great detail their conflict of interest. Then, as soon as the board of directors learns that a director has interests in a transaction, the board must appoint an external, independent auditor. The independent auditor has to evaluate the terms of the transaction and present a report to the board of directors and a meeting of the shareholders. After the transaction takes place, directors must record all relevant information regarding the transaction in the company's annual report.

The new law also regulates the approval process for large, related-party transactions. Specifically, it requires shareholders' approval of related-party transactions representing more than 5% of the assets of the company. And if the transaction represents less than 5% of the company's assets, it requires the board of directors' approval. Regardless of the transaction's value, directors with vested interests are not allowed to participate at any stage of the approval process.

Another important feature of the new law is increased access to corporate information for shareholders. With the new law, shareholders are allowed to access all the company's corporate documents—i.e., board minutes, shareholder meeting minutes, company books, financial statements and purchase agreements—with the exception of corporate secrets. And if management refuses to provide adequate information, shareholders can request a court-appointed inspector who is granted the power to access all corporate documentation. "Thanks to these new provisions, shareholders will be able to monitor the activities of the management of companies... and, of course, gather useful evidence to prove directors' misconduct," explained a well-respected Albanian corporate lawyer.

Besides prohibiting self-dealing, the new law effectively regulates single-member and holding companies (that is to say, groups of companies). Furthermore, the new law promotes clear obligations for maintaining accurate and reliable information. The new law also strengthens transparency and availability of

financial information by specifying responsibilities of directors. These financial obligations are also supported by two new laws: the “Law on the National Registration Center” (requiring the publication of annual reports) and the “Law on Accounting” (strengthening domestic accounting standards). Finally, the new law introduces provisions that facilitate the internal administration of a company. For example, the new law allows the use of videoconferencing for shareholders meetings and the use of proxies. These provisions had already existed in some companies’ bylaws, however, reformers thought that it was better to require these practices by law in order to ensure their correct application and make them enforceable.

Results: Modern legislation for a transparent system and a good base for more reforms

Initial signs show that entrepreneurs, investors and legal practitioners are happy with the new law. It modernizes corporate legal practices in Albania while creating a more reliable legal framework that could attract more investment in the future.

However, experts say it is still too early to see concrete results in the form of investment. Furthermore, the current global financial crisis has made both foreign and domestic investors extremely conservative.

Finally, it is important to point out that Albania’s reform processes should have a positive impact in the long run. In the meantime, reformers continue working on related reforms. Just a few days after the adoption of the new law, the government of Albania also adopted a new securities law.

“With good legislations, now we can train our judges in order to ensure the correct application and enforceability of these laws”.

Challenges ahead—the law’s application and enforcement by the courts

Challenges remain. Reports by donors and development organizations have noted that Albania’s courts lack experience and competence in corporate law. Some have highlighted the courts’ potential biases in favor of powerful defendants.⁵ The EU-funded Twinning Project has granted €1 million to enhance Albania’s judicial system in commercial matters. So far, the project has presented the following recommendations to bring Albanian law in line with European standards and improve business environment:

- Adapt its civil code to meet EU requirements regarding company law, unfair competition, insolvency, consumer protection and dispute settlements.
- Enhance judges’ specialized knowledge of commercial matters through

restricting their current mobility.

- Concentrate commercial cases in fewer district courts to improve efficiency.
- Monitor court proceedings.

Improvements in the judicial system are fundamental for law enforcement. As the head of the European Commission Delegation in Tirana explained, these improvements should “... lead to increased confidence from the public and the business community... [and] positively affect private sector development—in particular, foreign direct investment, because investors rely on the proper application of law, and a measure of predictability in conducting their business.”

Another step to further improve Albania’s legal environment for businesses would be to establish a designated Commercial Court in order to consolidate the handling of commercial disputes. The new law made no substantial changes to the way disputes and complaints are dealt with by existing Albania’s courts. As an additional step, the establishment of a Commercial Court could help ensure that the relevant proceedings are effectively handled with a specialized focus.

Next steps for a comprehensive business law reform project

Since Albania’s new law was passed in 2008, experts have turned their attention to the need for an effective “takeover law”⁶—which, they say, is now the most urgent piece of legislation for reform. At press time, this remains urgent: Albania’s government recently informed the public of its plans to privatize strategic state-owned enterprises. Privatization should attract significant foreign investment, so a solid legal framework regulating the acquisition of controlling stakes in these enterprises is crucial.

It is important to note that the new company law was designed to work integrally with Albania’s securities law. The creation of a takeover law that is closely coordinated with the securities and company laws would complete a well-designed web of closely-knit laws for business reform.

During the last few months, Albania has started to review its Civil Procedure Code. The government’s ultimate goal is to reform the Civil Procedure Code in order to facilitate access to evidence and the oral questioning process of parties and witnesses.

Lessons learned

One of the most important lessons learned from the new law is the benefit of collaboration among international donor organizations, local experts and

international experts. This multilateral approach helped build trust in new legislation—and helped the new law pass unanimously by Albania’s Parliament. Even rival political parties agreed to back the new law together.

Finally, reformers noted the importance of recognizing local realities during the drafting process, rather than imposing the law of another state as a “one-size fits all” model. In the past, Albania had adopted law copied from other countries without taking its unique realities into consideration. However, this time reformers changed their approach and involved local practitioners to draft a better law. As one of the private-sector lawyers involved in this reform explained: “Reforms are much more likely to be successful if they take into consideration local realities, and the manner in which commercial legal norms have evolved over time in the Albanian legal environment.”

Notes

1. Law on Commercial Companies N. 7638 – 11-12-1992.
2. “Commercial Laws in Albania. An Assessment by the EBRD,” April 2006.
3. Term used in European Union law to refer to the total body of EU laws accumulated thus far.
4. Ms. Janet Dine and Mr. Michael Blecher, who are also authors of a text on European company law and the EU *acquis*.
5. For example, see: “Commercial Laws in Albania. An Assessment by the EBRD,” April 2006.
6. A “takeover law” should ensure that transparent and public bids are made for a target company in a takeover and that an authorized supervisory body oversees the bids.