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MINIMIZING THE AGENCY PROBLEM AND ALIGNING THE INTERESTS IN INTERNATIONAL COMMERCIAL AGENCY

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Abstract

Purpose of the current research is how to ensure the balance of rights and lawful interests for the participants in legal relations of representation (agent, principal, third parties) in international commercial agency from the perspective of civil law and common law. Even though, the perception of legal institutions via just these legal systems has been widely critiqued as being too simplistic on both theoretical and empirical grounds (Coffee, 2001; Armour, at al., 2009), a closer look at these systems shows that approaches vary greatly regarding what mechanisms of controlling and minimizing the conflicts of interests are the most effective (Filatotchev, Jackson, & Nakajima, 2013, p. 975).

Design/methodology/approach in the research paper will be mainly aimed at revealing all the significant features of aligning the interests of commercial agency actors in common law and civil legal systems. The scientific work is based on the view and principles of qualitative methodology as it permits a study of a discrete phenomenon in order to discover its new perspectives without the need to come to a preliminary view on the nature of the problem set.

Findings. The analysis of scientific works has shown that agency theory is regarded as very pragmatic and widely applied. It has roots in different academic fields and its usefulness is very extensive and prominent. Nevertheless, the theory is vastly "under-theorized" as there has been no unified explanation or theory adopted on how legal and social environments shape the identities, interactions and interests among participants to agency relations in different countries.

International commercial agency usually implies the relationship of at least two of the participants (agent and principal) are located in different countries where an agent who is properly authorized performs legal acts on the principal's behalf (Bonell, 2018, p. 24). However, agency relationships are extremely complex and usually involve many participants, whose interests might be misaligned, thus, diminishing the quality of agency and increasing agency costs. The misalignment of interests between the participants to international commercial agency arises when the agency requires personal costs from the agent during the performance of actions directed at maximizing the principal's welfare. In other words, when the agency becomes not equally beneficial or even unprofitable for one of its participants, the agency problem arises. The most frequent reason of misalignment is the information asymmetry that influences agents' decisions and creates a systemic gap in the incentives of both the principal and the agent.

All mechanisms focused on minimizing agency conflicts are mainly aimed to minimize agency costs, leaving behind the importance to align the interests of the participants to such relationships, in the first place. The difference of interests may also cause the problem of unauthorized agency that severely diminishes the quality of agency relationships when the agent ignores the limits of the issued authority in order to get the agreed commission fee (Busch & Macgregor, 2009).

Research limitations/implications. The conflict of interest and agency costs arise due to the different risk preferences, information asymmetry and moral hazards. Scientists have developed many mechanisms in order to constraint opportunism of the agents acting on behalf of their principals (such as strong ownership control, compensation, etc.).

To balance the incentives of all participants to commercial agency, a good system of legal regulation should be developed in order to show the level of alignment of the parties' interestsю The main emphasis within

the current research is put on describing the mechanisms designed to minimize agency conflicts and align the interests of the participants to agency relationships in case their interests within are not properly aligned.

Practical implications Legal framework is extremely important in minimizing agency conflicts, since it sets the rules, under which the businesses and agents are expected to perform, however, this is not universally applicable. Courts are usually reluctant to interfere into the commercial decision with the constraint mechanisms either because they lack sufficient experience or such interference will slow up the pace of commerce (Lesini v Westrip Holdings Ltd, 2009, p. 85).

When it comes to the international and European legal framework, currently no standard legislation exists, neither nationally, nor internationally. European Community (EC) Directive on Electronic Commerce is based on the UNICITRAL Model Law on Software Commerce, however, unlike UNCITRAL is binding upon each Member State to which it is addressed, but it is left to the national authorities to choose the form and methods (Directive 2000/31/EC, 2000). This problem becomes even more crucial when the transactions are performed internationally, and the problem arises what national law has to be used, especially when there was no explicit agreement made on the applicable law in the general terms and conditions of the contract.

Originality/Value of the research is justified by the fact that no deep comprehensive international research has been provided in respect of the determination of agency conflicts in commercial law, ways of their minimization and control from the perspectives of civil law and common law. Common law terminology is currently prevailing in the international trade due to the simplicity of its application, in comparison to the continental vision. However, the agency theory in common law has developed in its distinctive manner and its exploration may be useful for comprehensive understanding of the problem and finding the most suitable unified solution.

Keywords: private international law; agent; commercial agency; agency problem; alignment of interests.

Research type: research paper.

JEL classification: K12, K15 K20.

Introduction

Agency relationships are currently representing an inherent part of modern commercial reality. It has roots in different academic fields and its usefulness is very extensive and prominent. Evidences are found in accounting (Watts & Zimmerman, 1983) finance (Fama & Jensen, 1983), economics (Jensen & Meckling, 1976), sociology (Adams, 1996) and marketing (Bergen, Dutta, & Walker, 1992).

The very concept of agency describes fiduciary relationships delegation as the only possible way to reach the common goal. As far as international commercial agency is concerned, it usually implies that at least two of the participants (agent and principal) are located in different states where an agent performs legal acts, and is authorized to act, on behalf of the principal (Bonell, 2018, p. 24). Therefore, in theory international commercial agency relations are equally beneficial for both parties, however, they are also extremely complex and usually involve many participants, whose interests might be misaligned, affecting the efficiency of agency relationships and increasing agency costs.

Even though in theory the interests of all the participants are aligned and share same objectives, in practice the level of awareness differs among them, which leads to numerous conflicts of interest.

The problem of misalignment of interests within agency relationships and conflicts that appear as a result of the former is very actual nowadays, however, the analysis of scientific works

written by Fridman (1996), Munday (2010), Powell (1951), Saintier & Scholes (2017) has shown that agency theory is vastly "under-theorized" as there has been no unified explanation or theory adopted on how legal and social environments shape the interests and interactions among agency participants in different countries.

This issue was also raised in the works of Reynolds (2018), Wyse (1979), Foriers & Jafferali (2005), etc. who tried to find an adequate legal solution to the agency problem, and align the parties' interests in order to increase the quality of agency relationships and minimize the possible negative consequences.

Profound differences could be found in different jurisdictions regarding the principals' rights and duties, commission regulation, organization of basic elements of agency. The conflict of interests and agency costs have been always a crucial part of the relationship and every organization has possibly suffered from this problem in different forms.

The most frequent reason of misalignment is the information asymmetry that influences agents' decisions and creates a systemic gap in the incentives of both the principal and the agent. Conflict between the principal and agent arises when the agency requires personal costs from the agent during the performance of actions directed at maximizing the principal's welfare. In other words, when the agency becomes not equally beneficial or even unprofitable for one of its participants, the agency problem arises.

According to Boshkoska (2015), agency problems can be inconsistent with the shareholders' incentive to wealth maximization. However, Brennan (1995) argues that most agency problems arise out of impossibility to predict every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal where ownership structure is diverse and corporate managers do not control the majority of shares.

Cho (1998), Himmelberg et al. (1999) and Aguilera et al. (2008) have developed many mechanisms in order to constraint opportunism of the agents acting on behalf of their principals (such as strong ownership control, compensation schemes, etc.). All mechanisms designed to minimize agency conflicts and align the interests of the participants to agency relationships, are mainly focused on minimizing agency costs that are higher when the interests within agency relationships are not properly aligned. Moreover, according to Busch & Macgregor (2009, p. 971) in cases of so-called malfunctioning agency, the problem of unauthorized agency may take place that severely diminishes the quality of agency relationships. This may bring an undesirable result to the principal caused by the agent acting against the instructions or ignoring the limits of authority in order to get the agreed commission fee.

Following the formulated purpose of the research to ensure the balance of rights and lawful interests for the participants in legal relations of representation (agent, principal, third parties) in

international commercial agency from the comparative perspective, the research will be conducted by contrasting the problem of aligning the interest of commercial agency actors and mechanisms of its solution in Civil Codes of countries with civil law and common law legal systems along with the mentioning of international sources of commercial agency regulation.

The divergence of approaches may be seen not only in different legal systems but also within one legal system. This statement only proves that basic principal-agent problem is shaped not only by the legal framework, but also by constitutional background and cultural features within certain legal relationships.

The need for such research is stipulated by the fact that no comprehensive international analysis has been provided in respect of the determination of agency conflicts, ways of their minimization and control from the perspectives of civil law and common law. Therefore, scientific value of the current research is also justified by the fact that a deep comparative analysis of the mechanisms of aligning the interests in commercial agency from the perspective of common law is absent nowadays.

1. Legal mechanisms of minimizing the agency problem

Agency is one of the central and most important areas of commercial law that is based on the fiduciary relationships between all the subjects, whose interests, in theory, are aligned towards the same goal. However, agents, principals and third parties do not always fully share common objectives. Even though, their interests are interwoven, the level of awareness differs among participants to agency relationships, which leads to numerous conflicts of interest.

As far as international commercial agency is concerned, it usually implies that at least two of the participants (agent and principal) are located in different states where an agent performs legal acts, and is authorized to act, on behalf of the principal (Bonell, 2018).

The complete definition of the commercial agent is given in the Article 1(2) of the Directive86/653/EEC (1986) where the commercial agent id described as ‘a self-employed intermediary who has continuing authority to negotiate the sale or purchase of goods on behalf of another person, or to negotiate and conclude such transactions on behalf of and in the name of that principal.

Despite the definition in the Directive, commercial agents are self-employed actors, they are never completely independent, in fact, they are on the “half-way” between the employees and distributors position. They are always appointed by their principals to sell or purchase goods and/or services who have the full overview over the terms of the contracts and the goods the commercial agent is in charge of selling (Goode, Kronke, McKendrick, 2015). Moreover, commercial agents

must always remain separate legal personalities with the principal, which also excludes employment relationships from the concept of agency.

The Directive, however, reveals mostly the civil law approach that it is the agent who has always to be protected. Such approach goes in contrast with the common law understanding that tends to protect principal in the first turn (Bowstead & Reynolds, 2014, para. 1-040). Despite the protection issues, profound differences in agency regulation could be found with regard to the issues of liability and compensation that can often mislead agents acting in two different systems simultaneously, like in case with international commercial agency.

Penetrating the foreign market, the principal requires the agent's knowledge and local connections in order to avoid the unnecessary commitments required by the establishment of a branch or subsidiary. The agent, on the other hand, gets a commission for the work done and other remuneration under the contract.

Therefore, in theory international commercial agency relations are equally beneficial for both parties; however, possessing more information about the state of affairs, agents may use it for their own benefit, not taking into account the interests of principals. Such inequality would necessarily lead to the situation of moral hazard affecting also the costs to principal-agent relationship (La Porta, et al., 2000). For this reason, it is essential to examine the reasons triggering the misalignment of incentives among participants to agency in order to minimize the negative consequences, including agency costs.

Conflict between the principal and agent arises when the agency requires personal costs from the agent during the performance of actions directed at maximizing the principal's welfare. In other words, when the agency becomes not equally beneficial or unprofitable for one of its participants, the agency problem arises.

Among the most frequent reasons that lead to the conflicts of interests between the principal and agent, there are:

1. Information asymmetries that could lead to problems, since agents are usually aware about all the information related to the business, while owners depend upon the managers to get the information. Therefore, the awareness may differ greatly (Chowdhury, 2004).

2. Managerial risk aversion may cause agency problems as principals and agents have different risk preferences. Agents will attempt to reduce their personal exposure to risk through corporate diversification and will prefer projects with a small risk, even though they are less profitable (Jensen & Meckling, 1976). Principals, in their turn, are considered risk-neutral, since they diversify their shares in multiple companies.

3. Moral hazard is another source of agency problem that results from information asymmetries. Moral hazard occurs when managers and owners have different objectives. For

example, agents consume private perquisites rather than investing or agents invest in projects specific to their skills to increase their value to the company, even though it would bring harm to the owners of the company (La Porta, et al., 2000). Moral hazard problems are more likely to arise in large, mature companies as the complexity of the firm's contracting nexus is higher there too.

Mostly, agency problems arise when managers as agents of shareholders (principals) tend to perform self-serving behavior that is sometimes inconsistent with the shareholders' interests. However, Brennan argues that most agency problems arise out of the impossibility to predict every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal where ownership structure is diverse and corporate managers do not control the majority of shares (1995, p. 14).

Legal framework also plays a crucial role in minimizing agency conflicts, since it sets the rules, under which the businesses and agents are expected to perform, however, this is not universally applicable. In the United Kingdom, for instance, the reliance on law to control agency problems is relatively small and large corporations have to develop their own mechanisms in order to control their agents.

Being based on the system of judicial precedent, English law require the courts to introduce constraint mechanisms, but in practice courts have remained reluctant to interfere into the commercial decision making either because they lack sufficient experience or knowledge to decide commercial matters and, moreover, such interference might slow up the pace of commerce (Lesini v Westrip Holdings Ltd, 2009, para. 85).

When it comes to the international and European legal framework, currently no internationally adopted standard legislation exists. Most of the countries modern commercial agency, distributorship, and franchising contracts have been governed by the general principles of tort and contract law. Even though those principles managed to provide the basis for the principal's liability for agent's contracts and torts, they fail to explain the doctrine comprehensively (Dalley, 2010). This is especially obvious in the light of new economy that has made certain adjustments to the functioning of businesses in the modern world.

One more closely related point is the effectiveness of these mechanisms in different types of firms and between actors with differences in interests, since there is no universal set of conflicts between agents and principals that may be resolved in the same way. For this reason, the effectiveness of all these mechanisms greatly depends on the firm's specific legal environment, since the contracting nexus varies from one firm to another.

2. Aligning the interests of subjects to international commercial agency by minimizing the agency costs

Mechanisms to align the incentives of agents and principals in the commercial agency relationships are meant to solve the agency problem in the most efficient way; nevertheless, they will always be captured by financial markets and reflected in agency costs. Vargas & Cruz (2018) define the divergence of interests between the principal and the agent that creates conflicts and results in agency costs.

Agency costs arise when the interests of the participants to agency relationship are not aligned and take the form of preference for making self-interested decisions that reduce principal's wealth (Ang, Cole & Wuh, 2000, p. 83). Therefore, it is generally assumed that the best way to solve the agency problem is to align the interests of principals and agents with the minimum costs.

After providing an analysis of scientific literature, several definitions of agency costs may be found. They are usually regarded as internal costs that arise out of the misalignment of interests between the participants to the agency relationships. Agency costs consist of the cost of examining and picking up a suitable agent, collecting of information to fix performance benchmarks, watching to control the agent's action, bonding costs and the loss due to the inefficient decisions of the agents (Panda & Leepsa, 2017, p. 85). Jensen & Meckling (1976), however, define agency costs as the aggregate of monitoring costs, bonding costs and residual loss.

Monitoring costs are costs incurred by principals to monitor, measure, observe and control the agents' behavior. These can be audit fees, costs of establishing a compensation plan, costs to impose budget restrictions, and costs incurred to establish operating rules (Nugraha et.al, 2021). Bonding costs are usually incurred by agents because of existing mechanisms so that agents comply with the instructions of the principals (Ayunitha, 2020). For instance, bonding costs can arise when managers provide financial reports, where these costs might be incurred while reducing monitoring costs. Residual loss, in its turn, arises when managers perform self-serving behavior and take actions that do not align with the principal's aim of value maximization.

Agency costs are real losses that are incurred by principals to assure that agents are acting in their best interests. The issue of high agency costs and their influence on the general value of the agency relationship becomes especially crucial for the principals conducting business in civil law legal system where they are considered financially stronger and obliged to assume all the risks in case the agent is acting outside the scope of his authority. Therefore, when it comes to liability, usually principals are liable to third parties for the actions of their agents. In order to avoid liability, businesses have to maintain strict control over agents, which results into bearing of additional costs

that are ultimately included into the final price of goods or services, making the agency, as a way of implementation of civil rights, not so efficient (Jurkevičius & Bublienė, 2017, p. 73).

To reduce agency costs scientists have introduced many mechanisms that are based on the optimal contracting relationships in order to minimize the damage to the principal’s wealth. Kole (1995, p. 416) proposed strong arguments that large divergences in interests between principals and agents could be found across the firms in different contracting environments, legal systems and cultures. Therefore, mechanisms of regulation and minimizing agency costs and agency conflicts also differ from state to state and from one legal system to another.

However Mahoney (2004) is convinced that good corporate governance, which is deemed to protect the interests of all parties to the agency relationship, can solve agency problems. The biggest problem of corporate governance is to align the interests of all participants (shareholders, board of directors, board of managers, the managers, the government, the employees, the clients, the suppliers, the regulation officers, the media, the investors etc.), who are dependent on regulatory enforcement, efficient capital markets, accounting standards and the legal tradition they are performing in.

Some scholars like Cho (1998) and Himmelberg et al. (1999) offer an ‘open-system’ approach that considers corporate governance practices as interdependent with the diversity, fluctuations, and uncertainties of their environment, and rejects universalistic ‘context-free’ propositions (Aguilera et al., 2008). Such practices are designed to shift the focus of corporate governing research towards the alignment of interests, creation of wealth and protection of agency parties, instead of only agency costs reduction.

Agency theory mentions the interrelation between the ownership structure and the reduction of agency costs. Hastori et al. (2015) argue that ownership concentration can influence the manager's behavior in order to reduce the agency costs. Therefore, in a company with the complete separation of ownership, the owners are not involved in the operation process and do not possess the same amount of the information as managers usually do. Managers performing agent’s functions are motivated by the self-interest, and most probably will use their power and knowledge to make a profit for themselves. Such opportunistic actions are impossible to predict, however, they will certainly have effect on both the principal’s welfare and his own.

This type of ownership along with a developed problem of coordination is especially sharp to “Anglo-Saxon model”. In contrast to corporations in Continental Europe, East Asia, India and emerging economies in other regions where dispersed ownership is more an exception than a rule (Filatotchev, et.al, 2013, p. 966). Separation of ownership causes serious conflicts of interests between shareholders and managers, and shareholders and creditors, since shareholders are passive and act more like investors, having different goals in profit maximization.

Contrasting to the complete separation of ownership and control, institutional ownership has proved to be effective in reducing the agency costs. In companies with such type of ownership, institutional shareholders are capable and are more motivated to monitor the agent's actions that positively affect agency costs. Institutional shareholders possess the relevant resources and expertise to monitor management decisions at a lower cost; moreover, they are more reliable in delivering of proper information (Henry, 2004). In addition, institutional shareholders own a certain percentage of shares that may still affect the preparation of financial statements and they are considered more professional in controlling their investment portfolios. For this reason, it can be inferred that institutional ownership affects operational expenses but has no significant influence on the efficient allocation of assets (Moez, 2018, p. 269).

As described in the Chapter 1 the most frequent reasons for the conflict of interest and agency costs to arise are different risk preferences, information asymmetry and moral hazards that usually occur because of a systemic gap between agent's and principal's social preferences. Agents start acting opportunistically and abuse the power granted to them in order to serve their own needs. For this reason, Jensen and Meckling described managerial ownership as a way of aligning the interests of shareholders and managers, which makes the manager work like an owner in the company and concentrate on the maximization of the company's value (1976). Such ownership structure allows agents to profit from incentive plans, acquisition of share capital that increases their motivation to serve the company's interests in favor of value maximization (Moez, 2018).

However, in the literature, this relationship has not been not found to be linear. Jensen and Meckling (1976) still describe a monotonic relationship, where managerial ownership helps to reduce agency costs only at a lower level of managerial ownership, however, agency costs increase when a certain level of managerial ownership reached (Khan, et. al, 2020, p. 160).

In addition, prior studies in the sphere of agency problem have mentioned concentration of ownership as the most effective type of ownership that minimizes the agency problem and reduces the agency costs (Shleifer & Vishny, 1986). With this scenario, shareholders are able to control managers and maximize the resource allocation, thus minimizing the conflicts of interests, information asymmetry and agency costs. Ownership concentration also allows rationalizing decision-making about investment and dividend distribution, thus introducing and greater financial discipline between the agents.

However, concentrated ownership is also described ambivalently, since it might cause new conflicts between majority and minority shareholders (Hu & Izumida, 2008). Therefore, in countries where minority shareholders' interests do not enjoy adequate legal protection, an extensive expropriation of minority shareholders by the controlling shareholders (like related-party transactions, assets stripping and other forms of 'tunneling' of revenue) may take place (La Porta

et.al., 2000). Ownership concentration has proved to be quite effective in the United Kingdom (Florackis, 2008), while Hastori et al. (2015) and found its ineffectiveness in Indonesia.

Moreover, ownership concentration may lead to a new type of agency problems described as a principal-principal conflict in family firms where family interests may dominate over the interests of non-family shareholders and create a preference toward family wealth (Young et. al. 2008). However, a high overlap between the controlling family and management may also lead to a weak monitoring and gives the opportunity for shareholder expropriation (Filatotchev, et. al., 2005).

From the mentioned above, it can be concluded that the structure of ownership indeed affects the agency costs. Some scholars have concluded that institutional ownership makes a positive effect on agency costs; however, it does not fully exclude the self-serving decision-making. Ownership concentration was proved quite effective structure where the agency costs are significantly reduced. At the same time, the latter can only work in legal systems with the extensive legal protection of minority shareholders.

High level of managerial ownership can align the interests of owners and managers and reduce both the agency problem and the costs (Jensen & Meckling, 1976). Indeed, managerial ownership does increase the managers' motivation to work for the company's value maximization. Since managers own certain amount of shares, they become more responsible for seeking profitable investment schemes as well as bearing shareholder risks.

However, except for aligning the interests, managerial ownership does not solve the problem of agency costs, contributing only to the reduction of the operational expenses mainly. Agents (in case they are not also shareholders) would focus on the increase of corporate growth and size, while principals would search for value maximization by looking at current value of cash flow driven by corporate investment (Rahmawati et al, 2018).

Therefore, it cannot be strictly defined what type of ownership is the most or the least effective when it comes to agency costs. The mechanisms of good governance together with the legal system within with these mechanisms are applied and the ownership structure help to mitigate the agency problem and reduce the agency costs.

3. Compensation schemes as a way of aligning the interests of participants to commercial agency

In theory, the commercial interests of the agent and the principal are aligned, rather than adverse. This is directly reflected in the concept of agency as a process of delegation where the agent provides a service and is remunerated for that by getting a commission for that.

A principal-agent relationship may also be considered a single economic unit unless the agent undertakes such commercial and financial risks that allow him to be considered an independent

subject in relations with third parties. In other words, the lower the level of risk assumed by the agent, the higher the possibility that two subjects can be considered a single economic unit (CEPSA Estaciones de Servicio SA v LV Tobar e Hijos SL, 2008).

It may be possible to rationalize the case law in the following way: where the agent and principal are no longer in a competitively neutral position towards each other, they cannot be considered as a part of a single undertaking and their commercial interests are no longer aligned (Bennett, 2013).

Whether the agency problem occurs at the internal or external level, a wide range of internal and external mechanisms should be introduced in order to align the interests of the participants to international commercial agency relationships.

Internal mechanisms come mainly from the contract terms, internal rewarding system and reveal the quality of agency relationships. Internal factors are more important under the theory of agency, since the success of the principal depends on the agent's efforts, and the latter is greatly influenced by the interrelations within the agency.

Indeed, the adoption of a proper compensation package can be used as a mechanism to align the incentives of agents and principals, and motivate them to work harder for the maximization the efficiency of the agency itself (Core, et. al., 1999).

The company's main aim will always be profit maximization with the set of compensation schemes that are available to the agent. Among these schemes, the one should be chosen that satisfies both the interests of the agent and maximizes the company's welfare. At the same time, companies, acting as principals in commercial agency relationships, are also willing to promote their corporate image, status and prestige. Therefore, sometimes they may sacrifice profit maximization for investing in environmental and social initiatives and organizing projects to help the poor that will contribute to increasing their prestige on the market (Lampert, 2016). Agents, in their turn, are less free in their actions, being sensible to profits; they are trying to choose the compensation package with the best coverage of their work done. Every action of the agent is usually associated with certain difficulties, expenses and time, therefore, reasonable compensation is needed to keep the agent motivated.

Remunerations are inherent outcomes of all commercial relationships and when are not satisfactory they can generate pathological incentives. For example, between two lawsuits the lawyer will always decide in favor of more profitable case that will look better in the "client's portfolio", consciously disregarding the cases of "less profitable clients" (Sacconi, 2011, p. 265).

Moreover, compensation schemes greatly depend on the ownership structure in a specific company. Agents are generally more exposed to personal risk, and in companies where the ownership is diversified they will prefer projects with a small risk level, even though they are less

profitable. Therefore, one of the ways to align the incentives of parties is to provide a reasonable amount of remuneration to the agent. In case, the commission is included, the amount of commission should also be counted according to the number of transactions concluded because of the agent’s actions in his territory or should depend on all orders received from the agent's territory.

Moreover, in most cases the agent possesses valuable information for the principal, however, he might be not motivated enough to share it. The reasons may be different: either it will not bring him any bonuses, or it will bring him more work he is not interested in.

Usually agent’s compensation does not depend on his performance, thus he puts less effort under the contract, being confident that he will get his compensation anyway. Nevertheless, situations are common when the principal does not perform an agreement either because of his own fault or due to the actions of the customer who, for example, does not pay the amounts due. In this case, the question arises, if the agent is still entitled to commission or only to the extent, the principal is responsible for the non-performance (Mykolska & Slipachuk, 2010).

Both the law and the court’s practice is ambiguous with regard to this question, however, making the agency serve for the benefit of both parties, the agent would not be entitled to commission in case of non-execution of the agreement by the principal (as well as the third party), unless otherwise provided for by the agency agreement. Such a principal-friendly principle may harm the interests of the agent, therefore, such terms and conditions should always be set out in the agency agreement/contract.

In order to maximize the professional self-interest and to ensure equality and impartiality under the agency agreement, some scientists suggest introducing an incentive contract that would provide an increased volume of damage compensation and diligently constrain the agents’ personal interest making them to treat all clients impartially, loyally and with the due care (Cenini, Luppi, & Parisi, 2011, p. 234).

An incentive contract includes a specification of “rewarded for luck” that might increase the agent’s incentive to take an active party in the relationship, increase the value of the agency itself and would motivate the parties to share valuable information, thus increasing the net income of the parties involved (Lubatkin, 2007, p. 59).

The contingency fee contract allows the agent (e.g. lawyer) to adjudicated amount: the higher the judgment, the more effort he puts into the case. The agent would be able to settle *ex post* the amount of damage compensation due to the time spent and the resources involved with the preservation of all loyalty and due care obligations. This would serve the agent a better economic incentive to do whatever is needed to obtain a judgment than a lawyer working under the conditional fees (Emons, 2006).

Nevertheless, there is not so much literature that would justify such an arrangement of payment because of legal and ethical considerations. Moreover, in some countries like Germany, India the conclusion of a “no win-no fee” arrangement between the lawyer and his clients has been completely banned for being against the public policy or condemned to be unworthy of legal profession (KL Gauba case, 1954).

Australia and the United Kingdom were also against the contingency fees until the reforms in 2018 and 2013 respectively, which allowed lawyers concluding a number of funding arrangements as per their needs. In the UK such agreements are known as ‘Damages Based Agreements’, and contribute greatly to the modern pace of commerce (UK: England Embraces Contingency Fees, 2013).

Contingency fee as a remunerations scheme for the agent seems to be a way out to install the fairness and equality in agency relationship. Nevertheless, the question arises, whether the agent possessing such a wide discretion of bargaining upon the compensation *ex post* would be compatible with the fiduciary duties under the agency contract. Indeed, contingent fee agreements might tempt the agent to overcharge a client by installing an excessive or unreasonable fee amount for richer clients, thus promoting a self-fulfilling behavior (Maurer et. al., 1998, p. 283). Therefore, goals of equal loyalty and impartiality might not be reached.

Moreover, the switch to the contingency fee method of compensation could make the lawyer reluctant to take a case even if it is within the sphere of his interests, because the lawyer bears all the costs of his time and obtains only a fraction of the benefit. Thus, the lawyer is not motivated to spend the proper amount of time on the case and simply wants to acquire the settlement instead of preparing the case for the trial (Polinsky & Rubinfeld, 2003, p. 166).

According to the view of Lester Brickman (2003) the lawyer who performs self-interest behavior and acts to the client’s detriment breaches his fiduciary obligation, which is a part of a more pervasive issue of professional responsibility.

Contingency-fee contracts require more powerful or extensive regulation, since some in order to increase the lawyer’s incentive to spend more hours on the case and prepare the case thoroughly, it is proposed to equalize the percentage of the reward received for the trial and the cost of litigation borne by the lawyer. Under such system the lawyer bears the same percentage of costs (time spent) as he obtains of the award, so his interests are aligned with the client’s and both of them are interested in the positive outcome of the case. At the same time, the conventional contingent fee arrangement usually implies that the reward obtained by the lawyer varies from 25 to 40 % and the percentage of the cost borne by the lawyer is usually 100% (Emons, 2006).

The offered solution might partially resolve the problem of lawyer's reluctance to assure that the clients' interests would be protected in the best possible way when making decisions regarding litigation strategy, settlement or alternative dispute resolution, not being dependent on the fee issue.

The abuse of fiduciary duties and impartiality also becomes possible because of the information asymmetry in agency relationships. Therefore, the agent (or the lawyer) should be responsible for disclosing all the information about the case, so the client is fully informed about all the possible alternatives in the case, especially when the case is international. When the agreement is mutually accepted, it reduces the probability of violating the principles of agency. Therefore, effective disclosure mechanisms are needed to ensure that information about the actions of agents can be 'verified' by the regulator.

4. Conclusions

The paper reveals the problem of the regulation of agency problem and mechanisms that are used to align the interests of the participants to international commercial agency relationships.

The conflict of interests and agency costs have always been a crucial part of agency and every organization has possibly suffered from this problem in different forms. Agency problems arise due to the different risk preferences, information asymmetry and moral hazard when the interests between the participants are not aligned. In such cases agency becomes not equally beneficial or even unprofitable for one (or all) of its participants, which will necessarily influence the costs spent on agency. Therefore, no matter how immaterial the alignment of interest might seem, businesses will always be dependent on financial component and seek to minimize the agency costs.

Agency costs greatly depend on the structure of ownership in a particular company. Some scholars have concluded that managerial ownership has a positive effect on agency costs, increasing managers' motivation to work for the company's value maximization. However, it cannot be strictly defined what type of ownership is the most or the least effective when it comes to agency costs. The mechanisms of good governance together with the legal system and the ownership structure helps to mitigate the agency problem and reduce the agency costs.

The adoption of a proper compensation package can be used as a mechanism to align the incentives of agents and principals, and motivate them to work harder. Compensation schemes adopted under the incentive contract might help in constraining the agent's opportunism and increase the volume of damage compensation to the agent that would promote impartiality, due diligence and loyalty in agency relationships. The contingent fee contract would give the agent a better economic incentive to do whatever is needed to obtain the best possible outcome in the principal's interests, not being dependent on the fee issue.

Even though legal framework is extremely important in minimizing agency conflicts, there is no universally applicable set of documents that would set the rules, under which the businesses and agents are expected to perform. Most of the countries modern commercial agency, distributorship, and franchising contracts have been governed by the general principles of tort and contract law. Even though those principles managed to provide the basis for the principal's liability for agent's contracts and torts, they fail to explain the doctrine comprehensively. This is especially obvious in the light of new economy that has made certain adjustments to the functioning of businesses in the modern world.

Irrespective of the chosen mechanism of elimination of the agency problem, the overall effectiveness of it would greatly depend on the specific legal environment and the adopted legislation. There is no universal set of conflicts between agents and principals that may be resolved in the same way and the mechanisms for resolution of agency conflicts and the costs vary from country to country, and from one company to another.

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