S.J.D. DISSERTATION

Internal governance structure and protection of shareholders’ rights in corporate governance in public corporations – comparative study between Uzbekistan, Germany and the United States

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ABSTRACT

The experience of the last few decades is showing the importance of regulating large scale corporations, both developed and developing countries have been on the path of reforms in corporate law and corporate governance. Problems such as agency conflicts, protection of minority shareholders, ensuring effectiveness of the corporation have been persistent. In this light, a developing country like Uzbekistan, which has recently been introduced to such issues, must be aware of the responses of developed countries such as Germany and the United States.

The thesis makes a comparative study between the corporate governance systems in public corporations of the three countries: Germany, the United States and Uzbekistan; in particular, the focus is on the allocation of powers within the corporation and protection of shareholders. The research analyzes the corporate governance systems through the prism of one-tier, two-tier and triangular structures, through in-depth analysis of the rights to appoint and remove corporate boards, as well as the rights and responsibilities of shareholders, the Management Board, the Supervisory Board and the Board of Directors.
INTRODUCTION

A. Scope of research

Corporate governance, in one form or another, has always been where the corporate form has caused the conflicts between investors and managers, starting with the East India Company and the Hudson Company; although the term “corporate governance” was scarcely used until the 1980-s. Despite numerous attempts to define corporate governance, by broadening or narrowing the scope of the definition, there is no single, accepted definition of it. The narrow definition restricts corporate governance to relationships between the management and the shareholders of the corporation; at the other end of the spectrum, the broad definition includes creditors, employees, and other stakeholders, as well as the society in general.

The earliest attempt to provide a definition of corporate governance appears in the Cadbury Report of 1992, where corporate governance is defined as the “system by which...”

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1 The phrase “Sed quis custodiet ipsos custodies?” can be translated as “But who will guard the guards themselves”, “But who guards the guards?” or “But who watches the watchmen?”, Juvenal, Persius, A New and Literal Translation of Juvenal and Persius: with Explanatory Notes in which these Difficult Satirists are Rendered Easy and Familiar to the Reader, Volume 1, (N. Bliss, R. Bliss, and R. Bliss. 1807), at 6.346–348.
2 Wells, Harwell, The Birth of Corporate Governance, 33 Seattle University Law Review 4, 1247-1292, (2010), at 1251; “Everywhere shareholders are re-examining their relationships with company bosses – what is known as their system of ‘corporate governance.’ Every country has its own, distinct brand of corporate governance, reflecting its legal, regulatory and tax regimes... The problem of how to make bosses accountable has been around ever since the public limited company was invented in the 19th century, for the first time separating the owners of firms from the managers who run them....”, Corporate Governance: Watching the Boss, The Economist 3, January 29, 1994.
5 Jill Solomon, Corporate Governance and Accountability, (John Wiley and Sons. 2007), at 12.
companies are directed and controlled‖⁶. Corporate governance is also defined as “the relationship among various participants in determining the direction and performance of the corporations. The primary participants are: (1) the shareholders, (2) the management, (3) the Board of Directors”⁷. One of the broad definitions of corporate governance is offered by the OECD: “[c]orporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders”⁸.

Developed countries like Germany and the United States have extensive experience in dealing with issues of corporate governance, whereas the developing countries, like Uzbekistan, have recently been introduced to such issues. Therefore, it is important for a developing country to be aware what solutions have the developed countries adopted to solve the issues such as agency conflicts, protection of minority shareholders, ensuring effectiveness of the corporation, as well as providing for liabilities and incentives for corporate managers.

The thesis makes a comparative study between the legal systems of the three countries: Germany, the United States and Uzbekistan; since it is not a qualitative study, it does not attempt to find out which system is better or more effective; nevertheless, some conclusions will be drawn with regard to specific issues.

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Uzbekistan belongs to the continental (Roman-German) legal family; the corporate law of Uzbekistan, as well as its Civil Code, is based on the German legal system. But as time passed, there were not so many changes introduced in the corporate law regarding public corporations after 1997, since as it will be discussed later, the main focus has always been on the small and medium enterprises. However, due to privatization efforts taken in the last two decades in Uzbekistan, the number of privatized public companies is steadily increasing, and the legal regulation of such public companies following this increase has not been successful. Thus, since the basis of corporate law is taken from Germany, an in-depth comparison of the Uzbek corporate system with its German counterpart will be necessary.

As to the sources of law, although Germany is a country with a federal legal system, all corporate and securities laws are a matter of federal regulation, therefore, only federal level statutes are discussed. The German law has also been affected by the EU regulations and directives, and they will also be touched upon when necessary. Important difference to be noted with regard to provisional nature of the laws is that, unlike the U.S. law, the provisions of the German Stock Corporation Act – “Aktiengesetz” (hereinafter referred to as AktG), are mandatory and the corporate documents can deviate from them only if explicitly provided in the AktG.

12 "The charter may deviate from the provisions of this Act only if expressly allowed", § 23(5) Stock Corporation Act [Aktiengesetz (AktG)], of 06.09.1965, published in Federal Law Gazette [Bundesgesetzblatt BGBT] I 1089, (hereinafter referred to as AktG). The AktG entered in force on the 1st January 1966. Translation of the AktG is available at:
I have chosen to include the United States as well into the analysis, and one might find it difficult to justify such choice due to the fact that, in particular, the corporate law, capital markets and securities regulations are different from the ones in both Uzbekistan and Germany. Nonetheless, one has to bear in mind that the notion of “corporate governance” as such has originated in the United States, and the German concept of corporate governance is actually taken from the U.S. (German scholars do not even have a proper translation of the expression into German – they simply use the English term “corporate governance”13). Moreover, Uzbekistan has a hybrid form of internal governance structure, which has the features of both the German and the U.S. corporate governance systems14.

Unlike in Germany and Uzbekistan, the corporate law in the United States is a matter reserved for the states, while the securities law is an issue of federal jurisdiction; therefore while referring to the U.S. law, the thesis will mainly refer to the current Delaware law15, i.e., the Delaware General Corporation Law (hereinafter referred to as DelGCL) and the case law of the Delaware state courts, or Model Business Corporation Act (hereinafter referred to as MBCA) as of 200716, and if necessary, applicable securities regulations and listing requirements will be used.

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13 J. J. Du Plessis, Bernhard Grossfeld, Claus Luttermann, German Corporate Governance in International and European Context (Springer 2nd ed. 2012), at 15-17.
14 For a more elaborate discussion see infra, section 3.1.3.
15 According to the official website of the State of Delaware, “[m]ore than 900,000 business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500”, see http://corp.delaware.gov (last visited November 1, 2011).
B. Motivation: why are corporate governance reforms needed in Uzbekistan?

A developing country such as Uzbekistan should follow the path of developed countries in order to be better prepared for the risks they are being exposed to by making the reforms. Since its independence, Uzbekistan has adopted the strategy of moving to market economy, by privatizing government shares in corporations and introducing new concepts. These reforms have led to the creation of publicly owned corporations and therefore the rise of agency problems; this research is aimed to analyze the results of these reforms, and compare them with the path of the developed countries, such as Germany and the United States.

The reason I have chosen this topic is that the large public corporations play an important role in the economy of a country. Alfred Chandler argues that the strongest economic nations are the ones having large corporations, and indeed, large corporations of Uzbekistan produce more than 82% of the GDP in industrial production and almost 60% of the GDP in services. The concern was initially to cover all types of corporations, but it became obvious that all of them cannot be covered within one thesis; also, given the policy decision of the Republic of Uzbekistan to distinguish between the large and small businesses, I have chosen to focus on public corporations.

Public corporations have an impact not only on those directly or even indirectly involved in its functioning, but also the whole economy. The corporate sector in the Republic of Uzbekistan is sizeable: on December 1, 2011, market capitalization of all joint-
stock companies was more than 5 billion USD\(^{19}\). The importance of the huge public corporations is evidenced by the fact that the five largest listed corporations comprise 79.4% of total market capitalization of all listed corporations\(^{20}\). Another example is the National Bank of the Republic of Uzbekistan with share capital of 400 million USD\(^{21}\), which has become one of those “too big to fail”, having the biggest turnover and serving 70% of all export-import operations in the country; it is the biggest investment bank and the biggest commercial bank\(^{22}\), accounting for over 60% of total banking assets in the country\(^{23}\). Although right now bank belongs to the government, 49% of shares have been promised to be privatized\(^{24}\), in particular, the bank’s twelve subsidiaries and holdings in more than twenty other enterprises have been announced available for sale\(^{25}\), and such privatization without a proper system of monitoring and effective governance may lead to a worse result compared to total government ownership.

In addition, one can observe that the involvement of the general public in the securities market is growing steadily, i.e., on January 3, 2012, the Central Depository of the Republic of Uzbekistan held accounts for 1,449,466 securities holders, including 1,365,133 private persons and 84,333 legal entities\(^{26}\).


\(^{26}\) For comparison: the numbers for the preceding years:
  - in 2010: 1,441,476 in total, including 1,357,746 private persons and 83,730 legal entities;
  - in 2009: 1,399,748 in total, including 1,344,634 private persons and 55,114 legal entities;
Businesses need money to perform and grow. Before investors consider providing such money, be that in the form of equity participation or loan to the corporation, they need to be confident that this business is both financially and structurally stable, which ensures that investors’ money will be returned.

Therefore, the investors look at three particular issues – financial stability and prospects of the corporation, means and scope of protection of the shareholders rights, and the internal governance structure of the corporation. For the financial issues, the investors can look at the yearly financial reports, audit reports and other documents that reflect the financial status of the corporation. To analyze the level of protection of the shareholders, one needs to look at both substantive shareholder rights and how the system ensures these rights procedurally. The substantive rights are the rights to elect the directors and vote on fundamental transactions, as well as on the distribution of profits. Procedurally, the shareholders should be able to nominate and elect the directors, propose the issues to be decided at the general meeting, as well as have an effective procedure of application to the court. In order to determine whether the internal governance structure assures the stability in the corporation and does indeed protect the investor from wrongful actions of the management, the investors shall look at the regulatory framework, corporate governance codes, and the level of compliance of the corporations with the regulations and codes.

C. Structure

This section discusses the structure of the thesis and why this particular structure has been chosen. The thesis deals with internal governance mechanisms in the corporation,

- in 2008: 1,266,180 in total, including 1,218,830 private persons and 47,350 legal entities;
- in 2007: 1,225,670 in total, including 1,181,667 private persons and 44,003 legal entities.
shareholder rights and obligations, since Uzbekistan and Germany have insider-controlled systems of corporate governance— the internal governance is more important than the involvement of other stakeholders in the activities of the corporation, which is why the issues of stock market regulations, mergers and acquisitions, and takeovers carry less weight than the internal governance structure. Although in the United States the corporate governance system is considered as an outsider-controlled system, inclusion of a legal system with one-tier governance structure was necessary, since Uzbek corporations have a hybrid structure (hereinafter it will be referred to as two-tier tripod) where prima facie the corporations have a two-tier structure, having both Supervisory and Management Board, however, the shareholders appoint both boards, therefore, the appointment rights of the shareholders are more similar to a one-tier system.

The internal governance structures of the corporations in the three countries are different—one-tier structure in the United States, two-tier in Germany and triangular in Uzbekistan. From all the three, Uzbek system is prima facie most complicated, with the triangle where the shareholders elect both Supervisory and the Management Boards, therefore, this tripod system is the start of the analysis. In such a triangle, the role of each of

27 “[T]he German and French corporate governance systems are perhaps best described as insider systems … Insider systems are those in which the corporate sector has controlling interests in itself and in which outside investors, while participating in equity returns through the stock market, are not able to exert much control. By contrast, the U.K. and the U.S. are outsider systems of corporate control, in which there are few controlling shareholdings (what controlling blocks do exist are rarely associated with the corporate sector itself) … [T]hese differences in ownership systems give rise to very different forms of corporate control”, Julian Franks & Colin Mayer, Corporate Ownership and Control in the U.K., Germany, and France, 9 Journal of Applied Corporate Finance (1997), at 39; A Tylecote, P Ramirez, Corporate Governance and Innovation: the UK Compared with the US and ‘Insider’ Economies, 35 Research Policy 1, 160-180, (2006), at 163; Marc Goergen, et al., Recent Developments in German Corporate Governance, 28 International Review of Law and Economics (2008), at 175.

28 Germany has a “lack of hostile takeover market”, Goergen, et al., supra note 27, at 175.

29 Franks & Mayer, supra note 27, at 39, Goergen, et al., supra note 27, at 175.

30 Hereinafter, the internal governance structure in the U.S. corporations will be referred to as one-tier, in German corporations as two-tier and in Uzbekistan triangular respectively. For elaborate discussion of these models, see infra section 3.1.3.
the abovementioned players is different than in the two-tier German system, moreover, in the United States, the Board of Directors and management cannot be equaled with the Supervisory Board or the Management Board, respectively. Therefore, the following structure will be employed by dividing the issues of internal governance of the corporation into following categories:

1. shareholder rights, duties and obligations (insofar as they are important from the viewpoint of internal governance structure of the corporation);
2. internal governance structure, focusing on the differences between the one-tier, two-tier and triangular structures, and the role of the general meeting of shareholders;
3. election, appointment, and removal of directors and officers of the corporation;
4. functions and duties of directors of the corporations.

The first chapter lays down the theoretical background, describes functionalism as the methodology to be employed and provides historical background for the thesis. Also, the chapter introduces two agency problems (managers/directors vs. shareholders, and dominant shareholder vs. minority shareholder), as well as the different models of corporate governance. Since one can hardly find English-language literature on corporate law or corporate governance in Uzbekistan, the chapter provides a short history of the development of the Uzbek corporate law, as well as the current trends and status quo of the [31]

31 I have divided the U.S. corporation into three layers – (1) shareholders, (2) independent/supervisory members of the Board of Directors and the (3) managers – executive members of the Board of Directors and designated officers. However, there is an alternative view that “theoretically, a corporation consists of three layers or tiers – (1) shareholders ... (2) Board of Directors, who are the managers of the corporation’s affairs, and (3) officers, who act for the corporation to implement the decisions of the directors”, see Robert W. Hamilton, Cases and Materials on Corporations, Including Partnerships and Limited Liability Companies (Thomson/West 8th ed. 2003), at 17.
The second chapter focuses on protection of shareholders both inside the corporation and outside of it, as well as their obligations towards the corporation and other shareholders. Protection of shareholders’ rights as residual claimants of assets of the corporation is important since the shareholders are the least protected constituency of the corporation. The shareholder rights are divided into procedural, substantive and special rights. Procedural rights are rights of the shareholders exercised at the general meetings of shareholders. Regarding the substantive rights, actual powers of voting for directors and on fundamental transactions are discussed. The special rights of the shareholders are the individual rights of a single shareholder or a class of shareholders that other shareholders in the same corporation do not have, for instance “golden shares” and special right to appoint and remove members of the Supervisory Board in Germany or directors in the U.S. The chapter further reviews the issue of derivative suits as means of shareholder protection; although they can play a practical role as well as have the deterring effect on the directors of the corporations, the problems associated with these types of actions may lead to inefficiency of these proceedings. The chapter concludes with the obligations of the shareholders, it shortly touches upon the duty to pay the contributions and more extensively describes the fiduciary duties of shareholders in the context of internal governance structure of corporations.

The third and fourth chapters discuss the allocation of powers within the corporation, which is viewed from two perspectives: first, in-depth analysis of the one-tier, two-tier and triangular structures and the dynamics of power within each of these, second, election, appointment and removal of the members of the Board of Directors, the
Supervisory Board and the Management Board. The difference in the election/appointment rights in the selected jurisdiction strongly changes the balances of power within the corporations. First of all, in Uzbekistan\textsuperscript{32}, as well as in other post-soviet countries like Russia\textsuperscript{33} and the Ukraine\textsuperscript{34}, the general meeting of shareholders is considered as the “supreme authority” of the corporation, and has the right to elect both the Supervisory Board and the Management Board. Germany, on the other hand, has a strict division between these rights; while the general meeting elects the members of the Supervisory Board, which in turn appoints the Management Board, the general meeting cannot have the power to elect the members of the Management Board. Moreover, the dominant role of the banks in Germany as shareholders, creditors and proxy holders has been noted in the literature. The co-determination in German corporations also changes the picture due to its nature of involving the non-shareholder constituencies in electing the members of governing bodies and in supervising such bodies. The United States can be considered as moving to a quasi-two-tier board structure with all the latest requirements on numbers of independent directors, and independence of various committees. In particular, the chapter discusses nomination, election and removal of governing bodies of the corporations, their term of serve, size and composition.

The fourth chapter first defines the differences in the rights between the different bodies of the corporation, i.e., the separation of decision-making powers between the boards, issues of reporting of the management. Then the chapter considers the extent of monitoring the actions of the corporation’s management, which has the executive power,

\textsuperscript{32} Art. 64 of the of the Law of the Republic of Uzbekistan on Joint-Stock Companies and Protection of Shareholders, April 7, 2009, No ZRU-206, (hereinafter referred to as “Uzbek Law on Joint-Stock Companies”).

\textsuperscript{33} Art. 48 section 8 of the Federal Law of Russian Federation On Joint-Stock Companies, December 12, 1995, № 208-FZ.

\textsuperscript{34} Art. 41 of the Business Administration Act of Ukraine, October 1, 1991, N 1577 – XII.
and the extent to which such monitoring is effectively performed in the given structure. Further, the chapter discusses the duties of directors and officers, showing the difference in the jurisdictions regarding specific duties, such as duty of care or duty of loyalty, and fiduciary duty. Last, the chapter reflects on the differences in the approach to the business judgment rule presumption in the three countries.

D. Methodology

This section describes functionalism as the main methodology that is applied in the thesis. Functionalism means identifying an issue, a function, notion, concept, institution or a problem which exists in several legal systems, and analyzing how each jurisdiction addresses it\(^\text{35}\). The section provides arguments for using this method in comparative corporate governance, and determines the extent to which functionalism is employed as the main method.

First, functionalism has been generally used as the basic methodology of comparative law in general\(^\text{36}\) and comparative corporate governance in particular\(^\text{37}\); mainly due to the fact that many jurisdictions face similar problems, e.g., the concept of ownership of the corporation, aligning the interests of different players, representative powers, liabilities of officers and directors for their actions on behalf of the corporation, controlling the managers and overseeing the controllers.

Second, functionalism is one of the few methods that allow comparing notions that are incomparable *prima facie* by reducing them to simpler conceptual terms. Most


\(^{37}\) Clarke, supra note 35, at 86, see also Kraakman et al., supra note 35, at 4.
importantly, functionalism is indispensable while comparing the legal systems of developed countries with an “exotic”\textsuperscript{38} jurisdiction (i.e., a developing country with a legal system having rare, special and uncommon features)\textsuperscript{39}.

Apart from the functional method, the thesis frequently relies on empirical studies using standardized data that have emerged as a part of the law and economics movement\textsuperscript{40} and became popular in the literature\textsuperscript{41}. Empirical studies using standardized data are important to put the words in numbers; for instance, although the ownership structure in Germany is believed to be controlled by large shareholders and banks, one cannot guess the stake of the largest shareholder. Such empirical studies assist in making a more correct comparison by having more precise data.

E. Expected contributions and limitations

The thesis is a first English-language in-depth comparative study involving corporate governance system in Uzbekistan, therefore, the target audience is large – the thesis will be of interest for both academics and practitioners interested in the Uzbek legal system, as well as possible investors into the economy of Uzbekistan. Moreover, it will be of interest for the academics in the Republic of Uzbekistan, since the comparative study is valuable to see the approaches that are taken in the developed countries. Last but not least, this thesis may provide some useful insight for the policy makers and legislative bodies in the Republic of Uzbekistan.

\textsuperscript{38} Also called “non-traditional” jurisdictions, see Clarke, supra note 35, at 78.
\textsuperscript{39} Id.
\textsuperscript{40} “Law and economics, of course is the school of jurisprudence in which the tools of microeconomic analysis are used to study the law”, S.M. Bainbridge, Corporation Law and Economics (Foundation Press. 2002), at 18.
\textsuperscript{41} Such empirical studies started with the so-called LLSV (abbreviation for La Porta, Rafael, Lopez de Silanes, Florencio, Shleifer, Andrei and Vishny, Robert W.) movement, see Clarke, supra note 35, at 89-90, for a further elaboration of the LLSV movement see infra, section 2.1.
Since the field of corporate governance is a broad topic, the thesis has the following caveats. First, the focus will be on public corporations only, and the definition of the public corporation for the purposes of the current thesis will also be provided. Second, the thesis will limit itself only to the internal governance structure of the corporations, and the issues pertaining to the system of checks and balances and allocation of power within the corporations. All of the issues regarding protection of creditors and other constituencies, as well as the impact and importance of other players in corporate governance, will be left out of the thesis.

First, as mentioned above, the thesis will provide the definition of “public corporation”. “Public corporation” is a business enterprise that meets the following five requirements: limited liability, separate legal personality, free transferability of shares, centralized management under the board structure, and shared ownership by contributors of capital. The focus on the public corporations is determined by the recent changes in the legal system in Uzbekistan that aims to distinguish the large public corporations from the small and medium businesses. Thus, since the thesis intends to draw conclusions for Uzbekistan as a developing country, the focus on public corporations is appropriate.

Second, as noted earlier, the internal governance structure in Uzbekistan carries more importance than relationships of the corporations with stakeholders (protection of creditors, employees and other stakeholders is provided by the law), moreover, the limits of the thesis do not allow including all issues pertaining to corporate governance, such as creditor and stakeholder protection, securities regulations, business ethics and accounting standards. Therefore, in order to retain the focus, the thesis will confine itself to

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42 See infra, section 1.5.
43 For the policy decision in Uzbekistan, see infra section 1.6.
shareholders rights and obligations, and the internal governance structure of the corporations.
1. CHAPTER ONE: THEORETICAL BACKGROUND

The first chapter provides the theoretical background, including the methodology and theories of corporate governance. Since the legal systems to be compared are different in many regards, the chapter will define the “public corporation”, which is the focus of the current thesis. In addition, the chapter gives a short history of the development of the corporate law in the country discussed, as well as the latest studies made on the subject.

1.1. Corporate Governance – duty to whom? What is Corporate Governance and whom does it protect?

In any corporation, the managers perform the day-to-day activities and have the executive power in the corporation, so the question is whom those managers owe the duty to. The common answer would be “to the corporation”\textsuperscript{44}, but who or what is the corporation? Is it the shareholders who own the shares of the corporation? Or should one consider the interests of other stakeholders, such as creditors who have been financing the corporation when needed, or employees that have assisted in the corporation’s success? Or maybe it is all the interested stakeholders? If so, to what extent should such interest be taken as the benchmark for the determining the appropriateness of managers’ actions?

As the 1995 Vienot Report\textsuperscript{45} puts it:

“The interest of the company may be understood as the over-riding claim of the company considered as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors, including the internal revenue authorities, suppliers and

\textsuperscript{44} A. Cadbury, Corporate Governance and Chairmanship: A Personal View (Oxford University Press. 2002), at 41.

\textsuperscript{45} The Vienot Report is a corporate governance framework recommendations comprised by employers’ associations – Conseil National du Patronat Français (MEDEF) and Association Française des Entreprises Privées (AFEP), see “Corporate Governance In France” available at: http://www.virtusinterpress.org/additional_files/book_corp_govern/sample_chapter04.pdf (last visited November 1, 2011).
customers. It nonetheless represents the common interest of all of these persons, which is for the company to remain in business and prosper\textsuperscript{46}.

The origins of the idea in the Vienot report can be seen in the concepts of \textit{owner shielding} and \textit{entity shielding} in corporate legal theory. \textit{Owner shielding} is the protection of the personal assets of the shareholders from the creditors of the corporation,\textsuperscript{47} while \textit{entity shielding} is the functional inverse of \textit{owner shielding} – corporation is a distinct actor, thus the corporation shall be protected from the creditors of the shareholder.\textsuperscript{48} These two theories taken together assure that the corporation is regarded as a separate entity regardless of who actually owns the shares of the corporation, thus having a status distinct and independent from those of its shareholders (in both economic and legal senses). If a corporation is a separate legal entity of its own, then what is the position of the shareholders who own the shares of the corporation? Can they be called the owners or at least the nominal owners of a corporation?

\subsection*{1.1.1. The definition of the corporation}

Although the concept of the corporation dates back to the Romans\textsuperscript{49}, the theories of corporations and corporate law have been formed much later. One can distinguish theories of corporations and theories of corporate law\textsuperscript{50}, as well as various approaches in understanding the nature, functioning and goal of corporations.

\begin{flushright}
\footnotesize
\textsuperscript{46} Id. at 7.
\textsuperscript{48} Id. at 1337.
\textsuperscript{49} Phillip A. Blumberg, Kurt A. Strasser, Nicholas L. Georgakopoulos, Eric J. Gouvin, Blumberg on Corporate Groups (Aspen Publishers 2\textsuperscript{nd} ed. 2011), Volume I, at 2-5.
\textsuperscript{50} Petri Maentysaari, Organising the Firm: Theories of Commercial Law, Corporate Governance and Corporate Law (Springer. 2012) at 74.
\end{flushright}
1.1.1.1. Development of the theories of corporation

A. Concession theory ⁵¹

The artificial person theory or concession theory was the main theory of corporate personhood in the first half of the 19th century ⁵². This theory describes the corporation as a legal construct, not more than a legal fiction that is used to facilitate commerce. The corporation is composed of two elements – the fictional aspect and the dependence aspect. The fictional nature of the corporation is evidenced by the fact that corporations are called “persons” for the legal convenience, since the corporations exist only on paper ⁵³. The dependence aspect of the corporations arises from the fact that the corporation cannot exist without consent of the state, since the corporation has to get approval from the state for incorporation and it possesses “only those properties which the charter of its creation confers upon it” ⁵⁴.

The concession theory supported the view that the corporations are public-oriented ⁵⁵, while the state can cancel the concession it has granted. This theory lost its validity by the mid-19th century, when the states of the United States started to allow the corporations to be established for any lawful purpose ⁵⁶.

⁵² Susanna Kim Ripken, supra note 51, at 109.
⁵⁵ “[T]he corporation is a creature of the State. It is presumed to be incorporated for the benefit of the public”, Hale v. Henkel, 201 U.S. 43, 74 (1906), cited in Susanna Kim Ripken, supra note 51, at 108.
⁵⁶ Connecticut was the first state to allow incorporation for a general business purpose without any special permission in 1837, New York enacted a similar statute in 1860. See Wesley B. Truitt, The Corporation (Greenwood Publishing Group. 2006), at 7; Model Business Corporation Act Annotated, supra note 16, at 2-24.
B. Aggregate theory\textsuperscript{57}

The state changed its attitude towards corporations, when the act of incorporation became a simple formality and people were free to establish corporations; and this change led to the development of the aggregate theory (also called contractual or associational theory) in the second half of the 19\textsuperscript{th} century. This theory suggests that the corporation is not more than the people who comprise it, it is owned and managed by these people, while the "word 'corporation' is but a collective name for the corporators [i.e., incorporators] or members who compose [it]\textsuperscript{58}. This theory lost its influence in the beginning of the 20\textsuperscript{th} century, when the dispersion of ownership led to the separation of ownership and control\textsuperscript{59}, and the actions of the corporation could not be attributed to individual shareholders.

C. Real entity theory\textsuperscript{60}

The real entity or natural entity theory emerged in the early 20\textsuperscript{th} century in the U.S. and claimed that a corporation is totally independent from its shareholders as well as from the state where it is incorporated. It has been further claimed that a corporation can have its own will and pursue its own goals, which do not have to reflect the will and goals of its individual shareholders.\textsuperscript{61} This view has been the dominant view in today's legal theory.

\begin{thebibliography}{99}
\bibitem{58} Morawetz, supra note 57, at 1-2.
\end{thebibliography}
1.1.1.1. **Economic theories**

**A. Transaction cost theory**

Economists have also come up with their own explanations of corporate existence. The first influential work in this context was “The Nature of the Firm” written by Coase in 1905. Coase suggested that the transaction costs of the participants of the market transactions inevitably lead to emergence of a firm. The contracts that are concluded between the participants of the market transactions require substantial costs, and merging the factors of production with the labor force will produce better result than producing the same goods or providing the same services individually. Coase’s work was developed later on into a branch of economic school that looks at the corporation from the perspective of transaction costs.

**B. Institutional variant of economic theory**

Coasean theory of transaction costs was modified into a separate theory – the institutional version of contractual theory. The proponents of this theory claimed that the firm is a contract, however, not a loose set of contracts, but as one umbrella contract amounting to a hierarchy. The firm has a governance structure which is distinguishable from market contracting. Also, the proponents of this theory claimed that the contracting parties have “bounded rationality” and “opportunistic conduct.”

**C. Neoclassical variant of economic theory**

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66 Id. at 1480.
The institutional variant of contractual theory was developed into a neoclassic version of contractual theory – *nexus of contracts* theory. The expression “nexus of contracts” appeared for the first time in the article by Michael C. Jensen and Meckling in 1976. This theory suggests that a corporation is a legal fiction that represents a set of complex contractual relationships between constituencies, and the corporation is not one “thing”, but a “web of interrelated contracts”. Moreover, the firm is not necessarily a hierarchy, while the actors within the firm are rational economic actors – self-interested individuals with divergent interests. It has been claimed that nexus of contracts theory has become the dominant in the theory of corporate law.

### 1.1.1.2. Theories of corporate law

#### A. Contractarian

The “contractarian” theory, which now is the mainstream approach in the Anglo-American legal science, has historical roots in English company law and the fact that the English courts treated the articles of association as the “statutory contract”. The theory

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69 “In brief, the nexus of contracts or contractarian model conceptualizes the firm not as an entity, but simply as a legal fiction representing the complex set of contractual relationships between many constituencies providing, or serving as, inputs for the corporation’s productive processes. In other words, the firm is not a thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm”. Stephen Bainbridge, *Abolishing Veil Piercing*, 26 Journal of Corporation Law 3, 470-535, (2001), at 486.

70 Id.

71 Id.

72 Bratton, supra note 65, at 1471.


74 Maentysaari, Organising the Firm, supra note 50, at 69.
suggests that the corporation is a set of contracts\textsuperscript{75}, therefore, the corporate law should be the enabling law without mandatory provisions. The book by Eastbrook and Fishel is considered as the summary of the arguments in favor of contractarian theory\textsuperscript{76}.

\textbf{B. Agency}

The contractarian theory is usually combined with the agency theory; although the agency theory is much younger and originated in the late 1960-s\textsuperscript{77}, and became popular in corporate governance research. For instance, in the influential book by Kraakman et al.\textsuperscript{78}, the authors start with the analysis of agency problems in the extended contexts compared to the original agency theory.

\textbf{C. Team production theory}

The team production theory is an attempt to solve the problem of several agency conflicts. The proponents of this theory are Margaret Blaire and Lynn Scott, who argue that the function of the corporation is not to address the agency conflicts, but instead, is a vehicle for stakeholders to exercise control over the joint resources through an independent body such as the Board of Directors\textsuperscript{79}, while the goal of the corporation is to maximize the joint welfare of all of the corporation’s stakeholders\textsuperscript{80}.

\begin{itemize}
\item \textsuperscript{75} With regard to the ownership of the firm, it is an irrelevant concept when the firm is regarded as a set of contracts. Eugene Fama, \textit{Agency Problems and the Theory of the Firm}, 88 Journal of Political Economy 2 (1980), at 290.
\item \textsuperscript{76} Easterbrook F., Fischel D., \textit{The Economic Structure of Corporate Law} (Harvard. 1991), at 15–16.
\item \textsuperscript{77} Fama, supra note 75, at 290; Ross S., \textit{The Economic Theory of Agency: The Principal’s Problem}, 63 American Economy Review 2 (1973), at 134–139; Jensen & Meckling, supra note 68, at 305–360.
\item \textsuperscript{78} Kraakman et al., supra note 35.
\item \textsuperscript{80} Maentysaari, Organising the Firm, supra note 50, at 74.
\end{itemize}
1.1.1.3. Corporation as a legal fiction

The view that the corporation is indeed a “legal fiction” is common nowadays. From the legal theory perspective, concession and contractual theories have lost their validity, leaving the real entity theory as the dominant theory. The real entity theory suggests that corporation itself is not a fiction (i.e., it can have real assets, such as buildings, cars, inventory) but corporate legal personality is a fiction. From the economic theory standpoint, the nexus of contracts theory suggests that the corporation, being a web of interrelated contracts, is indeed a legal fiction.

In 1819, the United States Supreme Court Chief Justice Marshall has opined that:

“[A] corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence.”

This view of the corporation by the United States Supreme Court was recently confirmed by Supreme Court Justice Stevens in his dissenting opinion:

“... corporations have no consciences, no beliefs, no feelings, no thoughts, no desires. Corporations help structure and facilitate the activities of human beings, to be sure, and their “personhood” often serves as a useful legal fiction.

1.1.2. Do the shareholders own the corporation?

This section intends to prove that the shareholders do not own the corporation, but

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81 “Legal fiction” is defined by the Black’s Law Dictionary: “An assumption that something is true even though it may be untrue, made especially in judicial reasoning to alter how a legal rule operates; specifically, a device by which a legal rule or institution is diverted from its original purpose to accomplish indirectly some other object”, B.A. Garner, Black’s Law Dictionary (West. 2010).
simply own the shares, which represent a “bundle of rights”. Each “bundle” is different, since each share may confer a different mix of rights.

1.1.2.1. Shareholder and share

In order to determine whether the shareholder do and actually can own the corporation, the concepts of “share”, “shareholder” and “corporation” need to be examined.

In the United States, share has been defined to represent “the units into which the proprietary interests” and “equity or ownership interest in the corporation” are divided. In Germany, share represents a fraction of the registered capital and membership rights of the owner of the share. In Uzbekistan, share is a security, which evidences the right of its holder to take part in the control of the corporation, receive dividends and part of liquidation property. All jurisdictions allow different classes of shares, which have a different set of rights. Shareholder, therefore, is the owner of the share, a piece of paper that defines the rights of the shareholder as the owner of such share, and these rights are defined in the nominee certificate or articles of association; thus the shareholder cannot have more rights or less rights than provided in the share certificate. Competing theories of the corporation have been discussed earlier, and it has been established that although a corporation can possess real and tangible property, it still is a legal fiction, itself existing only

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85 MBCA section 1.40(22).
86 B.A. Garner, Black’s Law Dictionary (West. 2010).
87 Wirth et al., Corporate Law in Germany, (Munich, C.H. Beck, 2nd revised ed. 2012), at 73-74.
89 “[I]n place of actual properties over which the owner could exercise discretion and for which he was responsible, the owner now holds a piece of paper representing a set of rights and expectations with respect to an enterprise. But over the enterprise and over the physical property – the instruments of production – in which he has an interest, the owner has little control”, Berle & Means, supra note 59, at 64.
90 Greenfield, supra note 73, at 45.
92 MBCA.
on paper.

### 1.1.2.2. Ownership of the corporation

Milton Friedman had relied on traditional view of the corporation, where a corporation is a “thing” and consequently it can be “owned”, hence the shareholders own the corporation, while the directors are the stewards of the shareholders’ interests. However, a corporation, being a legal fiction, is a unique subset of ownership, where the shareholders do not buy the corporation, but acquire a set, i.e., a “bundle” of rights from the corporation for a value.

What are the rights that the shareholders actually have? The shareholders have two fundamental rights: (1) voting on the election of the directors, as well as on other matters as defined by the law, and (2) right to get the net assets of the corporation in form of dividends, or liquidation distributions. Each of these rights has to be either reflected in the relevant share certificate or articles of association, or provided by the law. For instance, the right to vote can be a part of the “bundle”, but in case of preferred shares, the share might not have the voting rights. However, the preferred shares may carry a right to get more dividends than common voting shares in the same corporation, thereby creating a different set of rights for the shareholders of different classes. Some shares may also carry special rights not available to other shareholders in the same corporations, such as the rights to appoint a number of directors or veto powers. The law may interfere in the content of such “bundle” by restricting or granting certain rights provided by the share certificate and/or the

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94 Monks & Minow, supra note 82, at 101.
95 Hamilton, supra note 31, at 383.
96 Grant M. Hayden Matthew T. Bodie One Share, One Vote and the False Promise of Shareholder Homogeneity, 30 Cardozo Law Review (2008), at 474.
articles of association. For instance, the non-voting preferred shares can get voting rights in case their dividends are not paid for two years in a row in Germany\(^\text{97}\) and Uzbekistan\(^\text{98}\).

Regarding the rights of the shareholders in relation to the property of the corporation, due to the concepts of limited liability and separate legal personality, the shareholders “neither control corporate property nor bear the consequences of its abuse”\(^\text{99}\). For example, the shareholder does not have a right to use or possess corporate property\(^\text{100}\), and can bear the liabilities of the corporation only if he has breached a duty owed to such corporation.

Moreover, the corporation is a “legal fiction”, which exists only on paper and in contemplation of the law. One can own what can be owned, while a legal fiction cannot be owned, be that solely or jointly. Therefore, the shareholders do not and cannot own the corporation, they own the shares of the corporation, which are “bundles of rights”, and the extent of such rights is determined by the legal system, articles of association and share certificate\(^\text{101}\).

1.2. Two agency problems

The agency relationship is a contract, where one or more persons (agent) take

\(^{97}\)”If the preferred dividend is not paid or not paid in full in any given year and if the amounts in arrear are not paid in the next following year, together with the full preferred dividend for such year, the holders of preferred shares shall have voting rights until the amounts in arrear have been paid. In such case, the preferred shares shall also be taken into account in computing any capital majority required by law or the articles”, § 140(2) AktG.

\(^{98}\)Art. 29 of the Uzbek Law on Joint-Stock Companies.


\(^{101}\)”Owner of the share does not, in any strict legal sense, own any part of the corporate capital and does not have legal title to and is not the owner, or entitled to the possession of, any portion of its property or assets”, Fletcher Cyclopedia on Corporations, Volume 11, Chapter 58, 2011 Revised Volume (West, 2011), § 5100, at 95; for an elaborate discussion of ownership of the shares vs. ownership of the corporation, see Greenfield, supra note 73, at 41-72.
actions on behalf of the authority given by other person or persons (principal)\textsuperscript{102}, and the welfare of the latter depends on the actions of the former\textsuperscript{103}. Therefore, “any relationship between two parties where one (the ‘agent’) promises performance to another (the ‘principal’) is potentially subject to the agency problem”\textsuperscript{104}.

The main focus of the corporate governance studies has been on the agency problem and the common typology is to distinguish three agency problems\textsuperscript{105}:

- “classic” conflict between the managers and shareholders;
- conflicts among the shareholders themselves – the dominant and minority shareholders;
- conflicts between the shareholders and other stakeholders as constituencies affected by the actions of the shareholders.

Due to the fact that the thesis focuses only on the internal governance structure of the corporation, from these three agency problems, the thesis will consider the first two, while the third agency problem – conflict between shareholders and other corporate constituencies – is not discussed in the current thesis.

\textit{Classic - managers vs. shareholders}

In context of the corporations, the “classic” agency problem between the shareholders and managers was described by Adam Smith in his “Wealth of Nations”:

“The directors of such [joint-stock] companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance which the partners in private copartnery frequently watch over their own... Negligence and profusion, therefore, must prevail, more or

\textsuperscript{102} Jensen & Meckling, supra note 68, see also Bainbridge, Corporation Law and Economics, supra note 40, at 235.
\textsuperscript{103} Kraakman et al., supra note 35, at 35.
\textsuperscript{104} Id., at 35; while the agency theory originated in the United States, it became firmly established in German law, Ingo Saenger, \textit{Conflicts of Interest of Supervisory Board Members in a German Stock Corporation and their Independence}, 1 Corporate Governance Law Review 1 (2005), at 151.
\textsuperscript{105} Kraakman et al., supra note 35, at 36.
less, in the management of the affairs of such a company”\textsuperscript{106}.

Adolf Berle and Gardiner Means in their fundamental treatise\textsuperscript{107} have extensively elaborated on the agency problem, where the separation of ownership and control gave the rise to the problem when the principal – the shareholder of the corporation – did not have the power over the corporation, and the control was vested in the hands of the management, which did not have the controlling stake in the widely-held corporation.

\textit{Conflicts among the shareholders themselves}

The conflicts among the shareholders themselves arise usually when there is a controlling shareholder that can influence the activities of the corporation, alternatively, when the shareholder even without a controlling block directly or indirectly influences the management to advance his own interests to the detriment of the interests of the corporation or other shareholders. In this case the shareholder as an agent may be acting to the detriment of other shareholders as the principals, which gives rise to the agency problem\textsuperscript{108}.

\textbf{1.3. Main models of corporate governance}

Stephen Bainbridge argues\textsuperscript{109} that models are necessary in studying corporate governance, making reference to Friedman’s famous statement that “theory is to be judged by its predictive power for the class of phenomena which it is intended to ‘explain’”\textsuperscript{110}, not by whether it is a valid description of objective reality\textsuperscript{111}. Indeed, the models that are discussed further do not aim to describe the reality, rather, they provide a theoretical

\begin{flushright}
\begin{footnotesize}
\textsuperscript{107} Berle & Means, supra note 59, at 64.
\textsuperscript{110} Milton Friedman, Essays in Positive Economics (University of Chicago Press. 1964), at 8.
\textsuperscript{111} Bainbridge, The New Corporate Governance, supra note 109, at 2.
\end{footnotesize}
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background and assist in determining the conceptual differences in the corporations of selected jurisdictions.

There are two basic approaches to modeling in corporate governance. One approach tries to identify whom the corporate managers are supposed to serve and are ultimately responsible to, answering the question “whose interests prevail?” – shareholder value theory vs. stakeholder value theory; while the other approach attempts to find the proper division of rights and power within the corporation, answering the question “who decides?” – managerialism, director primacy and shareholder primacy.

1.3.1. Shareholder value theory vs. stakeholder value theory

The two basic models of the value maximization paradigm are the shareholder value theory and the stakeholder value theory.

The shareholder value theory states that the managers are agents of the shareholders and they are required to protect only the interests of the shareholders, disregarding all of the other interested parties; while stakeholder theory suggests that the interests of various groups of stakeholders have to be taken into account, denying the absolute primacy of the shareholders’ interest. There are arguments on both theories, and there is a certain division within the scholars, which is given below.

The roots of the shareholder value theory were laid down by one of the most
prominent works in the corporate governance — “The Modern Corporation and Private Property” by Adolf Berle and Gardiner Means. The simplest and most obvious explanation of the shareholder value theory would be that the managers are the agents of the shareholders, and they have to maximize the profit of the corporation solely in the interest of the shareholders, i.e., maximize the shareholder value\textsuperscript{117}. As Adolf Berle puts it:

> “[A]ll powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears”\textsuperscript{118}.

The shareholder value theory contributes to effective corporate governance in following ways. First, it provides a clear orientation for the management in terms of goal of the firm, which simplifies the expectations in the shareholder-management relationship. Second, the goal of shareholder value maximization ensures a closer interdependence between strategy formation and the setting of operational objectives for managerial decisions\textsuperscript{119}.

The dangers of this approach were revealed by the crisis of the 1980’s in the U.S., where the stock prices started falling rapidly, and the focus of the management on solely the share prices has resulted in significant losses to the companies and thus to the shareholders in the end\textsuperscript{120}. Further, the Enron crisis showed that blindly following the primacy of the shareholder value, by increasing the earnings and price of the shares of the corporation can be abused\textsuperscript{121}. In a recent research\textsuperscript{122} that analyses the behavior of

\textsuperscript{117} Alberto Chilosi & Mirella Damiani, Stakeholders vs. Shareholders in Corporate Governance, MPRA Paper No 2334 (2007), available at \url{http://mpra.ub.uni-muenchen.de/2334/} (last visited November 1, 2011), at 5.

\textsuperscript{118} A. A. Berle, Jr., Corporate Powers as Powers in Trust, 44 Harvard Law Review 7, 1049-1074, (1931), at 1049.

\textsuperscript{119} Rajeeva Sinha, Corporate Governance and Shareholder Value Analysis, 7 Global Business Review (2006), at 1-3.

\textsuperscript{120} William Lazonick & Mary O’Sullivan, supra note 168, at 18.

\textsuperscript{121} Edward Freeman, Managing for Stakeholders, published in T. Beauchamp N. Bowie and D. Arnold (eds.) Ethical Theory and Business (Prentice Hall 8\textsuperscript{th} ed. 2007), at 5.
managerial elite, it has been shown that the shareholder value theory, where the managers seek to maximize the shareholder value alone, leads to managers’ opportunistic behavior:

“The idea that corporations ought to maximize shareholder value is both an ideology and a proscription about a set of strategic behaviors that ought to follow. As an ideology, it caused managerial discourse to shift to focus on increasing profits and in doing so (for publicly held corporations), raising the stock price”123.

One can conclude that although the shareholder theory does provide a stable and concrete aim for the managers, it might not actually lead to the desired consequences.

The term “stakeholder” was first used in the context of corporate law in the 1963 Stanford Research Institute Memorandum as a descriptive term for “those groups without whose support the organization would cease to exist”124. The definition and the exact meaning of the term “stakeholder” has been disputed125; for the purpose of the current thesis, “stakeholder” shall mean a party that is substantially affected by the actions of the corporation, including, but not limited to the employees, customers, creditors and

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123 Id.
125 Here are some of the proposed definitions:
Stakeholder is a “party that has an interest in an enterprise or project. The primary stakeholders in a typical corporation are its investors, employees, customers and suppliers. However, modern theory goes beyond this conventional notion to embrace additional stakeholders such as the community, government and trade associations” Investopedia, available at: http://www.investopedia.com/terms/s/stakeholder.asp#ixzz1c4e8wEml (last visited November 1, 2011).
“[D]efinition of stakeholder [is] any group or individual who can affect or is affected by the achievements of an organization’s purpose”, R.E. Freeman, Strategic Management: A Stakeholder Approach (Cambridge University Press, 2010), at 52.
“[S]takeholders include all individuals or groups who can substantially affect or can be affected by, the welfare of the firm — a category that includes not only the financial claimholders, but also employees, customer, communities and government officials”, Jensen supra note 115, at 32.
communities\textsuperscript{126}.

The defenders of the stakeholder theory believe that there are certain groups that are so heavily affected by the actions of the corporation that their interest has to be taken into account\textsuperscript{127}. Nevertheless, there is no agreement among the scholars as to the definition of stakeholders in the context of corporate governance\textsuperscript{128}. If the managers and the board of the corporation are to follow the stakeholder theory, the fact that “[s]takeholder theory directs corporate managers to serve ‘many masters’”\textsuperscript{129} and the absence of clear criteria may lead to confusion in the duties of the board and management – they will not be sure whose interests they need to protect more\textsuperscript{130}, leading to adverse consequences as to corporation’s overall performance. Under the stakeholder theory, there is no objective benchmark according to which the results of the actions of the managers and the board could be assessed. The simple explanation here is that if some of the stakeholders are affected by a decision of the management, such decision should not be challenged solely on that basis, since actions of the corporation, one way or another, will be to the detriment of a group of stakeholders.

On the other hand, pursuing the shareholder value without regard to the stakeholders may lead to adverse and even disastrous consequences. One of the most memorable examples is the oil spill in the Mexican Gulf in 2009, which has received attention of scholars, politicians, governments, and media. The consequences of the oil spill even led to a rapid change in the business and marketing strategy of the British Petroleum,

\textsuperscript{126} Adapted from the definition provided in Jensen supra note 115, at 32.
\textsuperscript{127} Id.
\textsuperscript{128} Id.
\textsuperscript{129} Id.
\textsuperscript{130} Greenfield, supra note 73, at 38.
changing the corporate logo to a green sun\textsuperscript{131}.

The two concepts shown above are commonly considered as controversial\textsuperscript{132}, it is believed that the stakeholders’ varying interests are opposing to those of shareholders, i.e., getting fair income on their investments. However, there is an alternative view that in case of large corporations, the interests of the shareholders and stakeholders converge, thus the protection of stakeholders will eventually (in the long-term perspective) lead to better firm performance, which in fact is a better and more solid protection for the shareholders compared to the system offered by the classic shareholder value theory\textsuperscript{133}. To put in the words of the CEO of Medtronic, Bill George:

“Serving all your stakeholders is the best way to produce long term results and create a growing, prosperous company … Let me be very clear about this: there is no conflict between serving all your stakeholders and providing excellent returns for shareholders. In the long term it is impossible to have one without the other”\textsuperscript{134}.

The debate over these theories has been going on for decades, still, there is no consensus among neither scholars nor legislators. In Germany, some commentators argue that the move has been towards accepting the shareholder value theory\textsuperscript{135}, however, a closer look at the German Corporate Governance Code proves the opposite: the


\textsuperscript{132} Started with Berle-Dodd debate in 1930-s, continued with Friedman-Freeman debate. For shareholder theory, see Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 32-33; Milton Friedman, Capitalism and Freedom, (University of Chicago Press, 1962); for stakeholder theory, see Edward Freeman, Managing for Stakeholders, published in T. Beauchamp N. Bowie and D. Arnold (eds.) Ethical Theory and Business (Prentice Hall 8th ed. 2007), at 64.

\textsuperscript{133} Elena F. Perez Carrillo, Corporate Governance: Shareholders’ Interests and Other Stakeholders’ Interests, 4 Corporate Ownership and Control 4, (2007), at 96.

\textsuperscript{134} Bill George, Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value (John Wiley & Sons. 2004), at 104.

Management Board is “responsible for independently managing the enterprise in the interest of the enterprise, thus taking into account the interests of the shareholders, its employees and other stakeholders, with the objective of sustainable creation of value”[emphasis added], while “[a]ll members of the Supervisory Board are bound by the enterprise’s best interests”[emphasis added]. The German Corporate Governance Code, therefore, “clarifies the obligation of the Management Board and the Supervisory Board to ensure the continued existence of the enterprise and its sustainable creation of value in conformity with the principles of the social market economy (interest of the enterprise)”[emphasis added]. Moreover, it has been noted by scholars that the German system is focused on maximization of stakeholder value rather than the shareholder value, workers co-determination being one of the most important examples. Moreover, in the context of takeovers, the Management Board is obliged to act in the best interest of the corporation in general, not of the

136 The German Corporate Governance Code (as amended on May 26, 2010), section 4.1.1.
137 Id., section 5.1.1.
138 Id., Foreword.
139 “[T]he definition of corporate governance explicitly mentions stakeholder value”, see Goergen, et al., supra note 27, at 175; “[G]erman corporate governance regime is based on a long term perspective of the firm”, see Michael E. Porter & Rebecca Wayland, Capital Disadvantage: America’s Failing Capital Investment System, 70 Harvard Business Review (1992), cited in Goergen, et al., supra note 27, at 184; “[T]he company is seen by all its members as a community of interests”, see M. Albert, Capitalism Vs. Capitalism: How America’s Obsession with Individual Achievement and Short-Term Profit Has Led It to the Brink of Collapse (Four Walls Eight Windows, 1993), at 113, cited in Greenfield, supra note 73, at 23; “Stakeholder value’ thinking is deeply rooted in German society”, see Maentysaari, Comparative Corporate Governance, supra note 36, at 421; “In Germany, one should more correctly refer to ‘stakeholder interests’”, see Martin Schulz, Oliver Wasmeier, The Law of Business Organizations, (Springer, 2012), at 23; “According to the prevailing opinion, the boards are entitled and obliged to take into account equally the interests of the shareholders of the company, its employees and the public”, see Hanno Merkt, Corporate Governance, in Jürgen Basedow, Uwe Kischel and Ulrich Sieber, German National Reports to the 18th International Congress of Comparative Law: Washington, 2010 (Mohr Siebeck, 2010), at 244; “[T]he BGH sticks to the stakeholder theory and has in particular an eye on minority groups, creditors, employees and public interests”, see Saenger, supra note 104, at 155; “There is no duty to maximize the value of the shares; management may and has also to take the interests of the employees, creditors, and the community at large into account. Management has, on behalf of the company, to act as a “good citizen”. It may (and should), for instance, make donations to a university even though its competitors could profit from the research there”, see Baums Teodor, Personal Liabilities of Company Directors in German Law, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists’ Association, April 21st 1996, available at http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited January 8th 2010), at 7.
140 Greenfield, supra note 73, at 23-24; Basedow et al., supra note 139, at 244.
shareholders\textsuperscript{141}.

In a recent study, high-level officers of corporations have been asked whether only shareholders’ or all stakeholders’ interests should be pursued by the corporation, 83% of the German respondents have answered that all stakeholders’ interests should be put forward, while 76% of the U.S. respondents stated that the shareholders’ interest should be given priority\textsuperscript{142}.

Regarding Uzbekistan, neither the Civil Code nor the Law on Joint-Stock Companies has a provision regarding the goals of the corporation in general, and a Corporate Governance Code, which could provide for such a goal, does not exist yet. However, the Uzbek Law on Joint-Stock Companies establishes the duty of the Management Board and the Supervisory Board to act in the best interests of the corporation\textsuperscript{143} (not the shareholders or other stakeholders) and provides that both the Management Board and the Supervisory Board are liable for their actions towards the corporation\textsuperscript{144}. Moreover, the Supervisory Board has a right to terminate the contract with one or more members of the Management Board for causing loss to the corporation by the latters\textsuperscript{145}.

\textbf{1.3.2. Managerialism, shareholder primacy and director primacy}

This section will provide the three theories that describe the decision-making authority of the organs of the corporation – the general meeting, the Board of Directors, the Supervisory Board and the Management Board.

Managerialism has been defined as the power of the managers in widely held

\textsuperscript{141} Under the paragraph 33 of German Takeover Act, see Goergen, et al., supra note 27, at 189.
\textsuperscript{143} Article 88 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{144} Id.
\textsuperscript{145} Article 86 Uzbek Law on Joint-Stock Companies.
corporations, where the small individual shareholders are “powerless”\(^{146}\) and inexperienced to deal with corporate issues\(^{147}\), while the salaried managers dominate both top and mid-tier levels of corporation’s governing system\(^{148}\), and board of directors are no more than “rubber stamps”\(^{149}\). Such a corporation was defined by Alfred Chandler as managerial\(^{150}\).

Managerial movement was disturbed by the tender offer movement in the 1980-s, when the radical increase in numbers of mergers and acquisitions took place\(^{151}\), and while the managers had huge decision-making powers, the institutional investors expressed their concern. Combined with the fact that the share of institutional investors in corporate stakes rose steadily and significantly in USA, from 15.8% in 1970 to 38% in 1981, further to 44.8% by 1986, and to 53.3% by 1990\(^{152}\), there was a shift from managerialism towards empowering the shareholders\(^{153}\).

Shareholder primacy\(^{154}\) asserts that the shareholders must be given more power in decision-making of the corporation, since they “do (and should) exercise ultimate control” of the corporation\(^{155}\). The recent legislation on “say on pay”\(^{156}\), the attempt to introduce the

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\(^{146}\) Bainbridge, The New Corporate Governance, supra note 109, at 1.


\(^{148}\) Bratton, supra note 65, at 1471 et seq.

\(^{149}\) Bainbridge, The New Corporate Governance, supra note 109, at 1.


\(^{153}\) Cheffins, supra note 3, at 11.


\(^{155}\) Bainbridge, The New Corporate Governance, supra note 109, at 53.

rule 14a-11\(^{157}\) have also reaffirmed the increase in the powers of the shareholders.\(^{158}\)

The managerialism and shareholder primacy are on the two extremes, while the director primacy theory advanced by Professor Bainbridge\(^{159}\) takes a middle position by proposing that the ultimate power should be in the hands of the board of directors of the corporation. He contends that the managerialism has proved its ineffectiveness in the last crises, and the shareholder primacy is not effective due to failure of participatory democracy and problems with collective actions\(^{160}\).

Controversial issues, such as models of corporate governance, always attract attention and cause discussions; however, they should be viewed from the perspective of development. For instance, when Marx was writing Das Kapital, the problems of managerial misconduct caused by separation of ownership and control had not elevated to the extent they have now\(^{161}\), and it is the emergence of large corporations that changed the whole picture of the corporate America (and then the whole world)\(^{162}\), and it is exactly this divorce of ownership and control that led to reconceptualization of the notions of corporation, managers, shareholders, and control. In addition, corporate social responsibility became a widely discussed issue only when the corporations became powerful and big enough to have serious impact on the society, economy, and functioning of the government. Hence the keyword is the evolution of corporate law, and the social demand creates the

\(^{157}\) See infra section 2.2.3.
aforementioned theories. Managerialism as a theory is obsolete, while the shareholder primacy lacks objective basis, both theoretical and substantive; therefore, the director primacy is the reflection of the reality in today’s corporations163.

1.4. Defining the public corporation

Translating a term from one language to another and from one legal system to another is never easy. The definitions used in one system may not have the equivalent in the other; therefore, providing definitions is essential for laying a proper basis for comparison. To provide an example of difficulties related to translation of terms from one language to another while the notions differ among jurisdictions, an article on translations in law notes that:

“The terms public limited company and limited liability company can be used relatively safely when translating the company forms Aktiengesellschaft ... and Gesellschaft mit beschränkter Haftung ..., but there are no equivalent terms in the English legal terminology for company forms such as Offene Handelsgesellschaft ... or Kommanditgesellschaft .... Other cases of non-equivalence derive from the fact that two opposite governance systems are applied in public limited companies, the Anglo-Saxon one-tier and the continental European two-tier systems. Namely, the one-tier system only has one governing body, i.e., the board of directors, whereas in the two-tier system there are two governing bodies, i.e., the Management Board (Vorstand ...) and the Supervisory Board (Aufsichtsrat ...). The terms the Management Board and the Supervisory Board thus do not exist in the Anglo-American legal language and can be classified as neologisms according to de Groot. In practice, the executive (inside) directors have a function similar to the role of the members of the Management Board in the continental system and the non-executive directors to that of the members of the Supervisory Board. Similarly, the function of a Prokurist ... (a representative of a company holding a special power-of-attorney, i.e., a procura, authorizing him/her to act on behalf of the company) does not exist in British and American companies and to describe it either the source-language term or a paraphrase has to be used”164.

163 For a detailed reasoning in favor of director primacy, see Bainbridge, The New Corporate Governance, supra note 109, at 11 et seq.
The companies that can issue shares are called differently – *corporation* in the United States, *Aktiengesellschaft* in Germany and *joint-stock company* in Uzbekistan. Moreover, the United States and Uzbekistan have two types of corporations – closely held and widely held corporations, and while conducting the research, I was faced with the differences with regard to which of the companies to compare and why. I will employ the following requirement-based approach, and the business entities falling under these requirements will be considered in the framework of this thesis.

For the purposes of current thesis, the term “public corporation” shall mean a legal entity possessing all of the following five features\(^{165}\):

- legal personality;
- limited liability;
- fully and freely transferable shares;
- centralized management under a board structure;
- shared ownership by contributors of capital.

### 1.4.1.1. Legal personality

Legal personality is the basis for existence of the corporate form. Corporations, unlike partnerships and other types of associations, possess clear-cut legal personality in all jurisdictions, that being one of the most important characteristics. The legal personality means ability to:

- be legally and factually separate from the shareholders, i.e., *entity shielding*;
- possess assets in its own name;
- sue and be sued in the courts in its own name\(^{166}\).

Separate legal personality is essential for the corporation to issue shares, successfully operate on the market, and perform other operations.

\(^{165}\) These five features are taken from Kraakman et al., supra note 35, at 5, four of these features were earlier discussed in R.C. Clark, Corporate Law (Little, Brown. 1986), at 2, cited in Monks & Minow, supra note 82, at 11.

\(^{166}\) Kraakman et al., supra note 35, at 10.
1.4.1.2. **Limited liability**\(^{167}\)

The second feature that distinguishes the corporation from all other types of business entities is the limited liability\(^{168}\) of the shareholders with regard to the liabilities of the corporation whose shares they own, making the corporation separate and distinct from its shareholders. It is the so-called *owner shielding*\(^{169}\), i.e., the inability of the creditors of the corporation to turn to the personal assets of the shareholders. It is important that the buyer of the shares is ensured and informed about the extent of his liability; otherwise, the potential investors will be reluctant to buy shares making the capital markets unable to ensure the liquidity of the shares.

1.4.1.3. **Fully and freely transferable shares.**

Some of the business entities can have restrictions on the sale of shares, such as sale within a limited group of persons or with approval of other shareholders. The public corporation must not have any restrictions on transfer of shares, with the exception of certain security market restrictions. However, for the purposes of the current thesis, the public corporation does not have to be listed on the registered security exchange, such as NYSE, NASDAQ, DAX, or UZSE; full and free transferability of the shares and ability to get listed on such a securities exchange are sufficient.

1.4.1.4. **Centralized management under a board**

The issue of centralized management can be divided into two categories: first, the managers of the corporation and their supervisors are *legally* separate from the

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\(^{167}\) Although the liability of the shareholders is limited to their contributions, in certain cases their liability may exceed their contributions; see infra sections 2.7.2 and 2.7.3.

\(^{168}\) The notion of limited liability traces back to 2000 BC, when the sea vessels were financed by merchants, however, only in the 15\(^{th}\) century have the English courts defined it. See Monks & Minow, supra note 82, at 12.

\(^{169}\) The other side of the owner shielding is the *entity shielding*, due to which the creditors of the shareholders cannot turn to the assets of the corporation in case of the shareholders' insolvency.
shareholders, this division being the source of the manager vs. shareholder conflict; second, the supervisors of the managers of the corporation are, at least as a formal matter, separate from the managers of the corporation\textsuperscript{170}. The system can be one-tier or two-tier, but in both cases, regardless of actual allocation of powers, the difference between the shareholders, managers and the supervisor/controller/overseer has to be evident.

In Germany, the management functions are in the hands of the Management Board\textsuperscript{171}, and the supervision of the Management Board is performed by the Supervisory Board\textsuperscript{172}, the same is true for Uzbekistan – day-to-day management is performed by the Management Board\textsuperscript{173}, while the Supervisory Board is in charge of general supervision over the actions of the Management Board\textsuperscript{174}.

In case of the United States as a single-tier jurisdiction, the management of the corporation is exercised by the CEO and other executive directors and officers (who are not a part of the board\textsuperscript{175}). Under both MBCA and DelGCL, “business and affairs of the corporation managed by or under the direction of, its board of directors”\textsuperscript{176}. Although the DelGCL and MBCA do not provide minimum number of independent/non-executive directors, the NYSE Listed Company Manual section 303A provides that the majority of the Board of Directors must be independent (unless the corporation is “controlled company” within the meaning specified in Section 303A(2) of the NYSE Listed Company Manual)\textsuperscript{177}.

\textsuperscript{170} Kraakman et al., supra note 35, at 13.
\textsuperscript{171} “[M]anagement board shall have direct responsibility for the management of the company” § 76(1) AktG.
\textsuperscript{172} “[S]upervisory board shall supervise the management of the company”, § 111(1) AktG.
\textsuperscript{173} Art. 86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{174} Art. 81 and 82 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{175} While directors are elected as a general rule by the shareholders on the general meetings, the officers are appointed by the Board of Directors of the corporation. Importantly, the failure to appoint the officers does not dissolve or otherwise affect the corporation. MBCA 8.03(c), 8.40(c), DelGCL 141(b), 142(a), 142(d).
\textsuperscript{176} DelGCL 141(a), MBCA 8.01(a).
\textsuperscript{177} Kraakman et al., supra note 35, at 65.
1.4.1.5. **Shared ownership by contributors of capital**

All shareholders collectively own the shares of the corporation, and it is reflected in three essential features:

- Shareholders have certain rights with regard to control of the corporation, for example, rights to vote at the general meetings, propose issues for agenda of the general meeting, and bring derivative suits.
- Shareholders have the right to receive a part of the profit of the corporation as dividends.
- Shareholders are residual claimants of the corporation, i.e., in case of liquidation of the corporation, the shareholders have the right to all assets of the corporation after other creditors are satisfied.

Even though all three rights are by default proportionately allocated, the proportionality of voting rights, rights to earning and residuals claims of each holder is not the main concern, since these issues may greatly vary depending on the legal system and each corporation in particular. For instance, some of the legal systems might allow preferential shares with multiple voting rights, golden shares with veto power, preferential shares with special dividend rights or special liquidation claims, or some types of convertible shares or dual-class shares. Nevertheless, the main assumption is that the owners of the ordinary shares have the right to vote, receive dividends and hold residual claims.

Another issue in this regard is non-shareholder involvement in decision-making, the most famous example being the workers co-determination that has reached its peak in Germany.\textsuperscript{178} Although it means that non-shareholders participate in decision making, it does not exclude the power of participation of the shareholders in the decision making process.

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\textsuperscript{178} Goergen, et al., supra note 27, at 184.
Table 1. Five features of public corporations

<table>
<thead>
<tr>
<th>Feature</th>
<th>The U.S.</th>
<th>Germany</th>
<th>Uzbekistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name:</td>
<td>Corporation (Corp.) (under the DelGCL) Public corporation (under 1.40 MBCA)</td>
<td>Aktiengesellschaft (AG)</td>
<td>Open Joint-Stock Company (OAO)</td>
</tr>
<tr>
<td>Legal personality. Any restrictions on legal personality</td>
<td>Legal personality, from the date of the filing of the certificate of incorporation, (DelGCL 106, MBCA 2.03)</td>
<td>Legal personality, only after registration in the commercial register. Before registration it is considered Vor- (Aktien)-gesellschaft § 41(1) AktG</td>
<td>Legal personality, only after governmental registration in the Khokimiyat, Inspectorate for Registration of Entrepreneurial Entities (within 3 days, or 7 days to a month), article 41 of the Civil Code of the Republic of Uzbekistan, article 2 of the Uzbek Law on Joint-Stock Companies</td>
</tr>
<tr>
<td>Limited liability. Any specific provision on liabilities of shareholders going beyond their input</td>
<td>Limited liability, from the date of the filing of the certificate of incorporation, (DelGCL 106, MBCA 2.03)</td>
<td>Limited liability, only after registration of the corporation in the commercial register</td>
<td>Limited liability, only after governmental registration in the Khokimiyat, Inspectorate for Registration of Entrepreneurial Entities (within 3 days, or 7 days to a month)</td>
</tr>
<tr>
<td>Fully and freely transferable shares. Any restrictions on sale of shares, including the security market restrictions</td>
<td>Fully transferable only after the registration with the SEC pursuant to section 5 of the Securities Act of 1933.</td>
<td>Fully transferable only after registration of the corporation in the commercial register</td>
<td>Fully transferable, only for open joint-stock companies, and only after governmental registration in the Khokimiyat, Inspectorate for Registration of Entrepreneurial Entities (within 3 days, or 7 days to a month)</td>
</tr>
<tr>
<td>Centralized management under a board</td>
<td>One-tier board. Multiple members of the Board of Directors required.</td>
<td>Two-tier board. Multiple members for Supervisory Board required,</td>
<td>Two-tier board (triangular structure). Multiple members for Supervisory Board</td>
</tr>
<tr>
<td>structure</td>
<td>Management is performed by the CEO and executive directors and officers (officers are not a part of the Board of Directors)</td>
<td>the Management Board can consist of a single person</td>
<td>required, the Management Board can consist of a single person</td>
</tr>
<tr>
<td>-----------</td>
<td>-------------------------------------------------</td>
<td>---------------------------------------------------</td>
<td>----------------------------------------------------------</td>
</tr>
<tr>
<td>Shared ownership by contributors of capital</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Co-determination (Mitbestimmung)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1. More than 2000 employees – half of the Supervisory Board elected by employees (chairman is elected by shareholders, and he has a casting vote),</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. More than 500 but less than 2000 employees - one third of the Supervisory Board elected by employees</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Industry of coal and steel - full-parity co-determination by the shareholders and employees.</td>
<td></td>
</tr>
</tbody>
</table>

In Germany, the closest equivalent to the public corporation is the „Aktiengesellschaft“\textsuperscript{179}, which possesses all of the five characteristics as described above\textsuperscript{180}.

Regarding the United States, the Black’s Law Dictionary defines a corporation as an:

“entity (usually a business) having authority under law to act as a single person distinct from the shareholders who own it and having rights to issue stock and exist indefinitely; a group or succession of persons established in accordance with legal rules into a legal or juristic person that has a legal personality distinct from the natural persons who make it up, exists indefinitely apart from them, and has the legal powers that its constitution gives


\textsuperscript{180} In fact, some authors use the term “public corporation” while referring to AG, see Du Plessis et al., supra note 16, at 5, Wirth, et al., supra note 87, at 71.
while public corporation (publicly held corporation) is defined as a “corporation whose shares are traded to and among the general public” \(^{182}\).

The Model Business Corporation Act was amended in 2005 to include the section 1.40(18A), which specifically defines the term “public corporation”: “Public corporation’ means a corporation that has shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national securities association” \(^{183}\). This term covers the five features as described above, however, puts a more stringent requirement – mandatory listing on an accredited stock exchange. Introduction of such a specific definition was driven by the need to include the changes responding to the scandals such as Enron, and other corporations \(^{184}\).

Delaware General Corporation Law does not provide with a theoretical definition of “corporation” or “public corporation”, therefore, general definition employed by the MBCA can be used \(^{185}\).

In Uzbekistan, the entity possessing five features and qualifying as public corporation is the open joint-stock company. There are two types of joint-stock companies: open and closed joint-stock companies \(^{186}\), and they have two important differences: first, the number of shareholders in closed joint-stock company cannot be more than 50; second, closed joint-stock company cannot have an open subscription to its shares or otherwise offer the shares

\(^{181}\) B.A. Garner, Black's Law Dictionary (West. 2010).
\(^{182}\) B.A. Garner, Black's Law Dictionary (West. 2010).
\(^{183}\) MBCA 1.40(4).
\(^{184}\) Hillary A. Sale, The New “Public” Corporation, 74 Law & Contemporary Problems (2011), at 137. The paper further argues that the recent financial crisis shows that the corporations have not incorporated the lessons of the Enron and have consistently failed in governing the corporations properly.
\(^{185}\) “Corporation’ [...] means a corporation for profit, which is not a foreign corporation, incorporated under or subject to the provisions of this Act” MBCA 1.40(4).
\(^{186}\) Article 7 of Uzbek Law on Joint-Stock Companies.
to unlimited number of buyers. Thus, the closed joint-stock company is an equivalent of a closely-held corporation in the United States and resembles the Gesellschaft mit beschränkter Haftung (GmbH) in Germany. Hence, only open joint-stock company can be regarded as a public corporation, and the thesis will deal only with open joint-stock companies.

1.5. Uzbekistan: pre-independence heritage

This section lays down the basis for the comparison to be made; it shows the starting point in order to have the correct picture.

During the Soviet Union era (1918-1991), the corporate law in Central Asia was governed by the Soviet law; under the reign of the Russian empire (1867-1918), they were governed by the Russian law and only partially by Islamic law; before invasion of Russian empire (before 1860-s), the only governing law in the area was the Shari‘a – the Islamic law, while the existing sources regarding the history before the invasion of Arabs to the Central Asia do not contain any information in this regard.

1.5.1. Islamic law (Shari‘a)

Islamic law is in Arabic known as Shari‘a, which means “the right path”, and is considered as the divine law mainly based on Kur’an and hadith; Shari‘a reflects the

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187 For a discussion of pre-independence heritage see Rahmonqulov & Gulyamov, supra note 10, at 46-67; for a general discussion, see Akmal H. Saidov. Comparative Law (Wildy, Simmonds & Hill 2003).
188 The reign of the Russian empire on the territory of Central Asia, and Uzbekistan in particular, can be deemed to start from 1867, when the Turkestan Governor-Generalship was created by the Russian tsar. See Aminov, A.M., Bobohodjaev A.X. Ekonomicheskie i Politicheskie Posledstviya Prisoedineniya Sredney Azii k Rossii (Tashkent. 1996), at 85.
190 Ian Edge, Islamic Law and Legal Theory, the International Library of Essays in Law and Legal Theory, series editor Tom D. Campbell, (Dartmouth Publishing Co. 1996), at xvi.
commands given by Allah to His servants through any of prophets\textsuperscript{193}. The legal system of Uzbekistan and the Central Asia was based on Shari‘a from the end of the 8\textsuperscript{th} century till the Russian invasion in 1860-s, but was partly applied till 1920\textsuperscript{194}.

There are two main benefits of corporate legal personhood – simplification of litigation\textsuperscript{195}, and shielding of shareholders from the liabilities of the corporation\textsuperscript{196}. There is always a social demand for an innovation (such as pooling assets and limiting the liability) to appear in the society, and while the elite of the western states was trying to create corporations for various purposes they wanted to reach, the Islamic law, due to its internal characteristics, such as merger of religion and state, ban of interest loans, as well as strong position of waqf (religious unincorporated trust), not only banned creation of any such entities, but also eliminated the need for creating them\textsuperscript{197}.

Thus, due to the dominance of the Islamic law on the territory of Central Asia, there were no corporations possessing the limited liability and separate legal personality (i.e., in the western sense of it), only partnerships (\textit{sharikat}) have existed. Partnerships were divided into two types: \textit{sharikati milk} (joint ownership) and \textit{sharikati aqd} (contractual partnership)\textsuperscript{198}. \textit{Sharikati milk} (joint ownership) does not have a contractual nature and

\textsuperscript{192} “[T]radition, being an account of what the Prophet [Mohammed] said or did, or of his tacit approval of something said or done in his presence”, see M. Th. Houtsma (ed.), Encyclopedia of Islam, (E. J. Brill, Leiden. 1986), Volume III, at 23.

\textsuperscript{193} H.H. Hassan, An Introduction to The Study of Islamic Law, (Adam Publishers & Distributors. 2007), at 3.

\textsuperscript{194} Saidov, supra note 187, at 398; “Legal regulations in Russian Central Asia ... were governed by Islamic written law and local custom”, William E. Butler, Soviet Law, (Butterworths Law 2\textsuperscript{nd} ed. 1988), at 24.

\textsuperscript{195} Having a separate legal personality, the corporation can sue and be sued in its own name, not involving each of the shareholders of the said corporation; the limited liability ensures that the shareholder’s liability does not exceed his share in the enterprise.


\textsuperscript{197} Id. at 14.

\textsuperscript{198} W.B. Hallaq, \textit{Shari‘a}: Theory, Practice, Transformations (Cambridge University Press. 2009), at 251.
does not give a rise to fiduciary duties\textsuperscript{199}; on the other hand, \textit{sharikati aqd} (contractual partnership) implied the existence of agency relationships\textsuperscript{200} between the partners, where the principal gave his agent the power to act on his behalf\textsuperscript{201}, and gave rise to fiduciary relationship\textsuperscript{202}. Hence, only the \textit{sharikati aqd} (contractual partnership) will be discussed.

Four types of contractual partnership agreements have existed on the territory of Central Asia\textsuperscript{203}:

- \textit{“Shirkati muvafazot”} – partnership based on equal participation of partners in order to reach the stated objective. The essential feature of this type of partnerships was the equality between partners – equal contributions, equal division of profits and losses, equal rights and responsibilities in the management of the partnership (i.e., in representation of the partners, since each partner was viewed as a representative of other partners).

- \textit{“Shirkati inon”} – contract-based partnership created for the purposes of trading, i.e., buying, transporting and selling goods. The contributions did not have to be equal. In this type of partnership each partner was viewed as a proxy rather than a guarantor for the liabilities of the other partners, since partners were not liable for each other’s liabilities.

- \textit{“Shirkati vujuh”} – partnership aimed at joint selling of the goods. Each partner was both representative and guarantor of all other partners, the rights and liabilities being divided according to contribution of partners.

- \textit{“Shirkati sanoiya”} – partnership between craftsmen created for a specific purpose or for doing craftsmanship together. There was no requirement that the partners work at the same place or produce the same type of goods. The partners had joint and several liability for liabilities of other partners, and the division of profits could be different from the amount of contributions.

None of the partnerships listed above possessed legal status and could not be regarded as an entity separate from the participants. As noted above, there was no possibility of ensuring such status, due to the fact that most of the agreements were oral, and the specific terms were designed by the parties.

\textsuperscript{199} Sharikati milk (joint ownership) usually emerges from inheritance, and although called “partnership” in Islamic law, in fact it is not a partnership, but simple joint ownership. See Hallaq, supra note 198, at 251.

\textsuperscript{200} Hallaq, supra note 198, at 261.

\textsuperscript{201} Id.

\textsuperscript{202} Id. at 254.

\textsuperscript{203} Rahmonqulov & Gulyamov, supra note 10, at 49-50. For a more elaborate discussion of types of partnerships in Shari’a, see Hallaq, supra note 198, at 250-254.
Islamic law has strongly influenced the contemporary socio-cultural realities, as well as the legal system and government policy of Uzbekistan\textsuperscript{204}. One of the five main principles for the new economic model for Uzbekistan’s transition to market economy\textsuperscript{205} is the strong social policy, which is one of the underlying principles of Islamic law\textsuperscript{206}. Also, stemming from the fact that under the Islamic law, the core of the business was partnerships and sole proprietorships, protection of small and medium enterprises was declared as one of the mainstream policies in economic development of the country\textsuperscript{207}, and only recently has the legislator started to pay more attention to public corporations\textsuperscript{208}.

1.5.2. Russian empire

As noted earlier, it was not until the Russian invasion that the concept of legal persons in the current understanding was introduced to Central Asia\textsuperscript{209}. The Russian empire that invaded Central Asia in the 1850-s, also brought the bank and industrial capital, which in its turn started actively flowing into the new and untouched areas. The notion of “legal entity” with respect to private commercial enterprises was developed in the Russian empire at the end of the 19\textsuperscript{th} century\textsuperscript{210}, and this concept was introduced to Central Asia\textsuperscript{211}. In particular, the Russian empire introduced the concept of joint-stock company, which is a

\textsuperscript{204} Saidov, supra note 187, at 405.


\textsuperscript{206} Saidov, supra note 187, at 405.


\textsuperscript{208} See infra section 1.7.

\textsuperscript{209} Most of the territory of Central Asia, including the whole territory of Uzbekistan, was united under the Turkestan Governor-General, which was a part of the Russian empire. It was not before 1925 that Uzbekistan has appeared on the map, thus it would be appropriate to elaborate about Central Asia as a whole.

\textsuperscript{210} History of State and Law, Course of lectures (Novosibirsk, 2000), at 97., I. A. Isaev, History of State and Law of Russia (Yurist. 2004), at 227.

\textsuperscript{211} Saidov, supra note 187, at 391.
legal entity separate from the shareholders, and where the shareholders have limited liability\textsuperscript{212}.

First companies on the territory of Central Asia were the so-called “trading houses”\textsuperscript{213}, though they not only dealt with reprocessing cotton, silkworm breeding, importing and selling industrial products, but also were in the business of irrigation, engineering, and railways building. By 1916 there were, inter alia, already nine huge trading houses that owned more that 58 cotton reprocessing and 15 oil refining factories\textsuperscript{214}.

All companies were either partnerships or joint-stock companies; both were regulated and subject to various regulations issued by the Russian Emperor, as well as the Duma. In order to be registered and be able to issue shares, a joint-stock company had to comply with the government policy, and all the regulations in force; also, the joint-stock company would need to get approval from the Ministry of Finance to issue other securities\textsuperscript{215}. As a rule, all legal entities, including joint-stock companies, could be owned and managed solely by persons of Russian nationality and belonging to Christian confession\textsuperscript{216}. However, at the beginning of the 20\textsuperscript{th} century local and foreign investors started becoming shareholders by buying out bearer shares\textsuperscript{217}.

Although the legal system in Central Asia was generally governed by Islamic law until

\textsuperscript{212} Saidov, supra note 187, at 98; History of State and Law, Course of Lectures (Novosibirsk. 2000), at 97.
\textsuperscript{213} Trading house is a large commercial enterprise, which deals with commercial transactions using its own capital and debt capital. They are frequently involved in other types of business transactions, as well as closely collaborate with producers of goods. See Encyclopedia of Economics and Law, Moscow, 2005. The first trading houses first appeared in Russia in the XVI century, for instance, Stroganov trading house, Bazhenin trading house. See Isaev, supra note 210, at 227.
\textsuperscript{214} Aminov & Bobohodjaev, supra note 188, at 85.
\textsuperscript{215} Isaev, supra note 210, at 227.
\textsuperscript{216} Rahmonqulov & Gulyamov, supra note 10, at 51.
\textsuperscript{217} Id.
1920\textsuperscript{218}, the legal changes were directed towards the European model of regulating\textsuperscript{219}. For instance, the local courts had jurisdiction to settle the disputes between the locals, and such disputes could be resolved under Shari‘a\textsuperscript{220}. However, if the dispute involved persons of Russian nationality, or the subject matter of dispute arose in connection with the law of the Russian Empire, such disputes had to be resolved by the courts of the Russian Empire\textsuperscript{221}. Thus, any dispute arising in connection with a joint-stock company had to be decided under the laws and in the courts of the Russian Empire.

1.5.3. Soviet Era

When the corporate sector in Central Asia just started to develop, the Bolsheviks came to force in 1918, and brought the Soviet ideology based on the ideas of Karl Marx and Friedrich Engels. In Marxist thinking, the private property was the basis of the distinction between the capitalist and socialist society, and the essence of capitalism being the exploitation of the free labor by owners of the private property\textsuperscript{222}.

The first step taken by the Soviet government was the liquidation of private property\textsuperscript{223}, and establishing the primacy of collective interest over private interests\textsuperscript{224}. However, the Soviet government realized that total ban of private ownership is not possible,

\textsuperscript{218} Saidov, supra note 187, at 398; “Legal regulations in Russian Central Asia ... were governed by Islamic written law and local custom”, William E. Butler, supra note 194, at 24.

\textsuperscript{219} Saidov, supra note 187, at 391.

\textsuperscript{220} Art. 118, 210, 211 of the Regulation of Management of the Turkestan Region, June 12, 1886 (# 3814), Morduchaj-Boltovskoj, Ivan Dmitrievič, Svod’ Zakonov’ Rossijskoj Imperii (Saint-Peterburg, 1912), Volume 2.

\textsuperscript{221} Art. 143 of the Regulation of Management of the Turkestan Region, June 12, 1886 (# 3814), Morduchaj-Boltovskoj, Ivan Dmitrievič, Svod’ Zakonov’ Rossijskoj Imperii (Saint-Peterburg, 1912), Volume 2.


\textsuperscript{223} William E. Butler, supra note 211, at 38.

and in 1936 the difference between “private” and “personal” property was introduced. Ownership of “private” property – instruments and means of production – was banned, since “[t]he abolition of private ownership on the instruments and means of production is ... absolute condition precedent to the construction of the socialist order and the consolidation of its economic power base,” while the “industry is conducted primarily to develop national economy and not to make a profit.” On the other hand, ownership of “personal” property, i.e., consumer goods, was allowed and even enjoyed constitutional guarantees.

This distinction was aimed to limit the possibility of an individual to collect and own more property than any other individual. “Private” property had been banned since if a private person owns means of production, he will own and be able to sell the product that he may produce, which will lead to a difference in the wealth of individuals. Moreover, so-called “non-labour income” was also prohibited, and there was a constitutional requirement that only “labour income” is the basis of the allowed “personal” property. Although the Soviet law did not attempt to provide a list of what may be the object of personal property nor did it specify the maximum limit of property that could be possessed by a single person; nonetheless, if the amount held by a person was considered excessive by the state authority, such property could be seized by the state.

Regarding the ownerships of shares in corporations, since the business corporations are aimed to produce goods or provide services, ownership of a share in a corporation and

225 William E. Butler, supra note 211, at 38.
228 Id. at 182.  
229 Id. at 183.
230 Id. at 182.  
231 Id. at 186; for a discussion of specific examples regarding seizure of excess property by the State, see Samuel Kucherov, Property in the Soviet Union, 11 American Journal of Comparative Law 3, 376-392 (1962), at 384-388.
getting a dividend would be qualified as “non-labour income”, which was banned by the law\textsuperscript{232}, therefore, the legislature excluded the possibility of having private ownership in corporate property\textsuperscript{233}. Although a private person could own government bonds, he could not own shares; privately owned corporations were viewed as a threat to the stability of the Soviet regime, undermining the stability and the regime of the Soviet state\textsuperscript{234}; thus, the Civil Code of the Uzbek Soviet Socialist Republic of 1938 did not contain any norms governing private business organizations such as partnerships, limited liability companies and joint-stock companies\textsuperscript{235}.

The concept of the \textit{ownership rights of corporations} was more compelling. Since ownership of all the means of production belonged to the state, all corporations were also owned by the state. In fact, although corporations had property on the books, they could not dispose of it, since the property of a juridical person was within its “operative management”\textsuperscript{236}, which limits the decision-making powers of the corporate management. Consequently, the corporations were limited in their independent \textit{raison d’etre}\textsuperscript{237}, and the management of the corporations was constrained by the government production and distribution plans.

\textsuperscript{232} William E. Butler, supra note 211, at 182.
\textsuperscript{234} Id.
\textsuperscript{235} Makovskiy A.L., \textit{O Kodifikatsii Grajdanskogo Prava 1922 - 2006} (Statut. 2010), at 206.
\textsuperscript{236} “Operative management” is a type of ownership right, under which the enterprise’s rights of possession, use and disposition of property are limited; in particular, the enterprise cannot transfer any assets without owner’s express permission. See Bregman, Randy; Lawrence & Dorothy C., \textit{New Developments in Soviet Property Law}, 8 Columbia Journal of Transnational Law 189 (1990), at 189.
\textsuperscript{237} William E. Butler, supra note 211, at 246.
1.6. Independent Uzbekistan – the policy decision

Only after the collapse of the Soviet Union the concept of private ownership not limited by any governmental authority was introduced in Uzbekistan. After gaining its independence, Uzbekistan chose to move from planned to market economy, introducing new concepts and features, privatizing government property, giving freedom for businesses to operate. The new economic model was based on five main principles, which were defined by the President of Republic of Uzbekistan. The protection of small and medium enterprises (SME) was declared as one of the mainstream policies in economic development of the country. The government’s consistent strategy of supporting SMEs yielded its fruits, and from 1991 to 2011 the share of small and medium businesses in the GDP of the country reached 52% starting by 0%.

In the development of corporate law in independent Uzbekistan, one can distinguish three stages of development as described below.

During the first stage (1991-2002), the basic legislation was passed, including the Civil Code, the Code of Civil Procedure, the Code of Commercial Procedure, and the Law on Joint-Stock Companies. In addition, the regulatory vacuum that appeared in newly organized joint-stock companies was partly filled by adopting model bylaws on the General Meeting of

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238 The corporate governance system in a given country is also determined by the political choices, see Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance (Princeton University Press. 1994), at 19-26, see also Clarke, supra note 35, at 83.

239 See supra note 198.


241 In Uzbekistan, the year 2011 was declared as the “Year of small business and private entrepreneurship” see, at Press-Uz.info (December 2010), available at: http://pressuzinfo.uz/index.php?title=home&nid=10&my=122010&st=0 (last visited November 1, 2011).


243 This division of stages has initially been proposed by Ashurov, supra note 10, at 118-120. Available at: http://ssrn.com/abstract=1681572 (last visited November 1, 2011).
Shareholders, the Supervisory Board, the Management Board and a regulation on government representatives in joint-stock companies\textsuperscript{244}. Also, the basics of securities market were established at this stage\textsuperscript{245}.

At the second stage (2003-2007) the legislator recognized that the changes in the corporate law of transition period would not create the corporate governance system, and there is a policy decision to be made in order to create an own, viable corporate governance system. The attempts to create one started with the Decree of President Islam Karimov in 2003\textsuperscript{246}, which radically increased the minimum charter capital of the joint-stock companies from 2,807 USD\textsuperscript{247} to 50,000 USD. The same decree established the Center for Corporate Management of the Higher School of Business under the Academy of State and Social Construction under the President of the Republic of Uzbekistan. The Centre aims at preparing, training and retraining of managers by organizing courses on corporate governance\textsuperscript{248}, financial accountability, and management courses for members of supervisory boards and management boards. More than four thousand members of supervisory boards and management boards, as well as other executives have participated in such courses in five years\textsuperscript{249}, while President Islam Karimov has personally controlled the

\textsuperscript{244} Cabinet of Ministers of the Republic of Uzbekistan, Resolution on Measures for Improving Governing System of Joint-Stock Companies, 22 August 1998, №361.

\textsuperscript{245} Ashurov, supra note 10, at 118-120.

\textsuperscript{246} President of the Republic of Uzbekistan, Decree On Measures for Cardinal Increasing Share and Value of the Private Sector in Economy of Uzbekistan, 24 January 2003, №UP-3202.

\textsuperscript{247} The minimum charter capital requirement before this decree was 500 minimum monthly wages; the minimum monthly wage rate for that date was defined as 5,440 UZS (according to the Decree of the President of the Republic of Uzbekistan, 2 April 2003 (UP-3231), while the exchange rate was 968.69 UZS for USD for the same date. Available at: \url{http://finance.doda.uz/currency-rchive/01-04-2003/} (last visited November 1, 2011).

\textsuperscript{248} Most of the large corporations send at least several of their high-level executives to these seminars, for instance, Joint-Stock Company “Uzdonmahsulot”, see \url{http://uzdon.uz/}, “Uz-Daewoo Auto”, see \url{http://www.toshdeu.narod.ru/news.html}, Joint-Stock Company “Uztelecom”, see \url{http://www.uztelecom.uz/ru/company/career/personnel_policy/}, Joint-Stock Company “Trastbank” \url{http://www.trustbank.uz/ru/career/personnel_policy/} (last visited November 1, 2011).

\textsuperscript{249} See \url{http://iqtisod.zn.uz/721} (last visited November 1, 2011).
execution of these reforms\textsuperscript{250}.

The next step was the creation of the Centre for Studies of Problems of Privatization, and Development of Corporate Governance under the State Property Committee of the Republic of Uzbekistan\textsuperscript{251}, which has quite different, but more extensive research targets, compared to the Centre for Corporate Governance Studies under the Higher School of Business, including development of new programs of privatization, increasing the transparency of privatization mechanisms, development of corporate governance mechanisms in private, newly privatized, and state-owned companies, training of the employees of the State Property Committee, and many others.

The adoption of the securities market development program\textsuperscript{252} was also one of the landmarks of the period, it provided for a new structure of the securities system, including adoption of more than twenty new regulations and other changes.

The third stage (2008 – present) has been the turning point in the development of corporate governance in Uzbekistan. One of the most important changes was the introduction of the "golden share", which is a special right of State participation in the management of otherwise private corporations of strategic importance\textsuperscript{253}.

As noted earlier, the creation of own corporate governance system is indeed a policy decision, one of the questions being whether a transitory country needs large public...

\textsuperscript{250} The President Islam Karimov, On the Results of Economic and Social Sphere Development in the 1\textsuperscript{st} Half of 2003 and Measures Implementation According to the Priority Actions Reforms in These Spheres, 18 July 2003.

\textsuperscript{251} Cabinet of Ministers of the Republic of Uzbekistan, Decree on Establishment of the Centre for Studies of Problems of Privatization, and Development of Corporate Governance, 9 June 2006, №113.

\textsuperscript{252} President of the Republic of Uzbekistan, Decree on Measures for the Further Development of Securities Market, 27 September 2006, №PP-475.

\textsuperscript{253} President of the Republic of Uzbekistan, Decree on Additional Measures to Deepen Process of Privatization of Strategic Branches of Economy, 20 July 2007, №UP-3897.
corporations at all\(^2\text{54}\). Such a decision became evident with another huge change in 2008 – the minimum registered capital requirement for corporations was further increased from 50,000 USD to 400,000 USD\(^2\text{55}\), and from 1 January 2009 all newly registered corporations in Uzbekistan had to comply with the new requirements, while already existing corporations were obliged to increase their registered capital respectively till 1 January 2010 or had to be transformed into other types of legal entities. The results of this change were as follows: out of 1,377 joint-stock companies affected by the law (including 612 with government share) 652 corporations (39.7%) have increased their share capital to the required amounts, 657 corporations (40%) have transformed into other types of companies, and 68 corporations (4.2%) have not changed their status due to bankruptcy or other judicial proceedings\(^2\text{56}\).

The fact that the minimum registered capital was significantly increased by 140 times (from 2,807 USD to 400,000 USD) in the span of five years, as well as increased attention of the government to promote corporate governance are indicators that the policy in Uzbekistan is to distinguish the small and medium businesses from the big businesses, allow consolidation of assets and possibilities to use the economies of scale; also, this decision will have significant impact on the development of the corporate sector in the country.

\(^{254}\) Tajti, Tibor, Corporate Governance: An Oversold Elitist Idea of No Interest to or for the Central European Transitory Economies, 1 Corporate Governance Law Review 1 (2005), at 44.


1.7. Overview of the corporate governance system in Uzbekistan

**Basics of the legal system**

Uzbekistan belongs to Roman-German legal system\(^{257}\), and has codified most of the legislation, including the Civil Code, the Code of Civil Procedure, the Commercial Procedural Code, the Criminal Code, and the Labour Code. The Constitution, the Civil Code and the Law on Normative Legal Acts of the Republic of Uzbekistan\(^{258}\) establish the following hierarchy of substantive norms regulating the civil legal relations, including the issues related to corporations:

1. Constitution of the Republic of Uzbekistan\(^{259}\);
2. Civil Code of the Republic of Uzbekistan\(^{260}\);
3. laws enacted by the Parliament of the Republic of Uzbekistan\(^{261}\);
4. subordinate legislation:
   a. Decrees of President\(^{262}\);
   b. Resolutions of Cabinet of Ministers\(^{263}\);
   c. Legal acts of Ministries and State Committees\(^{264}\).

Moreover, the Law of the Republic of Uzbekistan on Courts\(^{265}\), the Plenum of the

\(^{257}\) Warring & Pierce, supra note 10, at 477; Rahmonquilo & Gulyamov, supra note 10, at 251.


\(^{260}\) “Norms of civil legislation contained in other laws and other acts of legislation must correspond to the present code”, Article 3 of the Civil Code of the Republic of Uzbekistan, December 21, 1995, №163-1 ; for an English translation of the code, see William Butler, Civil Code of the Republic Uzbekistan, (Kluwer Law International 3\(^{rd}\) ed. 1999)

\(^{261}\) Article 8 of the Law on Normative Legal Acts.

\(^{262}\) Article 10 of the Law on Normative Legal Acts.

\(^{263}\) Article 11 of the Law on Normative Legal Acts.

\(^{264}\) Article 12 of the Law on Normative Legal Acts.

\(^{265}\) The Law of the Republic of Uzbekistan on Courts, September 2, 1993, N 924-XII (as revised by the law of December 14, 2000, № 162-II).
Supreme Court and the Plenum of the High Economical Court can issue “explanations”\(^{266}\) that are mandatory for all courts, government and private actors applying the legislation in question.

**Basics of corporate law**

Functioning of the corporations in the Republic of Uzbekistan is governed by the Civil Code, the Law on Joint-Stock Companies, and the Law on Securities Market. However, these laws do not address a number of issues, such as nominations for the members of the boards, specific duties as well as specific bases for removal of members of the Management Board; these issues are addressed in the subordinate legislation, and Resolutions of Plenums, as described later. Apart from the legislative provisions, in accordance with the Resolution of the Cabinet of Ministers\(^ {267}\), the Joint Resolution of the Plenum of the High Economical Court and the Plenum of the Supreme Court of the Republic of Uzbekistan on Certain Issues Pertaining to the Application of Legislation on Joint-Stock Companies\(^ {268}\) following are also applicable with regard to the functioning of the corporations on the territory of the Republic of Uzbekistan:

- Model Bylaw on the General Meeting of Shareholders of Joint-Stock Company\(^ {269}\);
- Model Bylaw on the Supervisory Board of Joint-Stock Company\(^ {270}\);
- Model Bylaw on the Managing Organ of Joint-Stock Company\(^ {271}\);  

\(^{266}\) Articles 21 and 48 of the Law of the Republic of Uzbekistan on Courts, respectively.  
\(^{268}\) The Joint Resolution of the Plenum of the High Economical Court and the Plenum of the Supreme Court of the Republic of Uzbekistan on Certain Issues Pertaining to the Application of Legislation on Joint-Stock Companies of March 31, 2005, №02/124.  
Basics of internal governance structure in public corporations

Uzbek corporate law is believed to follow the German model and the Uzbek corporate governance system is characterized by a two-tier system, where the Supervisory Board (as Aufsichtsrat in Germany) has the power of oversight of the Management Board, whereas the Management Board (as Vorstand in Germany) has the executive power and direct executive responsibility. As in Germany, the Supervisory Board of the Uzbek corporation should not become responsible for the actual management of the corporation, but should exercise supervision of the Management Board. Members of both Supervisory and the Management Boards are obliged to act in the best interests of the corporation and are jointly and severally responsible for their actions towards the

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273 Resolution on Government Representatives in Joint-Stock Companies, Cabinet of Ministers of the Republic of Uzbekistan, Resolution on Measures to Improve Corporate Governance of Privatized Enterprises, 19 April 2003, №189, Appendix 2, (hereinafter referred to as Resolution on Government Representatives).

274 The Regulation on Affiliated Persons, on Keeping the Records and Disclosure of Affiliated Persons in the Joint Stock Companies, Order of the Center for Coordination and Control over the Securities Market and State Property Committee of November 20, 2002, №2002-14, Ministry of Finance №131, the State Antimonopoly Committee №7, registered at the Ministry of Justice 29.01.2003 №1212 (hereinafter referred to as Regulation on Affiliated Persons).

275 Resolution on Centre for Coordination and Control over the Securities Market under the State Property Committee, Cabinet of Ministers of the Republic of Uzbekistan, Resolution on Organization of Activity of Center for Coordination and Control over the Securities Market under the State Property Committee, March 30, 1996 №126, appendix 3.

276 Rahmonqulov & Gulyamov, supra note 10, at 251; see also Ashurov, supra note 10.

277 Art. 81 of Uzbek Law on Joint-Stock Companies.
corporation\textsuperscript{278} (apart from those members who have voted against the decision in question or have abstained from voting\textsuperscript{279}).

According to the Uzbek Law on Joint-Stock Companies, the general meeting of shareholders is considered as the “supreme authority” in governance of the corporation\textsuperscript{280}, and, unlike in Germany, has the default right to elect and remove the Management Board\textsuperscript{281} (but this right can be delegated to the Supervisory Board\textsuperscript{282}). Also, the general meeting of shareholders elects the Inspection Committee (or one Inspector)\textsuperscript{283} and has the exclusive rights to decide regarding the issues of liquidation and reorganization of the corporation, amendments to the charter, increase or decrease of the charter capital. All decisions at the general meeting of shareholders are taken based on the one share-one vote principle; cumulative voting is used only in electing the members of the Supervisory Board.

The Supervisory Board\textsuperscript{284} exercises general supervision of the corporation in all issues except for the issues within exclusive jurisdiction of the general meeting of shareholders\textsuperscript{285}. The law provides the following requirements for the members of the Supervisory Board – they cannot be members of the Management Board or Inspection Committee of the same corporation, or have an employment contract in any other capacity with the same corporation at the same time. The members of the Supervisory Board are elected for a year, and can be re-elected unlimited number of times. The maximum number of members for the Supervisory Board is not provided, however, for corporations with 500

\textsuperscript{278} Art. 88 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{279} Id.

\textsuperscript{280} Art. 64 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{281} Art. 65 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{282} Id.

\textsuperscript{283} The literal translation of this commission’s name is “Revision Committee”.

\textsuperscript{284} According the Uzbek Law on Joint-Stock Companies the supervising body is called “Supervisory Council”, for the purposes of this article, the term the Supervisory Board will be used.

\textsuperscript{285} Art. 81 of Uzbek Law on Joint-Stock Companies.
or more shareholders (owners of voting shares), the Supervisory Board has to have at least seven members, with more than 1,000 shareholders – at least nine members\textsuperscript{286).

The executive function in corporation in Uzbekistan can be delegated to a single person (Individual Executive Organ), a board (Collegial Executive Organ), a sole proprietor (Manager) or another organization (Managing Company)\textsuperscript{287}; moreover, the corporation can choose to have both Individual Executive Organ and Collegial Executive Organ. For the purposes of this thesis, in order to simplify the analysis, the Individual Executive Organ is referred to as the CEO and the Collegial Executive Organ including the Individual Executive Organ is referred to as the Management Board.

The Management Board has full executive power, reports directly to the Supervisory Board, and has authority over all matters that are not within the competence of either the Supervisory Board or the general meeting of shareholders\textsuperscript{288}. Members of the Management Board can only be removed for a cause – violation of terms of the agreement with the corporation, gross violation of the charter, and causing loss to the corporation\textsuperscript{289}, or violation of the law. However, the law does not define the “loss”, which leaves an open field for the interpretation of actions of the Management Board.

Regarding the remuneration of the Supervisory and the Management Boards, there is no specific procedure of determining, apart from the requirement that the remuneration be directly related to the effectiveness of the corporation and be determined by the contract\textsuperscript{290}. The remuneration of both Supervisory and the Management Boards is

\textsuperscript{286} Art. 83 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{287} Art. 86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{288} Id.
\textsuperscript{289} Id.
\textsuperscript{290} Id.
determined solely by the general meeting of shareholders\textsuperscript{291}, but the right to determine the remuneration of the Management Board can be delegated to the Supervisory Board by the articles of association of the corporation\textsuperscript{292}.

1.8. Previous studies on Uzbek corporate governance

As noted earlier, the topic of corporate governance is new to Uzbekistan as such, and one would hardly find studies made in the area. However, the international organizations have a long time ago seen the necessity to develop a workable system of corporate governance, in particular, the Asian Development Bank (ADB) and the European Bank for Reconstruction and Development (EBRD) have made considerable efforts in strengthening the system of corporate governance in the so-called “transition countries”, including Uzbekistan.

The ADB had undertaken a 700,000 USD project in 2001-2002 in Uzbekistan, which has resulted in accepting several new laws and changes in a number of other laws. According to ADB’s Technical Assistance Completion Report, this project was partly successful. EBRD has also worked on improving the corporate governance in the legal system of Uzbekistan. The main instruments for measuring the quality of corporate governance provisions were the OECD principles of corporate governance, and the EBRD is applying and including the OECD principles. The only local organization to conduct a rather in-depth study in corporate governance was the Centre for Economic Research in 2006.

The ADB project

The ADB project of 2001-2002, which was aimed at enhancing transparency and

\textsuperscript{291} Art. 81 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{292} Art. 82 of Uzbek Law on Joint-Stock Companies.
disclosure and safeguarding investors’ rights, was designed to:

- review the adequacy of the policy, legal and regulatory framework for corporate governance, and an assessment of the state of corporate governance practices in production and trade associations (PTAs) and corporations;
- develop a framework for efficient management of the Government’s shares in corporations;
- conduct capacity building activities for efficient and impartial supervision and regulation of corporations.

As a result of the project a review of the legal framework, including the Civil Code, the Law on Joint-Stock Companies, and the Audit Law, was made; Corporate Governance Centre at the State Property Committee was established and its staff was trained\(^{293}\). However, the completion report noted that sustainability of these reforms is under question due to the lack of financial resources to go on with the reforms\(^{294}\).

**The EBRD study**

In 2003, EBRD has made an assessment of how extensive the laws of Uzbekistan concerning corporate governance were, and how they conformed to the OECD Principles, which were taken as the basis. Assessment was made according to the five criteria and methodology developed by the EBRD, and the result showed the level of compliance out of maximum 100%:

- rights of shareholders 90%
- responsibilities of the board 70%
- equitable treatment of shareholders 70%
- disclosure and transparency 25%
- role of stakeholders in corporate governance 84%

According to the assessment, Uzbekistan is a “medium compliance” country, but comparing to other countries in the region, Uzbekistan has a good basis. The EBRD study has


\(^{294}\) Id.
pointed out the following suggestions: the law should require that all shares be fully paid before they can be transferred, companies should be required to prepare quarterly financial reports and group accounts on a consolidated basis, in line with internationally recognized accounting standards, the law should set specific rules to guarantee auditors’ independence, boards should include a certain number of non-executive and independent directors and separate committees for dealing with financial reporting. Finally, laws addressing disclosure of corporate information should be improved, as should the legislation on insider trading.295.

The CER research

The Centre for Economic Research296 (hereinafter CER), an independent non-profit research institution established in April 1999 jointly by the Government of Uzbekistan and the United Nations Development Program, has conducted a research named “Challenges to Introducing Corporate Governance in Uzbekistan”297 in 2006. I consider analyzing this particular report as a source of valuable information, given the fact that:

- it is the only in-depth field-specific research in Uzbekistan that was published in the media;
- the research reflects the current understanding of corporate governance among the officials concerned, since most part of the research was accomplished by the two high-level government officials responsible for corporate governance reforms in the country298;
- the research also reflects the position and understanding of the scholars on the subject, since part of the research was made by a prominent professor of

298 Renat Yaushev - Head of Department of Studies Center of Privatization, Corporate Governance and Securities Market under the State Property Committee, and Tolipov Kamoliddin Fakhrutdinovich - General Director of the Center for Coordination and Control over the Securities Market under the State Property Committee.
economics, who has in fact defended a doctoral thesis on corporate governance in Uzbekistan.

The report makes an in-depth analysis of the current situation in the country, and while stressing the importance of protecting the rights of shareholders and investors, focuses on current legal and regulatory framework, degree of the state involvement, effectiveness of the controls of the joint-stock companies (General Meetings of Shareholders, Supervisory and the Management Boards), and problems of the stock market.

Then the report goes on with specific legal issues concerning the legal and regulatory framework, such as the enormous amount of subordinate legislation concerning the securities market, the inadequate reporting system for joint-stock companies, and the absence of specific regulations such as on insider trading. It also identifies most of the problems in the system of corporate governance in the country, and provides a list of suggestions. The thesis will frequently rely on the CER study as a valuable source of information.

The efforts of the international institutions are highly appreciated, and they have reached good results, nevertheless, one should always keep in mind that it is not reasonable to have a full transposition of the European and U.S. standards to Uzbekistan, a country without history of corporations. Thus, a reconsidered version of corporate governance system should be developed in order for it to be effective; otherwise all these laws will remain on paper.

299 Khamidulin Mikhail Borisovich, Professor of Economics, Doctor of Economic Sciences, Academic Pro-Rector of Banking and Finance Academy of the Republic of Uzbekistan.
300 CER research, supra note 297, at 5.
1.9. Conclusions

The chapter had two basic objectives: first, to introduce the theoretical background on which the thesis will be based upon and second, to familiarize the reader with the history of development of corporate law in Uzbekistan, especially with its recent developments.

The chapter has elaborated on the notions of “corporate governance”, “public corporation” and defined them in order to be able to uniformly use the said terms throughout the thesis. Moreover, since Uzbekistan has only recently introduced these notions, the legal status of the shareholders within the corporation has also been described.

The chapter has also discussed the history of development of corporate law on the territory of Uzbekistan. Although the concepts of limited liability and separate legal personality were introduced to Uzbekistan in mid-19th century, the concept of fiduciary duty in the agency relationships between business partners has a long history. In addition, the newest developments in the field of corporate law are also discussed and the policy of Uzbekistan to distinguish the large corporations from the smaller enterprises was discussed. Last but not least, the previous research made in the area of corporate law and corporate governance in Uzbekistan have been enumerated, including the efforts of ADB, EBRD and the research conducted by the CER.

To conclude, the chapter revealed that there is legitimate basis for discussing the issues of internal governance structure in Uzbekistan and compare it with Germany and the United States, since Uzbekistan is on its way to develop a hybrid version of internal governance structure, and is attempting to create large public corporations with numerous shareholders.
2. CHAPTER TWO: SHAREHOLDER RIGHTS AND OBLIGATIONS

Aktionäre sind dumm und frech. Dumm, weil sie Aktien kaufen, und frech, weil sie dann auch noch Dividende haben wollen. (Shareholders are stupid and impertinent: stupid, because they buy shares, and impertinent, because they demand dividends in return.)

—Carl Fürsenberg (1850-1933)

This chapter concentrates on various issues of protecting the shareholders’ rights in Uzbekistan, Germany and the United States, focusing on shareholders’ rights and obligations within the context of the internal governance structure of the corporation, while other aspects, such as the consequences of the ability or inability of the shareholders to effectively elect and remove the directors are discussed in the third chapter.

It is generally agreed that the primary investors into a firm\textsuperscript{302}, i.e., the shareholders, are often the most difficult to protect by mere contractual means\textsuperscript{303}, thus, shareholders need special statutory protection. Moreover, shareholder protection plays an important role in the development of the corporate sector since it leads to increased confidence of the


\textsuperscript{302} Shareholders provide the initial capital for the corporation to start the business, therefore they are considered as primary investors. See Kraakman et al., supra note 35, at 15.

\textsuperscript{303} Kraakman et al., supra note 35, at 15; “Although a well-developed market in shares permits individual stockholders to terminate ownership easily by selling their shares, it does not follow that stockholders as a group have a limited stake in the firm. What is available to individual stockholders may be unavailable to stockholders in the aggregate. Although some students of governance see only an attenuated relation between stockholders and the corporation, this view is based on a fallacy of composition. Stockholders as a group bear a unique relation to the firm. They are the only voluntary constituency whose relation with the corporation does not come up for periodic renewal. Labor, suppliers in the intermediate product market, debt-holders, and consumers all have opportunities to renegotiate terms when contracts are renewed. Stockholders, by contrast, invest for the life of the firm and their claims are located at the end of the queue should liquidation occur. Stockholders are also unique in that their investments are not associated with particular assets. The diffuse character of their investments puts shareholders at an enormous disadvantage in crafting the kind of bilateral safeguards”, Oliver Williamson, \textit{Corporate Governance}, 93 The Yale Law Journal (1984), at 1210.
investors and a rise in the investments in general. Furthermore, a minority shareholder who is not willing or not able to use extra effort to use his rights of participation in the corporation invests mostly for getting return on his investment.  

The chapter starts with discussion of the ownership structure in the three countries of study, followed by discussion on procedural rights, which are exercised at the general meetings of shareholders. Then the chapter reveals the differences in the voting procedures and substantive voting rights, and similarities in special rights to elect/appoint and remove members of the governing bodies. Further, the chapter discusses the protection of the aforementioned rights by the courts, while the derivative suits serve as a very important means of both ex-ante and ex-post means of shareholder protection. Last, the chapter compares the obligations of the shareholders towards the corporation and other shareholders.

2.1. Ownership structure

The corporate governance system of any given country is determined, to a certain extent, by the ownership structure. This section touches upon the law and finance movement; however, the question to be answered by this section is not why this ownership structure has emerged in a particular jurisdiction, rather, it is to determine the ownership structure in the given jurisdictions in order to better understand the current corporate governance rules through the prism of this ownership structure.

In 1998, La Porta, Lopez-de-Silanes, Sheifer and Vishny (hereinafter referred to as LLSV) conducted a study on shareholder protection. They argued that the phenomenon of weak shareholder rights in the continental legal systems has created a dominant

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304 Rahmonqulov & Gulyamov, supra note 10, at 305.
305 Rafael La Porta, et al., Corporate Ownership around the World, 54 Journal of Finance (1999), at 471.
shareholding pattern, and the strong shareholder protection in the United States and the Anglo-American jurisdictions has allowed the effective functioning of the disposed ownership pattern\textsuperscript{306}.

However, after the LLSV’s findings, an array of scholarship has emerged criticizing their findings\textsuperscript{307}, as well as their methodology\textsuperscript{308}. A recent study by Franks suggests that:

“The differences in ownership concentration between the United Kingdom and continental European countries today are not a recent phenomenon—dispersed ownership emerged rapidly in the first half of the twentieth century, even in the absence of strong investor protection ... [w]hen investor protection was finally strengthened in the second half of the century, it had little effect on either levels or rates of ownership dispersion. Ownership of well-established companies was already dispersed, and rates of dispersion of newly incorporated firms [...] were similar to those of firms incorporated at the start of the century\textsuperscript{309}.”

If we look at ownership structure, the evidence suggests that in Europe as a whole it tends to remain tightly controlled. Faccio and Lang in their study of 5,232 publicly traded corporations in 13 Western European countries discovered that 36.93% of firms have dispersed ownership, while 60.07% have large controlling owners\textsuperscript{310}.

Regarding Germany in particular, a recent study has concluded that the average

\textsuperscript{306} Id.
ownership concentration of Germany’s largest firms dropped over the past 10 years.\textsuperscript{311} Another study of listed corporations shows that the voting control in Germany is highly concentrated: “about 82% of officially listed AGs have a minority block holder (controlling more than 25% of the votes) and 65% are majority controlled. Blocks are clearly aligned with important control thresholds (25, 50, and 75%)”\textsuperscript{312}. The study also mentions that banks and other custodians are not obliged to disclose the votes they receive via proxies or through other instruments such as investment companies.\textsuperscript{313} Given the large shareholdings and voting powers of German banks, such a discloser gap suggests that the actual voting power of banks and other custodians is higher than actually reported.\textsuperscript{314}

The United States corporations are widely believed to have extremely dispersed ownership,\textsuperscript{315} and due to their experience in dealing with such a status quo, they are believed to have the best operational system of corporate governance. However, recent studies suggest that this may not necessarily be true. A study by Clifford Holderness discovered that 96% of the United States corporations listed on NYSE, AMEX and NASDAQ have blockholders, and on average the large shareholders in a corporation collectively own 39% of the voting power of the common stock. In addition, the ownership of directors and officers as summarized in proxy statements averages 24%,\textsuperscript{316} therefore, it can be concluded


\textsuperscript{312} Marco Becht & Ekkehart Boehmer, Voting Control in German Corporations, 23 International Review of Law and Economics (2003), at 1.

\textsuperscript{313} Id.

\textsuperscript{314} Goergen, et al., supra note 27, at 175.

\textsuperscript{315} Although this statement has been taken for granted, no study has been made similar to the one made by Clifford Holderness, i.e., a study of ownership structure from the randomly selected corporations. Most of the studies refer to share of institutional investors in the top companies in the United States, which does not necessarily reflect the reality in all of the industry, see Clifford G. Holderness, The Myth of Diffuse Ownership in the United States, 22 Review of Financial Studies (2009).

\textsuperscript{316} Id., at 1406.
that almost 63% of the voting power in the United States corporations in fact is not dispersed.

Uzbekistan does not provide operational statistics in a western manner, and there are no reported studies of ownership structure; the collection of data and exact numbers on Uzbek corporations is still ongoing. However, the author has conducted a study using the BEEPS database\(^\text{317}\), which contains information on ownership structure of a sample of corporations. The results of the study are as follows:

Table 2. Ownership structure in joint-stock companies in Uzbekistan

<table>
<thead>
<tr>
<th>Year</th>
<th>2008</th>
<th>2005</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share of largest owner</td>
<td>Number of corporations observed</td>
<td>Share of largest owner</td>
</tr>
<tr>
<td>Open joint-stock companies</td>
<td>59.3%</td>
<td>91</td>
<td>30.7%</td>
</tr>
<tr>
<td>Closed joint-stock companies</td>
<td>58.6%</td>
<td>14</td>
<td>60.5%</td>
</tr>
<tr>
<td>All joint-stock companies</td>
<td>59.2%</td>
<td>105</td>
<td>55.6%</td>
</tr>
</tbody>
</table>

The sample of the firms for 2008 is considerable, amounting to 23.2% of all listed corporations – 91 out of 392\(^\text{318}\), although the outcomes for 2002 and 2005 are less representative. The study shows that on the average the largest blockholder effectively controls the firm by having majority of the voting shares, i.e., 59% of the shares in listed corporations.


In Uzbekistan, the state still plays an important role in the market for control of joint-stock companies, since the share of the government in the corporate sector amounts to 54% of total market capitalization of all corporations, both listed and unlisted.\textsuperscript{319}

2.2. Procedural rights of individual shareholders at the general meeting

It has been argued that Germany has the so-called “meeting-centered”\textsuperscript{320} form of shareholder protection, where due to the dominant ownership paradigm, the strong protection of shareholders and the weaker capital markets (compared to the United States), the general meeting of shareholders plays an important role, and minority shareholders have direct rights to demand convening the general meeting, nominate members of the Supervisory Board, propose issues to be included in the agenda and vote on the shareholder meeting on the issues on the agenda; thereby directly influencing the governing bodies of the corporation.

In the United States, the general meeting plays a role only in change of control\textsuperscript{321}, and shareholders lack adequate means to exercise meaningful oversight over the actions of the management. Nevertheless, the latest changes introduced by the Securities and Exchange Commission (hereinafter referred to as SEC) might change this picture to a certain extent.

In the case of Uzbekistan, since the ownership structure is roughly similar to the one of Germany, the “meeting-centered” form of shareholder protection has been employed by

\textsuperscript{319} Total market capitalization of all public corporations was nine billion UZS, see Monthly Bulletin of the USZE for November 2011, available at \url{http://www.uzse.uz/new/analyt/bulletin.asp} (last visited December 1, 2011). The government held shares in the amount of 4.9 billion USZ, which comprises 54% of the total market capitalization. Report the State enterprise “Central securities depository” (UzCSD) for the year 2011, at 2, available at \url{http://www.deponet.uz/download/Otchet_CD%20za%202011.pdf} (last visited February 1, 2012).


\textsuperscript{321} Id.
the legislature, where the general meeting has extensive powers\textsuperscript{322}, and the minority shareholders possess real powers regarding the general meeting.

Since the procedural rights of the shareholders are exercised at the general meetings of shareholders, and although the procedural details might seem unnecessary, it is important to note that the regulatory and procedural framework regarding the procedure of general meetings carries particular importance for transition countries. For instance, even if \textit{prima facie} the shareholders have the right to elect directors and vote on the fundamental transactions, their rights will be hardly effective if the shareholders cannot propose issues for the meeting, nominate directors and call the general meeting\textsuperscript{323}.

The section discusses the procedural aspects of shareholder participation at the general meetings of shareholders, and analyzes the jurisdictional differences in positive law, insofar as it has a direct influence on the allocation of powers within the corporation. However, this section does not intend to analyze whether the general meetings of shareholders are “an expensive waste of time and money”\textsuperscript{324}, nor does it intend to argue whether or not giving more power to shareholders might have a better effect on the system, since these issues are discussed in the third chapter.

\textsuperscript{322} General meeting of shareholders in Uzbekistan is the “supreme authority” of the corporation, and has the right to elect both Supervisory and the Management Boards. For more elaboration, see infra, section 3.3.

\textsuperscript{323} For the shareholders to exercise their individual rights on the general meetings there are three types of requirements – (1) holding requirement, (2) relative threshold and (3) absolute threshold. For example in the United States, the holding requirement is the requirement put by the SEC rule 14a-11 that the shareholders advancing the demand have to have held the shares for at least three years; the relative threshold is when holders of 1\% of voting stock under the SEC rule 14a-8 can demand for their proposal to be included in the managements’ proxy, and the absolute threshold is holding shares with of 2,000 USD of fair market value under the same rule. None of the three legal systems examined here uses all three requirements simultaneously, either one or two of them is sufficient.

\textsuperscript{324} “My advice to all German corporations with international shareholders: Don’t invite these shareholders to a German shareholder meeting. Seized with horror, they could sell their securities the next morning.” Ditto the Former Chairman of the Supervisory Board of Deutsche Bank AG, \textit{Rolf Breuer}, Frankfurter Allgemeine Zeitung, 27 November 2002, at 15; “A stockholders’ meeting is a kind of ancient, meaningless ritual like some of the ceremonies that go on with the mace in the House of the Lords”, Adolf A Berle, \textit{Economic Power and the Free Society} (New York, Fund for the Republic, 1957), at 7, cited in Zetzsche, supra note 320, at 115.
2.2.1. Convening the general meeting of shareholders – “calling right”

General meetings can be of two types: annual (ordinary) general meetings (hereinafter referred to as AGM) and extraordinary general meetings (hereinafter referred to as EGM). While the former has to be convened at least once a year in every jurisdiction, the latter is convened upon request or demand of a party or the court as determined by the law or corporate documents. The annual general meeting has to be convened in every jurisdiction, while extraordinary meetings are differently regulated.

In Germany, the AktG mentions the ordinary general meetings (ordentliche Hauptversammlung), but it does not mention the extraordinary general meetings. However, the rights of the individual shareholders to call a meeting imply that more than one meeting can be conducted within a year, in which case all meetings other than the annual meeting can be called as extraordinary general meetings. In the United States, the MBCA makes a clear difference between the annual meeting and the special meeting: the former has to be conducted every year by the corporation and the latter may be called by the shareholders and/or the Board of Directors. The DelGCL also makes a difference between the annual general meetings and special meetings in a manner similar to the MBCA. In Uzbekistan, the Law on Joint-Stock Companies provides that the corporation has

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325 Zetsche, supra note 320, at 118.
326 “Such shareholders’ meeting shall be held during the first eight months of the fiscal year”, § 122(1) AktG.
327 “A corporation shall hold a meeting of shareholders annually, at a time stated in or fixed in accordance with the bylaws”, MBCA § 7.01 (a).
328 “A corporation shall hold a special meeting of shareholders:
(1) on call of its board of directors or the person or persons authorized to do so by the articles of incorporation or bylaws; or
(2) if the holders of, at least 10 percent of all the votes entitled to be cast on an issue proposed to be considered, at the proposed special meeting sign, date, and deliver to the corporation one or more written demands for the meeting describing the purpose or purposes for which it is to be held”, MBCA § 7.02 (a).
329 “An annual meeting of stockholders shall be held for the election of directors on a date and, at a time designated by or in the manner provided in the bylaws”, DelGCL 211(b).
330 “Special meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws”, DelGCL 211(d).
to call an ordinary general meeting of shareholders every year\textsuperscript{331}, while all meetings other than the ordinary meeting are deemed extraordinary\textsuperscript{332}.

The most important difference among the jurisdictions analyzed here is the direct calling right against mandatory court involvement in calling the general meeting by the shareholders, both annual and extraordinary ones. While in Germany and in Uzbekistan, as well as under the MBCA, the shareholders have a direct calling right, the DelGCL does not provide for such a statutory right.

In Germany, the general meetings are convened by the Management Board with a simple majority of votes\textsuperscript{333}, and the Supervisory Board has the right and even an obligation to call the meeting if the interests of the corporation so require\textsuperscript{334}. Shareholders who have at least 5\% of the registered share capital\textsuperscript{335} can request the Management Board to convene an extraordinary general meeting. If such a request is not satisfied, then the shareholder may apply to the court, and the court may authorize the said shareholders to call the meeting on their own, referring to such authorization of the court\textsuperscript{336}, and in such a case the corporation will bear all of the costs related to these issues\textsuperscript{337}. The general meetings of shareholders of German corporations can take place only in Germany\textsuperscript{338}, since the minutes and resolutions of the general meeting of listed corporations have to be notarized by a German public notary\textsuperscript{339}.

\textsuperscript{331} Art. 64 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{332} Id.
\textsuperscript{333} § 121(2) AktG.
\textsuperscript{334} § 111(3) AktG.
\textsuperscript{335} § 122(1) AktG.
\textsuperscript{336} § 122(3) AktG.
\textsuperscript{337} § 122(4) AktG.
\textsuperscript{338} “The place of the shareholder meeting must be within Germany ... [s]hareholder meetings abroad are generally disapproved, however, it might be argued that they are admissible if the articles of association explicitly provide for, but only if all shareholders are present”, Dornseifer, supra note 179, at 231.
\textsuperscript{339} § 130(1) AktG; see also Dornseifer, supra note 179, at 232.
In the United States, the MBCA and DelGCL significantly diverge upon issues of calling the meetings. Under the MBCA, the shareholders have the direct right\(^{340}\), i.e., holders of at least 10\% of the votes that are entitled to be cast on an issue proposed may demand convening the extraordinary general meeting. This threshold, however, can be both lowered and even increased(!) by the articles of incorporation, but up to no more than 25\% of the votes.

Under DelGCL, the annual meeting is called by the Board of Directors, while the law does not allow direct calling right for shareholders to convene the extraordinary general meeting; therefore, the shareholders always have to apply to the courts to do so. This might have a deterrent effect on the shareholders, since first, one will need to pay his own litigation costs; second, this procedure takes time, which will mitigate the shareholders’ vigor and help the management to prepare for the meeting and strengthen its position in the meantime\(^{341}\). The first way for the shareholders to demand calling a general meeting is to apply to the court in case the Board of Directors fails to hold a meeting within 30 days from the date as determined in the bylaws or within 13 months from the latest meeting, upon application by any shareholder or director\(^{342}\) (courts have called this right “virtually absolute”\(^{343}\)). Second, in case the number of directors in the Board of Directors constitutes less than the majority of the number provided in the corporate documents, the Court of Chancery can order to convene the general meeting upon application by the holders of at least 10\% of the voting stock\(^{344}\). The burden of proof in such a case lies on the shareholder.

\(^{340}\) MBCA 7.02(a)(2).
\(^{341}\) Zetsche, supra note 320, at 119.
\(^{342}\) DelGCL 211(c)(3).
\(^{343}\) “A stockholder’s right to have a meeting convened to elect directors is virtually absolute. Nonetheless, a stockholder’s prima facie case can be defeated by an adequate affirmative defense” Saxon Indus. v. NKFW Partners, 488 A.2d 1298, (Del. 1985), at note 4.
\(^{344}\) DelGCL 223(c).
In *MFC Bankcorp v. Eduiqune corp*, MFC as the major shareholder applied to the court for an order to convene the general meeting, since the meeting had not been convened for 15 months since the last meeting. The Board of Directors determined a date for the general meeting immediately after the lawsuit was filed, therefore the court declined to order to convene the meeting, and dismissed MFC’s claim by determining that such an order to convene was redundant, since the demand of the MFC was to have the meeting and because the Board of Directors set the date, there was no need to continue\(^{345}\).

This case evidences that a procedurally effective right to sue in the court for failing to hold a meeting will have a deterring effect, since the Board of Directors will know that any shareholder may apply to the court for the meeting to be convened. Still, regarding the particularities of the general meeting, such as date and place, the power lies in the hands of the Board of Directors, unless the court specifically determines a reason. To sum up, in Delaware, the general meetings can be called by the Board of Directors, persons provided in the bylaws\(^ {346}\), or the court, while the shareholders do not have the direct calling right.

Both MBCA\(^ {347}\) and DelGCL\(^ {348}\) allow significant flexibility with respect to the place of the general meeting. Such place can be stated in bylaws, or determined by the Board of Directors when necessary; consequently, holding a general meeting outside the country is not directly prohibited under neither laws\(^ {349}\).

In Uzbekistan, the shareholders have a direct right to call the EGM, and even more, in certain cases they may convene the meeting without the involvement of the governing

\(^{345}\) MFC Bankcorp v. Eduiqune corp, 844 A.2d 1015 (Del Ch. 2003).

\(^{346}\) “Special meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws”, DelGCL 211(d).

\(^{347}\) MBCA 7.01.

\(^{348}\) DelGCL 211.

bodies of the corporation.

The annual general meeting has to be convened by the Supervisory Board within the time prescribed by the articles of association, but no more than 6 months after the end of the financial year\textsuperscript{350}, and all details regarding the annual general meeting are determined by the Supervisory Board. All other general meetings convened within the same year are deemed as extraordinary meetings. The following have the power to demand the convening of the extraordinary general meeting of shareholders:

- Supervisory Board;
- Inspection Committee (or the Inspector);
- shareholder possessing more than 10\% of voting shares on the date of advancing the demand (with no minimum holding requirement)\textsuperscript{351}.

The request of the shareholders is reviewed by the Supervisory Board for procedural compliance, and the meeting upon such a request has to be convened within 45 days from the date of the request. Importantly, the shareholders in such a case are also in charge of preparing the agenda of the shareholders’ meeting, which cannot be changed by the Supervisory Board\textsuperscript{352}. The request can be declined by the Supervisory Board for three procedural reasons: first, if the shareholders demanding to convene the meeting do not own 10\% of voting stock, second, if none of the issues proposed for the meeting are within the competence of the general meeting, and third, if such issues are in conflict with law\textsuperscript{353}.

In case the Supervisory Board fails to call an extraordinary general meeting within the specified time, the persons demanding to convene have a right to convene the said meeting on their own, thereby assuming the role of the Supervisory Board. Such general meeting can

\textsuperscript{350} Art.64 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{351} Art.72 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{352} Art.72 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{353} Art.72 of Uzbek Law on Joint-Stock Companies.
put the burden of bearing the costs associated with the meeting onto the corporation.\textsuperscript{354}

The fact that extraordinary general meetings are actually called is evidenced by the following: in 2010, the Central Depository\textsuperscript{355} has received requests to prepare 3101 registry for general meetings from 1402 joint-stock companies\textsuperscript{356}, thus in average, every joint-stock company has convened more than 2 meetings per year; in 2011, 2525 requests for 1309 joint-stock companies have been received, including 315 requests in the fourth quarter of the year\textsuperscript{357}.

The Uzbek Law on Joint-Stock Companies provides that the place of the meeting shall be determined by the persons calling the general meeting\textsuperscript{358} and such information has to be communicated to the shareholders\textsuperscript{359}. As a general rule, the Supervisory Board is in charge of calling the general meeting and preparing the agenda, hence, the Supervisory Board has the power to decide on the place of the general meeting. The Uzbek law does not explicitly prohibit holding the general meeting of shareholders outside the country.

To conclude, from all three jurisdictions, Delaware gives the lowest level of shareholder protection with regard to the power to convene the general meeting, due to mandatory court involvement, and the absence of a proviso regarding the costs in case the shareholders apply to the court, assuming that everyone bears his own legal costs, which deters applications to courts. Uzbekistan has a much higher level of shareholder protection.\textsuperscript{354} Art. 72 of Uzbek Law on Joint-Stock Companies.\textsuperscript{355} The State Central Securities Depository of the Republic of Uzbekistan fulfills the functions of the Central Depository and holds information on all issued shares and securities. Moreover, the State Central Securities Depository issues shareholders registers upon application by the corporations for the general meetings of the shareholders. See http://www.deponet.uz/ (last visited November 1, 2011).\textsuperscript{356} Report the State enterprise “Central securities depository” (UzCSD) for the year 2010, at 4, available at http://www.deponet.uz/download/Otchet%20_CD%202010g.pdf (last visited November 1, 2011).\textsuperscript{357} Report the State enterprise “Central securities depository” (UzCSD) for the year 2011, at 4, available at http://www.deponet.uz/download/Otchet_CD%202011.pdf (last visited February 1, 2012).\textsuperscript{358} Art. 71 of Uzbek Law on Joint-Stock Companies.\textsuperscript{359} Art. 69 of Uzbek Law on Joint-Stock Companies.
participation and power with regard to convening the general meeting, since the shareholders can not only request convening the meeting, but even call the meeting themselves, without mandatory court involvement; moreover, all costs can be put upon the corporation. The German system provides, apart from the abovementioned characteristics – the shareholders can not only request convening the meeting, but they may even call the meeting themselves without mandatory court involvement, and all costs can be put upon the corporation – provides for a much lower threshold for calling the general meeting, i.e., 5% of the registered share capital compared to 10% in Uzbekistan.

2.2.2. Power to propose issues

As noted earlier, in order for shareholders to act at the general meeting of shareholders, an issue to be discussed at the general meeting has to be included in the agenda, which is controlled by the Board of Directors, the Supervisory Board or the management, depending on the legal system. Thus, the power to propose issues to the agenda of the meeting is a vital right of the shareholders, and they should have power to influence the agenda by having the statutory right to propose the issues to be included in the agenda. Similar to the issue of convening the general meeting, the difference lies in the direct right of shareholders and procedure of proposing issues for the agenda of the general meeting. While in Germany and Uzbekistan the power to propose the issues is provided by corporate law, in the United States mandatory provision for it is only contained in the SEC rules.

In Germany, the shareholders have the right to propose issues for the agenda of the meeting – shareholders having more than 5% of voting stock or having in the aggregate 500,000 Euros of share capital can demand that issues be added to the agenda and
published as required, and such a demand has to be sent to the Management Board at least 24 days before the general meeting (30 days in the listed corporations), accompanied by the explanation of their reasons.\footnote{§ 122(2) AktG.}

In the United States, neither MBCA nor DelGCL provide for a right of shareholders to propose issues for the agenda of the meeting. However, under SEC rule 14a-8\footnote{On September 6, 2011, the SEC stayed the rule 14a-8 after the DC Circuit Court struck down the rule 14a-11, see Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation, available at: \url{http://www.sec.gov/news/press/2011/2011-179.htm} (last visited March 1, 2012). The SEC published the rule 14a-8, with the effective date of September 20, 2011, see Federal Register / Vol. 76, No. 182 / Tuesday, September 20, 2011, available at: \url{http://www.gpo.gov/fdsys/pkg/FR-2011-09-20/pdf/2011-24118.pdf} (last visited March 1, 2012).}, the shareholders can propose an issue to be discussed at the general meeting, provided that certain requirements are satisfied.

First, there is a minimum ownership requirement – the shareholder has to possess equity in the “fair value”\footnote{Due to market fluctuations, the value of a shareholder’s investment in the company may vary throughout the year before he or she submits the proposal. In order to determine whether the shareholder satisfies the 2,000 USD threshold, we look, at whether, on any date within the 60 calendar days before the date the shareholder submits the proposal, the shareholder’s investment is valued, at 2,000 USD or greater, based on the average of the bid and ask prices. Depending on where the company is listed, bid and ask prices may not always be available. For example, bid and ask prices are not provided for companies listed on the New York Stock Exchange. Under these circumstances, companies and shareholders should determine the market value by multiplying the number of securities the shareholder held for the one-year period by the highest selling price during the 60 calendar days before the shareholder submitted the proposal. For purposes of this calculation, it is important to note that a security’s highest selling price is not necessarily the same as its highest closing price.”} of at least 2,000 USD or at least 1% of the voting stock for at least one year. Second, under the rule 14a-8 (c) one shareholder can submit only one item and third, such proposals have to be submitted to the management at least five months prior to the general meeting.

Rule 14a-8 provides for five reasons for which the management can refuse to include
the proposal into the agenda\textsuperscript{363}:

- specific amount of dividends. The proposal cannot call for a specific amount of dividends, in either cash or stock;
- relevance. If the proposal is related to an issue that accounts for less than 5% of the corporation’s total assets, net earnings or gross sales for the most recent fiscal year or is not related to the business of the corporation at all, such proposal may be deemed as irrelevant and denied by management\textsuperscript{364};
- not more than one item. One shareholder can submit only one proposal per meeting (although before the deadline he can modify it in accordance with the rules);
- conflicts with the corporation’s proposal. If the board has already put an issue on the agenda, then a shareholder cannot propose the same issue;
- director election. If the proposal provides a nominee for the voting in the election of directors, such a proposal cannot be included in the management’s proxy under rule 14a-8.

In Uzbekistan, the shareholders have a right to propose issues to the agenda – holders of more than 1% of voting shares can propose issues for the agenda, while the Supervisory Board has to accept or reject the proposition within 15 days. If the proposition is refused, the Supervisory Board has to send a motivated refusal in three days after the decision is made, and such refusal may be based only on the following:

- proposal is sent later than the date set by the statute (30 days after the end of the financial year), unless provided otherwise by the articles of association;
- the shareholders submitting the proposal do not have the required 1% of voting stock;
- the proposal is not in written form, does not contain the names of shareholder(s), and number and type of their shares, or does not include the reasons for including such proposal\textsuperscript{365}.

The importance of the right of the shareholders to propose issues to the agenda lies in the fact that although the shareholders can have the power to decide on certain issues, their inability to propose such a change in the first place does not allow them to use their rights effectively. In Germany and Uzbekistan, the shareholders have the statutory right to

\textsuperscript{363} Rule 14a-8(c) and (i), sub 5., 8., 9., 13., cited in Zetzsche, supra note 320, at 119.
\textsuperscript{364} Goodman & Olson, supra note 362, at 14-19.
\textsuperscript{365} Art.70 of Uzbek Law on Joint-Stock Companies.
propose issues to be included in the agenda, however, in the United States, it is only the SEC rules that empower the shareholders to propose issues. Interestingly, however, the threshold in Germany for such proposal is higher – 5% or 500,000 Euros compared to 1% in Uzbekistan and 1% or 2,000 USD in the United States. This might be caused by the fact that German corporations, apart from the first largest blockholder, frequently have the second and third large blockholder in the corporation\textsuperscript{366}, and such a high threshold differentiates between the active big investors willing to participate in the decision-making in the corporation from the minor investors that invest mostly for financial return.

2.2.3. Power to nominate directors

In Germany and Uzbekistan, the shareholders have a statutory right to nominate the members of the Supervisory Board; in the United States, such statutory right to nominate members of the Board of Directors is provisional, and it is the listing rules of the national securities exchanges\textsuperscript{367} that empower the shareholders to do so\textsuperscript{368}.

In Germany, any shareholder may propose his own candidate for the position of member of the Supervisory Board up to 14 days prior to the meeting, and such a nomination does not need to provide supporting grounds\textsuperscript{369}, but it needs to state the nominee’s name.

\textsuperscript{366} Goergen, et al., supra note 27 at 175.
\textsuperscript{368} For a great comparative study on director nominations in Germany and the United States, see David C Donald, Nomination of Directors under U.S. and German Law, (2004) Johann Wolfgang Goethe University, Frankfurt/Main, Institute for Law and Finance Working Paper Series No. 21, available at: www.sec.gov/rules/proposed/s71903/dcdonald033104.pdf (last visited November 1, 2011); see also Cools, supra note 307, at 5.
\textsuperscript{369} §§ 126-127 AktG.
profession and place of residence\textsuperscript{370}. Additionally, in case of listed corporations, such nomination has to contain the membership of the nominee in other Supervisory Boards, as well as any positions held in domestic and foreign controlled enterprises\textsuperscript{371}. If these requirements are not met, the Management Board has the right to deny circulation of the nomination for membership in Supervisory Board\textsuperscript{372}.

However, the seemingly simple system of the Supervisory Board nominations in Germany is complicated by the worker co-determination provisions\textsuperscript{373}, and the so-called special rights of shareholder to appoint and remove members of the Supervisory Board\textsuperscript{374}, which are discussed later in this thesis\textsuperscript{375}.

In the United States, as noted earlier, the shareholders do not have the statutory right to nominate the directors under neither DelGCL nor MBCA. However, DelGCL was recently amended\textsuperscript{376} to include new sections\textsuperscript{377}, which allow the corporations to put a provision in their bylaws that gives a right to the shareholders to include their nominee for a director into the corporation’s proxy\textsuperscript{378}, and the expenses of the shareholder related to the

\textsuperscript{370} § 124(3) sentence 4 AktG.
\textsuperscript{371} § 125(1) sentence 5 AktG.
\textsuperscript{372} § 127 AktG.
\textsuperscript{373} “The members of the supervisory board shall be elected by the shareholders’ meeting, unless they are to be […] elected as representatives of the employees pursuant to the Codetermination Act, the Supplemental Codetermination Act, the One-Third Co-determination Act or the Act on Employee Co-determination within Cross-border Mergers”, § 101(1) AktG; see infra section 3.2.2.
\textsuperscript{374} “The right to appoint members to the supervisory board may only be granted by the articles and only to specific shareholders or the holders of specific shares”, § 101(2) AktG; see infra section 2.5.1.
\textsuperscript{375} For a discussion of co-determination in Germany, see infra section 3.2.2, for discussion of the special right of a shareholder to appoint and remove member(s) of the Supervisory Board in Germany, see infra section 2.5.1.
\textsuperscript{377} For a discussion of these amendments, as well as the implications thereof, see Lisa M. Fairfax, Delaware’s New Proxy Access: Much Ado About Nothing?, 11 Tennessee Journal of Business Law 87 (2009), at 87.
\textsuperscript{378} “The bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required … to include in its proxy solicitation materials … in addition to individuals nominated by the board of directors, 1 or more individuals nominated by a stockholder”, DelGCL 112.
nomination of directors may be covered by the corporation. The bylaws of the corporation may also provide for additional requirements for the persons who have the right to nominate directors. This addition is believed to have a “vital impact on shareholders’ ability to participate in elections and influence corporate conduct”, since Delaware intends to “maintain its importance as the pre-eminent state” for corporate law in the United States. Under the MBCA, the shareholders cannot include their nominee into management’s proxy; the provision on reimbursement for expenses of such nomination does not exist either; therefore, the move of the Delaware is considered as a very unconventional step. Nevertheless, the actual effect of this provision is still unclear, since the provision is not binding, and it is not yet known how many of the corporations will make use of the said provision.

In the United States, voting issues have always been considered as exclusive jurisdiction of the states; however, directors may be elected via proxy solicitations, and the listed companies also have to comply with the requirements of the SEC, mostly provided in the 1933 Act and 1934 Act. Before the amendment of the SEC to include rule 14a-11 in the Exchange Act 1934, the shareholders did not have any right to include their nominees to the slate of directors proposed in the management’s proxy, and the only way for a

379 “The bylaws may provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors”, DeLGCL 113(a).
380 “[F]or example, section 112 authorizes the bylaws to prescribe that a stockholder have a minimum level of stock ownership as a prerequisite”, see Welch et al., supra note 349, at 57.
382 Lisa M. Fairfax, supra note 377, at 87-89.
383 “No principle of corporation law and practice is more firmly established than a State’s authority to regulate domestic corporations, including the authority to define the voting rights of shareholders”, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987).
shareholder to nominate a director was to start his own proxy, which is a lengthy and costly procedure (unless a whole slate is nominated and the elections become contested). Therefore, in most cases the shareholders would not take the risk of launching their own proxy, and since under both MBCA and DelGCL, the statutory default is the plurality rule\(^{385}\), the nominees of the corporation’s management would get the approval even if they did get only one vote unless the elections are contested. In this light, the Disney case is one of the most prominent examples of shareholders’ powerlessness.

Michael Eisner, the CEO of the Disney Corporation, in spite of his contribution to the corporations’ success, was involved in a series of mismanagement activities; however, the management’s proxy in 2004 still included him as the nominee. At the same meeting, 43% of the shareholders of the corporation withheld their votes (i.e., declined to vote)\(^{386}\) in order to clearly send their message of disappointment with the CEO\(^{387}\). Nevertheless, due to the fact that Disney had plurality voting, the elections were not contested, and the shareholders were not able to nominate their own slate of candidates, and management’s unanimous support was enough for Eisner to stay as the CEO\(^{388}\).

However, this picture seemed to have changed significantly with the addition of Rule 14a-11\(^{389}\). The SEC stated that the last crisis has raised “serious concerns about the

\(^{385}\) DelGCL 216.3; MBCA 7.28.


accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence”, and the new rule is designed to increase “the ability of shareholders to hold boards accountable through the exercise of their fundamental right to nominate and elect members to company boards of directors”\textsuperscript{390}.

Rule 14a-11 “requires, under certain circumstances, a company’s proxy materials to provide shareholders with information about, and the ability to vote for, a shareholder’s, or group of shareholders’, nominees for director”\textsuperscript{391}. This rule provided that shareholders having possessed at least 3% of the voting shares for at least three years have the right to include their nominee to the slate of the nominees in the management’s proxy\textsuperscript{392}, and it was believed that rule 14a-11, with certain conditions “effectively ends management’s monopoly over the corporate proxy statement”\textsuperscript{393}.

The rule 14a-11 did not last for even one year – the United States Court of Appeals for the District of Columbia Circuit struck it down in July 2011\textsuperscript{394}. The Court found that "the Commission acted arbitrarily and capriciously for having failed ... adequately to assess the economic effects of a new rule". The Court ruled that although the SEC has “statutory obligation to determine as best it can the economic implications of the rule”\textsuperscript{395}, it failed to adequately quantify the costs that the corporations would incur in implementing the rule, or

\textsuperscript{391} Facilitating Shareholder Director Nominations, 75 Fed. Reg., at 56,668 (stating that Rule 14a-11 “will require” a company to include qualifying shareholders’ nominees for the board), cited in Schuster, supra note 388, at 1037.
\textsuperscript{392} Facilitating Shareholder Director Nominations, 75 Fed. Reg., at 56,668, at 24-25.
\textsuperscript{395} Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C. Cir. 2005).
to explain why those costs could not be quantified, since “company boards may be motivated by the issues at stake to expend significant resources to challenge shareholder director nominees”\(^{396}\). Possible benefits of the rule were not accounted either, i.e., whether the corporations will benefit from having dissident directors on the Board; furthermore, the SEC failed to provide empirical evidence with regard to the abovementioned issues. Besides, the court criticized that the unions and government pension funds may use rule 14a-11 for personal gain. Despite the possibility to challenge the decision, the SEC announced that it is not seeking rehearing of the decision\(^{397}\); nevertheless, the Chairman of the SEC Mary L. Schapiro stated that the saga is not over:

> “providing a meaningful opportunity for shareholders to exercise their right to nominate directors at their companies is in the best interest of investors and our markets. It is a process that helps make boards more accountable for the risks undertaken by the companies they manage. I remain committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards”\(^{398}\).

In Uzbekistan, the general meeting elects both bodies: the Supervisory Board and the Management Board; however, the power of the shareholders with regard to nominating members for these boards differs.

Nominations for members of the Supervisory Board are similar to proposing the issues for the general meeting, i.e., the shareholders possessing more than 1% of the voting shares may nominate directors\(^{399}\), and procedure and grounds for refusal are the same as for propositions of issues\(^{400}\). However, the nomination for members of the Supervisory Board, apart from the conventional issues as the name of the nominee, the name of the


\(^{398}\) Id.

\(^{399}\) There is no absolute threshold or any holding requirement, only relative threshold provided.

\(^{400}\) See supra section 2.2.2.
shareholder advancing the proposal, the number and the type of his shares, has to include the number and type of the shares of the nominee (if any) in the corporation itself. This ensures the knowledge of the shareholder with regard to any possible conflict of interest between the nominee’s position as member of the Supervisory Board and shareholder of the corporation.

The shareholders do not ordinarily have the power to nominate members of Management Board. On the AGM, which is called by the Supervisory Board, the shareholders have the statutory right to nominate only the members of the Supervisory Board. The nominations for the Management Board on AGM are in exclusive jurisdiction of the Supervisory Board, since the Supervisory Board is in charge of preparing the agenda, while general meeting may neither take any decisions with regard to the issues not included in the agenda, nor change the agenda itself on the meeting. Therefore, the Supervisory Board prepares the list of nominees and has total power of the slate of nominees for the Management Board on the AGM.

However, this situation can be circumvented by the shareholder(s), having more than 10% of the voting shares. Since the shareholders having more than 10% of voting stock can call the extraordinary general meeting, and the Supervisory Board cannot make any changes to the agenda when the meeting is called by the shareholders, the shareholder(s) calling the meeting is able to propose the removal of one or more members of the

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401 Art.70 of Uzbek Law on Joint-Stock Companies.
402 Art.71 of Uzbek Law on Joint-Stock Companies.
403 Art.66 of Uzbek Law on Joint-Stock Companies.
404 Art.66 of Uzbek Law on Joint-Stock Companies. For more discussion, see supra section 2.2.1.
405 Art.72 of Uzbek Law on Joint-Stock Companies.
Management Board and nominate one or more members of the Management Board⁴⁰⁶.

To conclude, the power to nominate directors and members of Supervisory and the Management Boards carries special importance, since one cannot elect or appoint a representative unless such representative is nominated; therefore, both right to nominate and procedure of nomination are important. From the three jurisdictions, Germany and the United States have different systems of nomination, while the one existing in Uzbekistan provides for an interesting mix, giving the Supervisory Board right to act in a manner similar to the German board, while the activist shareholders still have the right to elect their own members of the Management Board circumventing the Supervisory Board, and the procedure is more similar to the U.S. system.

2.3. Voting procedures

After the general meeting is called and the agenda is defined, it is necessary to define how and which of the votes of the shareholders will be counted. This section will deal with the peculiarities of voting procedures, such as the one share-one vote rule and deviations from it, plurality and majority voting, cumulative voting, voting caps, as well as class voting systems.

2.3.1. One share-one vote rule

One share-one vote rule is believed to ensure equal rights to the shareholders, while each deviation from this rule can change the balance of powers and give some of the shareholders more power compared to their share of investment. For instance, multiple voting rights can give some of the shareholders excessive powers, empowering the

⁴⁰⁶ Several provisions of the law have to be read together in order to get this conclusion, the Uzbek Law on Joint-Stock Companies does not explicitly provide anything with regard to nomination of the Management Board members.
incumbent managers or some of the shareholder in detriment to the interests of other shareholders, thereby aggravating the agency problem between the shareholders.

One share-one vote rule is enshrined in the laws of Germany\(^{407}\) and Uzbekistan\(^{408}\); however, in the United States, since such a rule is not statutorily provided\(^{409}\) and is outside of the SEC’s scope of powers\(^{410}\), it is only the national security exchanges that provide for rules of this sort.

The German law provides that all shares have one vote, and multiple voting rights shall be prohibited\(^{411}\). Regarding preferred shares, the German default rule is that all shares have voting right, but non-voting preferred shares may be issued by the corporation only if such shares provide for cumulative right to dividends\(^{412}\). Such non-voting preferred shares may not exceed half of the share capital of the corporation. The implication is a strict division between the common shares having voting rights, and preferred shares without voting rights but with cumulative right for dividends.

In the 19\(^{th}\) century in the United States, the approach was to provide for a per capita voting, where each shareholder received equal votes regardless of number of shares owned\(^{413}\); later, mandatory one share-one vote statutes became common\(^{414}\). In 1903,

\(^{407}\) AktG Article 12 says that “[e]ach share shall confer voting rights. .. Multiple voting rights shall be prohibited”. Multiple voting rights have existed before KoNtraG was passed: for example RWE AG had restricted shares with multiple voting rights (x20), that belonged to municipalities, and Siemens also had restricted shares with multiple voting rights (x6) which belonged to the Siemens family, see F. Barca & M. Becht, The Control of Corporate Europe (Oxford University Press. 2001), at 134.

\(^{408}\) Art.76 of Uzbek Law on Joint-Stock Companies clearly says that the voting on the general meeting on all issues except for election of members of supervisory board is performed on “one share-one vote” principle.

\(^{409}\) Both MBCA and DelGCL allow any level of voting power allocation. See MBCA 6.01, and DelGCL 151(a).


\(^{412}\) § 139(1) AktG.

Delaware introduced the providing that the one share-one vote rule which applied "unless otherwise provided in the certificate of incorporation"\textsuperscript{415}, and a similar language was enacted in the MBCA in 1950\textsuperscript{416}. Hence, although the statutes provide for default one share-one vote rule under both DelGCL and MBCA, the articles of incorporation can include restrictions on the allocation of voting rights to be conferred upon the shares within different classes\textsuperscript{417}. As a rule, the holders of all voting shares elect the directors; however, the corporation may create several classes of shares and provide in its charter that each class elects a certain number of directors\textsuperscript{418}. The state legislation in Delaware and most other states have always allowed dual-class shares, however, the exchanges, such as the NYSE, have specific rules banning dual-class shares.

In 1986, NYSE declared a moratorium on the long-standing rule of “one share-one vote”\textsuperscript{419}, due to a huge rise in the takeover offers\textsuperscript{420}, the fact that other exchanges at that time did not have a ban of dual-class shares\textsuperscript{421}. Such an action of NYSE was triggered by the fact that when in 1984 General Motors issued a second class of common stock with only half a vote per share, it became evident that General Motors will be delisted, since the new


\textsuperscript{416} Model Business Corporation Act Annotated, supra note 16, Volume 2, at 7-111.

\textsuperscript{417} “Any class or series of classes of shares may be granted multiple or fractional votes per share without limitation”, see Model Business Corporation Act Annotated, supra note 16, Volume 1, at 6-8; providing different voting rights within the same class of shares is not allowed, see Providence & Worcester Co. v. Baker, 378 A.2d 121 (1977).

\textsuperscript{418} DelGCL 151(a).


\textsuperscript{420} See supra note 151 (in 1980-s more than 50% of corporations got tender offers).

\textsuperscript{421} O’kelley & Thompson, supra note 419, at 756.
shares of General Motors would be in conflict with the existing requirements of the NYSE\textsuperscript{422}. Since delisting of General Motors from NYSE would lead to diminished value of listing on the NYSE, NYSE abandoned “one share-one vote” rule, and following this decision, 46 NYSE-listed companies also issued disparate voting stock\textsuperscript{423}.

This chain of events triggered a response from the SEC – on July 7, 1988, the SEC adopted the Rule 19c-4\textsuperscript{424}, which banned the national exchanges from listing the corporations that have taken any action “with the effect of nullifying, restricting or disparately reducing the per share voting rights of [existing common stockholders]”\textsuperscript{425}. The businesses reacted and in the suit against the SEC\textsuperscript{426}, the United States Court of Appeals for the District of Columbia held that the SEC has exceeded its powers\textsuperscript{427}, explaining that “the Exchange Act cannot be understood to include regulation of an issue that is so far beyond matters of disclosure (such as are regulated under § 14 of the Act), [...] and that is concededly a part of corporate governance traditionally left to the states”\textsuperscript{428}, thereby returning this power to the exchanges.

Nevertheless, in 1994, the NYSE, the American Stock Exchange, and NASDAQ have adopted rules similar to 19c-4, which severely limit the power of corporations to deviate from the one share-one vote rule\textsuperscript{429}. Currently, it has been reported that six percent of the

\textsuperscript{423} Id.
\textsuperscript{424} Rule 19c-4 was the SEC’s first attempt to regulate the substantive matter related to corporate governance applicable to all public corporations, see Stephen M. Bainbridge, Corporate Governance after the Financial Crisis (Oxford University Press. 2012), at 31.
\textsuperscript{427} For an elaborate discussion of the reasons of the court in invalidating the rule 19c-4, see Stephen M. Bainbridge, The Short Life and Resurrection of Sec Rule 19c-4, 69 Washington University Law Quarterly (1991) (hereinafter referred to as Bainbridge, Rule 19c-4)
\textsuperscript{429} Bainbridge, Rule 19c-4, supra note 427, at 2.
listed United States corporations have dual-class shares\textsuperscript{430}, which is the evidence of the fact that most of the exchanges effectively eliminate this phenomenon; however, there is no evidence on dual-class shares in non-listed corporations.

In Uzbekistan, the Law on Joint-Stock Companies explicitly provides that one share-one vote rule is used for all issues voted at the general meeting of shareholders except for the election of the Supervisory Board, which is elected by cumulative voting\textsuperscript{431}. The shares can also be of only two types – common shares and preferred shares\textsuperscript{432}, hence each common stock carries one vote, while preferred shares do not have voting rights\textsuperscript{433}, and the total amount of preferred stock cannot exceed 25% of the share capital of the corporation\textsuperscript{434}. Preferred shares, however, have a right to vote on mergers, reorganization and liquidation of the corporation, as well as on amendments to the articles of association that limit the rights of such shares\textsuperscript{435}. Moreover, the preferred shares (except for preferred shares with cumulative dividends) obtain voting rights on all issues one year after the dividends have not been fully paid for such shares\textsuperscript{436}.

2.3.2. Majority and plurality voting

Under majority voting, the results of the election are determined by the affirming majority. Both Germany and Uzbekistan employ majority voting for the purposes of decision taking at the general meeting, except for the election of the Supervisory Board in


\textsuperscript{431}Art.76 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{432}Art.24 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{433}Art.24 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{434}Art.19 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{435}Art.29 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{436}Art.29 of Uzbek Law on Joint-Stock Companies.
Uzbekistan, which is elected by cumulative voting. In the United States, the default rule is majority voting too; however, when it comes to the election of directors, plurality voting is the default rule.

Plurality voting is defined as follows: “[a] ‘plurality’ means that the individuals with the largest number of votes are elected as directors … the individuals elected may have fewer than a majority of all the votes cast in the election,” hence, a “candidate for director must receive a greater number of the votes cast in an election than any other candidate in order to obtain a board seat, even if he or she does not receive an outright majority.”

The plurality voting regime has received negative comments, and shareholder activists, as well as the SEC have tried to encourage both the states and corporations to use the majority voting, thereby starting the so-called “majority voting movement.” It has been reported that this movement had considerable success, and over 66% of the S&P 500 and 57% of Fortune 500 companies have adopted a form of majority voting. Moreover, commercially important states, such as Delaware and California, have adopted

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437 Art.76 of Uzbek Law on Joint-Stock Companies. For elaboration on cumulative voting, see infra section 2.3.3.
438 “In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy, at the meeting and entitled to vote on the subject matter shall be the act of the stockholders”, DeLGCL 216(2).
439 “Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy, at the meeting and entitled to vote on the election of directors”, DeLGCL 216(3); “Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election, at a meeting, at which a quorum is present”, MBCA 7.28(a).
440 Model Business Corporation Act Annotated, supra note 16, Volume 1, at 7-61.
443 Falcone, supra note 441, at 855.
changes that would facilitate corporations switching to the majority standard, and the American Bar Association has amended the MBCA with the same purpose\textsuperscript{445}.

However, the actual effects of these reforms have been disputed. According to a recent study of the move towards majority voting in the United States corporations, it has been reported that as of February 2007, more than 371 public companies had implemented some form of majority voting\textsuperscript{446}, after describing each of the procedures in detail, the authors conclude that:

“[i]n the end, we failed to find a single company that had actually adopted a form of majority voting that gives shareholders veto power over incumbent directors”\textsuperscript{447}.

Thus, the real effect of the move towards majority voting is yet to be seen, hence, the difference between the United States and Germany, as well as Uzbekistan, remains significant with regard to election of directors and members of the Supervisory and the Management Boards. Taking into consideration that neither MBCA nor DelGCL provide for a mandatory rule regarding majority voting, and both Germany and Uzbekistan have the majority voting, it is obvious that the shareholders have more powers under the latter systems than the former.

\subsection*{2.3.3. Cumulative voting}

Cumulative voting is a proportional system of voting\textsuperscript{448} that is used in the director

\footnotesize{\textsuperscript{445}ABA, Committee on Corporate Laws, Report of the Committee On Corporate Laws on Voting by Shareholders for the Election of Directors 14-16 (Mar. 13, 2006) [hereinafter ABA Final Report] (describing the difficulties of setting majority voting as a default rule), available at http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20060313000001.pdf (last visited November 1, 2011), see also Falcone, supra note 441, at 856.}

\footnotesize{\textsuperscript{446}William K. Sjostrom, Jr. & Young Sang Kim, Majority Voting for the Election of Directors, 40 Connecticut Law Review 459, at 485.}

\footnotesize{\textsuperscript{447}Id.}

\footnotesize{\textsuperscript{448}“[C]umulative voting [is a] system in which each voter may cast more than one vote for the same candidate. Cumulative voting helps a minority to elect, at least one representative. It is common in shareholder}
elections in corporate context. Under cumulative voting each shareholder receives “for each share, a number of votes equal to the number of directors to be elected, which may be allocated among the candidates as the shareholder chooses”. Cumulative voting is in fact a violation of one share-one vote principle, since a shareholder can cumulate his votes for electing one or more candidates.

The concept of cumulative voting appeared in U.S. corporate law by inclusion in the Illinois constitutional convention of 1870, for which two main reasons are attributed:

“...an ideological belief in minority representation in legislative bodies, which was carried over to the boards of directors, and a functional concern about the vulnerability of minorities to exploitation by overreaching majorities, especially in light of the difficulties that public shareholders faced in obtaining information about the firm”.

Hence, in the context of corporations, cumulative voting is a system of voting for the election of directors and members of the Supervisory or the Management Boards that is intended to give the minority shareholders representation on the board by allowing them to concentrate their votes on a limited number of nominees. In such a scheme, a shareholder’s votes are equal to the number of his votes multiplied by the number of

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449 Choper, et al., supra note 422, at 571.
450 Gordon, supra note 448, at 8.
452 “[T]he following hypothetical illustrates the operation of the system: Corporation has 99 shares outstanding; A owns 59; B owns 40; three directors are to be elected. Under a system of straight voting, each share carries one vote for each director to be elected. B may cast 40 votes for each of B’s three candidates, but her 120 votes may do her no good because A may cast 59 votes for each of A’s three candidates and defeat B’s slate. Cumulative voting permits a shareholder to cast all his votes for a single candidate or to spread his votes among several candidates. It gives B the option of casting her 120 votes (three directors times 40 shares) for one, two or three candidate ... A cannot prevent B from choosing one director”, Choper, et al., supra note 422, at 571.
454 Gordon, supra note 448, at 166.
455 Choper, et al., supra note 422, at 571.
positions that are to be filled.\textsuperscript{456}

In the 1950-s in the United States, cumulative voting was mandatory in 22 states\textsuperscript{457}; currently only seven states make cumulative voting mandatory: Arizona, Hawaii, Kentucky, Nebraska, North Dakota, South Dakota, and West Virginia, while 45 states allow but do not require a corporation to have cumulative voting rights for the directors. Permissive clauses have two versions: opt in (34 states) and opt out (11 states)\textsuperscript{458}. One must note that Delaware and New York have never mandated cumulative voting. Furthermore, according to a recent study\textsuperscript{459}, cumulative voting is not the most popular provision included in the corporate charters, and thus is rarely used. To provide a recent example, the Goldman Sachs have been receiving a proposal of opting for election of directors by cumulative voting for the last several years; however, this proposal has always been unsuccessful. At the 2010 annual meeting of shareholders of Goldman Sachs, this proposal received support of 25.2\% of votes present in person or by proxy and consequently was not approved.\textsuperscript{460}

In Germany, although the AktG states that the articles of association may provide for different rules in respect of elections\textsuperscript{461}, German Law on Control and Transparency (KonTraG) has mandated the one share-one vote rule\textsuperscript{462}. Thus, although some authors

\begin{footnotes}
456 O’kelley & Thompson, supra note 419, at 154.
457 Gordon, supra note 448, at 165.
460 http://www2.goldmansachs.com/our-firm/investors/overview/annual-meeting-highlights.html (last visited November 1, 2011).
461 § 133(2) AktG.
\end{footnotes}
suggest that the cumulative voting is not banned in corporations\textsuperscript{463}, no important German corporation has such a provision in the charter\textsuperscript{464}, and the issue is not yet clarified by the courts\textsuperscript{465}.

In September 2008, Uzbekistan introduced cumulative voting at the general meeting of shareholders in the election of the members of the Supervisory Board\textsuperscript{466}, in all other cases the one share–one vote principle shall apply. It was believed that the introduction of cumulative voting would provide more protection to the minority shareholders; however, the resulting questions, such as the removal of the member of the Supervisory Board elected by cumulative vote of minority shareholders, have remained open.

If majority shareholders can remove directors elected by certain shareholders by their cumulative vote, it undermines the purpose of cumulative voting. In the United States, under both DelGCL and MBCA, the directors elected by cumulative voting are protected from removal by the majority shareholder\textsuperscript{467}, while the Uzbek law does not provide for such protection. Therefore, a provision similar to the following Delaware provision on removal of directors elected by cumulative voting should be introduced in Uzbek law:

“In the case of a corporation having cumulative voting, if less than the entire board is to be removed, no director may be removed without cause if the votes cast against such director’s removal would be sufficient to elect such director if then cumulatively voted at an election of the entire board of directors, or, if there be classes of directors, at an election of the class of directors of which such director is a part”\textsuperscript{468}.

Such a provision would ensure that the member of the Supervisory Board elected by a shareholder who used his cumulative vote, would be protected from the removal by the

\textsuperscript{463} M.M. Siems, Convergence in Shareholder Law (Cambridge University Press. 2008), at 172, see also Kraakman et al., supra note 35, at 91.

\textsuperscript{464} Kraakman et al., supra note 35, at 91 footnote 9.

\textsuperscript{465} Siems, supra note 463, at 172.

\textsuperscript{466} Art. 83 section 10 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{467} For a discussion of removal of the directors in the United States, see infra, section 3.4.3.7.

\textsuperscript{468} DelGCL 141(k)(2).
majority shareholders.

2.3.4. Voting caps

Voting caps is a technique of diluting the voting powers of the dominant shareholders by imposing a ceiling on their control rights\(^{469}\), whereas regardless of actual shares held, no shareholder can cast more than a certain number of votes. For instance, if a corporation provides for a voting cap of 5\%, the shareholder having 20\% of voting shares of the corporation will lose \(\frac{3}{4}\) of this voting power; the shareholder having 10\% of voting shares will lose half of his voting power\(^{470}\). Voting caps are commonly used as an anti-takeover defense\(^{471}\).

In Germany, voting caps in all corporations were allowed before 1998. The KonTraG prohibited new voting caps in all listed corporations in 1998\(^ {472}\), and provided for a grandfather clause, which allowed an existing voting cap in a listed corporation to survive. The grandfather clause lapsed on June 1, 2003\(^ {473}\), thereby effectively ending all voting caps in listed corporations, while not listed corporations are still allowed to provide for voting caps\(^ {474}\). KonTraG and AktG were applicable only to the voting caps provided by the articles of association of the corporation, and did not apply to the statutory voting cap in Volkswagen AG.

\(^{469}\) Kraakman et al., supra note 35, at 91.
\(^{470}\) Id.
\(^{472}\) § 1(20) KonTraG; § 134(1) AktG; R.A.I.V. Frederikslust, et al., Corporate Governance and Corporate Finance: A European Perspective (Routledge. 2008), at 197.
\(^{473}\) § 11(1) KonTraG; see also Goergen, et al., supra note 27, at 179.
\(^{474}\) § 134(1) AktG “Voting rights shall be exercised in proportion to the par value of shares. In case of a company not listed, at a stock exchange, the articles may limit voting rights with respect to shareholders holding more than one share by setting a maximum par value or a sliding scale”; for further elaboration on voting caps, See Frederikslust, et al., supra note 472, at 197.
The Land of Lower Saxony owned 20% of the voting stock of the Volkswagen AG, while the special “Volkswagen Law”\footnote{\textsuperscript{475}} provided for a voting cap of 20%\textsuperscript{476}. In the midst of the takeover battle between Porsche SE and Volkswagen\textsuperscript{477}, the European Commission, upon the initiative of Porsche SE, brought a case in the European Court of Justice\textsuperscript{478}. The ECJ has ruled that such a voting cap is in conflict with the article 56 of the EC Treaty, and noted that the public authorities should not have extensive powers going beyond their input in private corporations\textsuperscript{479}. As a response to this ruling, the German parliament passed a new VW Law without the 20% voting cap, and provided that each share shall have one vote\textsuperscript{480}. As a result, as of April 2012, Volkswagen AG does not have the voting cap by virtue of neither the law\textsuperscript{481} nor the articles of association\textsuperscript{482}, however, the blocking minority provision was not changed. In 2013, European Commission brought an action seeking financial penalties.

\begin{footnotes}
\item[475] “Gesetz über die Überführung der Anteilsrechte an der Volkswagen Gesellschaft mit beschränkter Haftung in private Hand” (VW Law) of Dec. 8 1960, Bundesgesetzblatt Teil III, Nr. 641-1-1, last modification July 31, 1970 (BGBl. I S. 1149). This law was not affected by KonTraG, see KonTraG article 10.
\item[476] § 2(1) of old VW Law: “The voting rights of a shareholder whose part value shares prerepresent more than one fifth of the share capital shall be limited to the number of votes granted by the par value of shares equivalent to one fifth of the share capital”, § 3(5) of old VW Law: “At the general meeting, no person may exercise a voting right which corresponds to more than one fifth of the share capital”, translations from Du Plessis et al., supra note 16, at 183.
\item[477] Id. at 179 et seq.
\item[478] Case C-112/05, Commission of the European Communities vs. Federal Republic of Germany, available at \url{http://ec.europa.eu/dgs/legal_service/arrets/05c112_en.pdf} (last visited November 1, 2011).
\item[479] “After having recalled its case-law on the concept of “movements of capital”, and having observed that the VW Law was indeed a national law, the Court examined the limitation of the voting rights of every shareholder to 20% of the share capital, and the fixing of the blocking minority, at 20% for the most important decisions of the general meeting. It pointed out that these limitations were indeed derogations from German law, imposed by way of specific legislation, affording any shareholder holding 20% of the share capital a blocking minority. Thus the fact that the Land of Lower Saxony still had a share of approximately 20% meant that this public actor had procured for itself a blocking minority allowing it to oppose important resolutions, on the basis of a lower level of investment than would be required under general company law. The Court concluded that this situation was to dissuade direct investors from other Member States and thus constituted a restriction on the movement of capital within the meaning of Article 56 EC”. Case C-112/05, Commission of the European Communities vs. Federal Republic of Germany, available at: \url{http://ec.europa.eu/dgs/legal_service/arrets/05c112_en.pdf} (last visited November 1, 2011).
\item[480] Du Plessis et al., supra note 16, at 183.
\item[481] Id.
\end{footnotes}
against Germany for failing to comply with the judgment. The ECJ has dismissed the case due to the fact that the judgment of 2007 established the violation of the EC Treaty only not from that clause considered in isolation, but only as a result of combination of that provision with another clause in the law.

In the United States, the voting caps are not per se prohibited, since the DelGCL explicitly allows the corporation to issue “restrictions ... as shall be stated and expressed in the certificate of incorporation,” and the MBCA provides that “the description of the preferences, rights and limitations of classes or series of shares ... is not exhaustive.” While the SEC does not limit the voting power either, it is only the national exchanges that may restrict voting caps by denying listing the corporations that have such voting caps – for instance corporations listed on NYSE and NASDAQ cannot adopt voting caps.

In Providence & Worcester Co. v. Baker, the articles of incorporation of Providence & Worcester Co. provided for a voting cap of fifty shares per shareholder, and one vote per each twenty share owned by the same shareholder, but not exceeding one-fourth of the total votes of common shares, unless as a proxy for other shareholders. The Court of Chancery of Delaware first found the voting cap to violate the section 151(a) of the DelGCL, however, the Supreme Court of Delaware upheld the voting cap and noted that:

“[T]hese restrictions are limitations upon the voting rights of the

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483 Case C-95/12, Commission of the European Communities vs. Federal Republic of Germany, [2013] WLR (D) 399.
484 Id.
485 DelGCL 151(a), 102(4).
486 MBCA 6.01(f).
488 Choper, et al., supra note 422, at 545.
stockholder ... if the General Assembly [of Delaware] intended to bar the type of restriction on stockholders' voting rights here under review, such prohibition would appear in § 212 ... The absence in § 212(a) of such similar cross reference to § 151(a) is, in our judgment, indicative of the absence of any legislative intent to prohibit, by § 151(a), charter restrictions upon stockholders' voting rights such as are under challenge here”.

In Uzbekistan, voting caps are neither prohibited nor expressly allowed; therefore, one can assume that voting caps can be used by corporations\textsuperscript{492}.

2.4. Substantive voting rights

Substantive voting rights may be divided into two main categories – right to elect directors, members of the Supervisory and the Management Boards, and the right to vote on fundamental transactions at the general meeting of shareholders. Each of these issues has its own peculiarities, such as differences in nominations for directors, members of the Supervisory and Management Boards, differences in the voting requirements for different classes of shareholders, different voting thresholds and voting procedures.

2.4.1. Right to elect directors

Shareholders cannot be directly involved in the activities of the corporation, therefore the power to elect directors, or the Supervisory Board members, who appoint the Management Board, is one of the most important powers of the shareholders. This section discusses the issues of director elections and the actual power of the shareholders in the context of the ownership structure in each jurisdiction.

In Germany, due to the two-tier board structure, and strict division of powers between the boards, the general meeting (hence the shareholders) elects only the members

\textsuperscript{492} Art. 15 of the Uzbek Law on Joint-Stock Companies states that the articles of association may contain other provisions restricting the voting rights provided that such provisions are not in conflict with law.
of the Supervisory Board of the corporation\textsuperscript{493}, while the appointment of the Management Board is in the powers of the Supervisory Board\textsuperscript{494}. The members of the Supervisory Board are elected at the general meeting by simple majority\textsuperscript{495}, unless the corporation falls under the requirements of co-determination. Members of the Supervisory Board may be removed at the general meeting with not less than three-fourths of the votes (the articles of association may provide for another majority and additional requirements)\textsuperscript{496}, by the shareholders who have appointed the said member according to the articles of association\textsuperscript{497} or by the court following the motion of the Supervisory Board\textsuperscript{498}.

In the United States, due to the one-tier board system, all directors of the Board are elected by the general meeting. Plurality rule is the default rule under both MBCA\textsuperscript{499} and DelGCL\textsuperscript{500}; however, if the corporation chooses to use the majority rule, such a provision in the bylaws cannot be changed by the directors\textsuperscript{501}.

In Uzbekistan, the issue of director election is far more thought-provoking. Both the Supervisory Board and the Management Board are by default rule elected by the general meeting of shareholders; the Supervisory Board is elected by cumulative voting\textsuperscript{502}, while the Management Board is elected by majority voting. This is complicated by two provisions: first, in case there are fewer than 30 shareholders, the functions of the Supervisory Board

\textsuperscript{493} §101(1) AktG.
\textsuperscript{494} § 84(1) AktG.
\textsuperscript{495} Under § 133 AktG, all resolutions of shareholder general meeting are passed by simple majority of votes, unless otherwise specified in the articles of association.
\textsuperscript{496} § 103(1) AktG.
\textsuperscript{497} § 103(2) AktG.
\textsuperscript{498} § 103(4) AktG.
\textsuperscript{499} “Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election, at a meeting, at which a quorum is present”, MBCA 7.28(a).
\textsuperscript{500} “Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy, at the meeting and entitled to vote on the election of directors”, DelGCL 216(3). 
\textsuperscript{501} A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors, DelGCL 216(4).
\textsuperscript{502} Art. 76 of Uzbek Law on Joint-Stock Companies.
may be delegated to the general meeting, and second, the functions of the Management Board may be delegated to an external business entity. Second, if the general meeting decides to delegate the management of the corporation to another enterprise – the “managing company”, the choice of the “managing company” can be made on a tender/bidding basis.\textsuperscript{503}

2.4.2. Right to vote on fundamental transactions and changes

The management decides on all of the day-to-day activities of the corporation, the supervisory organ oversees the actions of the management and approves important decisions. However, when it comes to changes of a bigger scale, such as the change of the articles of association or a merger, shareholders are legitimate in their expectation “that their investment cannot be altered without their approval”\textsuperscript{504}, since “[r]equiring shareholders’ consent for any fundamental change in corporate policy is a safeguard for the residual risk bearers of a corporation against fundamental changes in their investments ex post”\textsuperscript{505}.

It is necessary to define the requirements or at least put some threshold when a change or a transaction is fundamental and indeed requires shareholder approval. In that regard, the transaction may be deemed as fundamental if it is large relative to the capital of the corporation, or the transaction creates a possible conflict of interests, such as manager-shareholder, or shareholder-shareholder conflicts\textsuperscript{506}.

Amendment of the articles of association as the core document of the corporation,

\textsuperscript{503} Art. 86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{505} Id., at 111.
\textsuperscript{506} Kraakman et al., supra note 35, at 184.
increase or decrease of the registered share capital, merger, reorganization or liquidation of the corporation are transactions that possess one of the above features, and require shareholder approval in all three countries of study.  

2.4.2.1. Germany

In Germany, the general meeting of shareholders has extensive powers, although some authors doubt that the general meeting is the highest body of the corporation. The general meeting has the following powers:

- election of members of the Supervisory Board;
- appropriation of distributable profits;
- ratification of the acts of the members of the Management Board and the Supervisory Board;
- appointment of the auditor;
- adoption of and amendments to the articles of association;
- increase or decrease the registered share capital;
- dissolution of the corporation.

Since the AktG is mandatory and the articles of association may have provisions different than provided in the law only if the law expressly permits, the powers of the general meeting are fixed. The Supervisory Board may be “conferred the power only to make amendments that relate solely to the wording of the articles of association.”

Fundamental transactions, therefore, are in the powers of the general meeting. As discussed earlier in sections 2.2.1 and 2.2.2, individual shareholders in German corporations have the power to both propose issues for the agenda of the meeting, and nominate the

507 Wirth, et al., supra note 87, at 132.  
508 Id.; “[T]he prevailing opinion no longer regards the general meeting as the ‘highest body’ ... [T]oday, in Germany, the management board is the most important body”, Siems, supra note 463, at 151-153.  
509 Wirth, et al., supra note 87, at 134.  
510 § 23(5) AktG.  
511 Baums & Wymeersch, supra note 504, at 115.  
512 § 179 AktG.
members of the Supervisory Board.

2.4.2.2. The United States

Regarding the fundamental transactions, it is important to distinguish between the charter and the bylaws of the corporation. The charter, as well as any amendment to the charter, has to be registered with the secretary of the state513, while the bylaws are not registered with any government authority and the change in them is not registered either. Hence, the charter usually contains most basic provisions, such as the name and address of the corporation, types and number of authorized shares, while provisions regarding the Board of Directors are usually put in bylaws.

Concerning the amendments to the charter, the MBCA and DelGCL take the position of the so-called “bilateral veto” between Board of Directors and shareholders514, where the board of directors proposes, and the general meeting votes on the amendments. Under this system, neither can decide on its own – consent of both the general meeting of shareholders and the board of directors is required. Under both MBCA and DelGCL, the shareholders do not have the right to propose amendments to the charter515, but they can initiate changes of the bylaws of the corporation.

Amendments to bylaws are regulated differently. Under the MBCA, the directors may change the bylaws of the corporation without shareholder consent516; however, the directors cannot change the bylaws if the shareholders, either in bylaws or in the charter, have provided that a decision right is reserved to the shareholders. Under DelGCL, the shareholders may adopt, amend and repeal bylaws; however, the Delaware courts have not

513 DelGCL 242(b); MBCA 10.03.
514 Kraakman et al., supra note 35, at 187.
515 Zetzsche, supra note 320, at 120, see also DelGCL 242(b), MBCA 10.03.
516 MBCA 10.20(a).
provided a clear answer whether the Board of Directors can amend or repeal the bylaws adopted by shareholders\textsuperscript{517}.

In Delaware, all resolutions of the general meeting are accepted by simple majority\textsuperscript{518}; however, issues as mergers, sale of substantial amount of assets, or amendments to the charter have to be approved by the majority of the shares entitled to vote\textsuperscript{519}.

Although in Delaware the shareholders have the right to amend the charter and bylaws of the corporation, in \textit{Hollinger International Inc. vs. Black}, the Delaware court invalidated the amendment adopted by the general meeting of shareholders\textsuperscript{520}. The defendant, Conrad M. Black was the chairman of the Board of Directors of Hollinger International, a newspaper publisher, and he also indirectly controlled the corporation through a controlling interest in an intermediate holding company. Black had been facing accusations of self-dealing by the SEC, and could be stripped of his corporate office by independent directors. Therefore, Black signed a “Restructuring Proposal”, a formal contract, where he undertook the obligation to resign as the CEO of the Hollinger International (but stay as the Chairman of the Board), repay certain funds without admission of wrongdoing, and develop a value-maximizing transaction for Hollinger International. However, Black violated the “Restructuring Proposal” by agreeing to sell part of the assets of Hollinger International or the corporation as a whole to Barclays. The Board of Directors of Hollinger International believed this transaction was not in the interests of the corporation,

\textsuperscript{517} Welch et al., supra note 349, at 45.
\textsuperscript{518} DelGCL 216(2).
\textsuperscript{519} DelGCL 251(c), 271, 242(b).
\textsuperscript{520} Hollinger International vs. Black, 844 a.2d 1022 (Del. Ch. 2004).
therefore the Board of Directors took measures to prevent the transaction\textsuperscript{521}. Black responded by enacting the “Bylaw Amendments”, introducing unanimous action by the Board of Directors for any significant decision. The court noted that

“[a]lthough it is no small thing to strike down bylaw amendments adopted by a controlling stockholder, that action is required here because those amendments complete a course of contractual and fiduciary improprieties”.

The court found that Black breached his fiduciary and contractual duties\textsuperscript{522}, and that the amendment pursued an “inequitable purpose”\textsuperscript{523}, and therefore infringing the rights of the shareholders\textsuperscript{524}.

2.4.2.3. Uzbekistan

In Uzbekistan, as noted earlier, the general meeting is considered as the “supreme authority” of the corporation, having power to elect and remove members of both Supervisory and the Management Boards. The general meeting has two types of powers – powers in the exclusive jurisdiction of the general meeting, which cannot be delegated, and the powers that may be conferred to the Supervisory Board of the corporation.

The exclusive powers of the general meeting are:

- adoption and amendment of the articles of association;
- approval of merger, reorganization and liquidation of the corporation;
- electing and removing the members of the Supervisory Board and Inspection Committee (Inspector), deciding on their number;
- approval of increase and decrease of the authorized share capital, share buybacks;
- approval of yearly business plans, annual financial reports, distribution of profits;

\textsuperscript{521} The actions of the Board of Directors were found to be a proportionate response and had satisfied the burden under the \textit{Unocal vs. Mesa Petroleum Co.} standards. Hollinger International vs. Black, 844 a.2d 1022 (Del. Ch. 2004).

\textsuperscript{522} Welch et al., supra note 349, at 50.

\textsuperscript{523} The “inequitable purpose” can be perpetuating directors in control, Douglas M. Branson, \textit{The Chancellor’s Foot in Delaware: Schnell and Its Progeny}, 14 Journal of Corporation Law, 515-525 (1989), at 522.

\textsuperscript{524} The burden of proving the “inequitable purpose” in shareholder-approved amendments is high, see Frantz Manufacturing Co. vs. EAC Industries, Inc., 501 A.2d. 401 (Del. 1985).
exclusion of pre-emptive rights of the shareholders.

Also, with regard to limitation of the rights of the preferred shareholders, or any separate class of shareholders, the majority of the class which will be affected by the proposed change has the right to vote for such a change\textsuperscript{525}. Thus, the law by conferring these rights to the general meeting and explicitly prohibiting their delegation ensures that the shareholders have the right to vote on all fundamental transactions.

2.5. Special rights of shareholders

Some of the shareholders can be given special rights that other shareholders do not possess. Such rights may include, for example, the right to appoint and remove members of the Supervisory Board in Germany, right to elect and remove directors in the United States, right to veto on certain transactions, “golden share”.

2.5.1. Right to appoint and remove Supervisory Board members in Germany

In Germany, in addition to the general rights, some of the shareholders may be given special rights (\textit{Sonderrechte})\textsuperscript{526}, which do not have to be associated with any share classes\textsuperscript{527}, for instance rights to use the company's facilities\textsuperscript{528}, but the most important of type of such rights is the right to elect and remove member(s) of the Supervisory Board\textsuperscript{529}.

A right to elect and remove member(s) of the Supervisory Board may be granted by the articles of association only to holders of registered shares. Such right may be given regarding not more than one third of the shareholder representatives on the Supervisory Board.

\textsuperscript{525} Art. 26 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{526} “The following special rights are commonly granted: shares without a voting right but with a preference in profits sharing, the right to delegate members to the Supervisory Board, rights to use the company's facilities”, Wirth, et al., supra note 87, at 91.

\textsuperscript{527} § 101(2) AktG.

\textsuperscript{528} Wirth, et al., supra note 87, at 91.

\textsuperscript{529} Right to appoint under § 101(1) AktG, right to remove under § 103(2) AktG.
Board\textsuperscript{530}, which means that if co-determination applies, the shareholder possessing such right will be able to appoint not one-third of the board, but one-third of the number of representatives to be elected by the shareholders\textsuperscript{531}.

\textbf{2.5.2. Right to elect and remove directors in the United States}

In the United States, both DelGCL and MBCA provide that apart from the general rights to elect and remove directors, specific shares may be given a right to elect a specific number of directors\textsuperscript{532}.

DelGCL provides that the charter may “confer upon holders of any class or series of stock the right to elect one or more directors”\textsuperscript{533}. In \textit{Insituform of North America, Inc. v. Chandler}\textsuperscript{534}, the court upheld the right of certain shareholders to elect and remove a specific number of directors. The corporation had two classes of shares (class A and class B), which had identical rights, except that class B had a right to elect two thirds of the directors. After a change in the holders of the majority of class B shares, the new holders decided to remove the directors elected by their predecessors; the removed directors applied to the court. The court confirmed the right of a class of shareholders to elect a number of directors under article 141(d) DelGCL, and remove said directors without cause under 141(k) DelGCL\textsuperscript{535}.

MBCA also allows certain shareholder(s) to elect and remove directors by providing that a separate class of shares may elect “all or a specified number of directors by the

\textsuperscript{530} \S 101(4) AktG.
\textsuperscript{531} \S 101(4) AktG, for more elaboration, see Wirth, et al., supra note 87, at 91.
\textsuperscript{532} DelGCL 141(d), MBCA 8.04.
\textsuperscript{533} DelGCL 141(d).
\textsuperscript{534} Insituform of North America, Inc. v. Chandler, 534 A.2d 257 (Del. Ch. 1987), at 267.
\textsuperscript{535} Model Business Corporation Act Annotated, supra note 16, Volume 2, at 8-52; Welch et al., supra note 349, at 393.
holders of one or more authorized classes of shares.”

2.5.3. “Golden share”

“Golden share” is a special power of the shareholder that gives its holder special rights not available to any other shareholder in the same corporation. Usually, the golden shares are used by the governments to retain control over privatized enterprises. Typically, such powers include the right to appoint members in corporate boards, the right to consent to or to veto fundamental transactions such as sale or acquisition of assets, and transfer of subsidiaries, as well as dissolution of the corporation. Also, the government can provide for statutory constraints, which may cover ownership limits, voting caps, and national control provisions. Golden shares are currently not allowed in both Germany and the United States but they are allowed in Uzbekistan.

Golden shares were first used by the United Kingdom in the 1980s while privatizing Britoil and since then have widely been used in privatization schemes in both Western

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536 MBCA 8.04; for elaboration, see Model Business Corporation Act Annotated, supra note 16, Volume 1, at 8-52.
537 Bernardo Bortolotti and Mara Faccio, Government Control of Privatized Firms, 22 The Review of Financial Studies 8, 2907-2939 (2009), at 2918.
538 “A golden share refers to a single share retained by the government to which special rights attach, such as the right to veto or pre-approve certain company decisions. The term golden share is used to refer to rights retained by the government even in the absence of an actual share being held”, Christine O’Grady Pute Limited But Not Lost: A Comment on the ECJ’s Golden Share Decisions, 72 Fordham Law Review 5, 2004, at 2220.
539 Alberto Santa Maria, European Economic Law, (Kluwer Law International. 2009), at 224.
540 Bortolotti & Faccio, supra note 537, at 2918.
541 Id.
544 Art. 24-1 of Uzbek Law on Joint-Stock Companies.
and Central and Eastern Europe. However, the European Court of Justice attacked golden shares in the member states on the basis that they violated the freedom of movement of capital under the EC Treaty, and delivered the first three judgments on June 4, 2002.

The ECJ continued to attack golden shares stating that “such discriminatory restrictions can be accepted only if they are justified on grounds of public policy, public security or public health.” A German case of golden share is the Volkswagen case, where the ECJ decided that although voting cap is not per se equal to a golden share, when Lower Saxony’s veto rights and the right to appoint two members of the Supervisory Board were combined with a voting cap, it violated the free movement of capital and on the freedom of establishment guaranteed by the EC Treaty.

The Uzbek Law on Joint-Stock Companies defines the "golden share" as a special right of the State participation in otherwise private corporations of strategic importance, and such a share has the following features:

- golden share can be introduced in corporations where the State does not have any participation or possesses not more than 25% of the registered share capital;

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551 For elaboration on the Volkswagen case in the ECJ, see supra section 2.3.4.

552 President of the Republic of Uzbekistan, Decree on Additional Measures to Deepen Process of Privatization of Strategic Branches of Economy, 20 July 2007, NeUP-3897.
• golden share has no value;
• golden share is not subject to alienation, and cannot be used as a security;
• golden share is not considered when determining the amount of authorized capital and dividends;
• rights of the golden share are implemented through appointment of a representative of the State in the Supervisory Board, who has a right of veto for liquidation, reorganization of the corporation, amendment of the charter, increase or decrease in the share capital.

The golden share is already being utilized in privatized corporations in the fields of cotton refining, fat-and-oil industries, and is planned to be used even more widely later on, since the government is attempting to privatize the strategic enterprises.

2.6. Derivative suits as means of shareholder protection

Black’s Law Dictionary defines derivative suit as:

“A suit by a beneficiary of a fiduciary to enforce a right belonging to the fiduciary; esp., a suit asserted by a shareholder on the corporation’s behalf against a third party (usu. a corporate officer) because of the corporation’s failure to take some action against the third party”.

When harm is done to a corporation, the general principle is that the corporation (via its agent and/or organs) has a standing in the court to pursue remedies; this is called the proper plaintiff principle, and derivative action is an exception to the proper plaintiff principle. The corporation decides whether to bring a lawsuit and it does so via its organs – the Management Board, the Supervisory Board or the Board of Directors; however, if members of the Management Board, the Supervisory Board or the Board of Directors are

554 B.A. Garner, Black’s Law Dictionary (West. 2010).
555 The proper plaintiff principle was first stated in Foss vs. Harbottle: With regard to the harm done to the corporation, the “corporation should sue in its own name and its corporate character, or in the name of someone whom the law has appointed to be its representative”, Foss v Harbottle (1843) 67 ER 189.
556 X. Li, A Comparative Study of Shareholders’ Derivative Actions: England, the United States, Germany, and China (Kluwer. 2007), at 2.
the wrongdoers or are controlled by the wrongdoers\textsuperscript{557}, they are not willing or not able to make a fair decision.

When a corporation suffers a loss, the shareholders, who thus also suffer and indirect loss, may take collective actions through the general meeting of shareholders to remove the persons who have caused the loss to the corporation. Nonetheless, such actions are not enough to compensate for the loss, and therefore, as an alternative strategy, a derivative suit should be employed.

In Germany, until 2005, derivative suits had been prohibited\textsuperscript{558}; however, the general meeting could request the corporation to assert the claim against the member(s) of the Supervisory Board or the Management Board or any third person (including another shareholder)\textsuperscript{559}. In 2005, the AktG was amended\textsuperscript{560} to introduce derivative action for a shareholder possessing more than 1\% of the share capital or shares in the amount of at least 100.000 Euros\textsuperscript{561} to claim for damages from founders of the corporation, member(s) of the Supervisory Board or the Management Board\textsuperscript{562}.

However, before going to the merits of the case, there is a procedural action, where the shareholders bringing the derivative action have to prove that:

- they have acquired the title to the shares before the alleged violation;
- they have requested the corporation to assert the claim in the manner prescribed by the law;
- corporation has incurred loss due to violation of the law or the articles of

\textsuperscript{557} Id.
\textsuperscript{558} Wirth, et al., supra note 87, at 91.
\textsuperscript{559} Id.
\textsuperscript{561} §§ 147(1), 148(1) AktG.
\textsuperscript{562} Id.
association;
- corporation does not have an overriding claim.\(^{563}\)

Hence, the new system introduced in Germany resembles the preventive trial in the United States to determining the legitimacy of the judicial action.\(^{564}\)

After the derivative suit has been brought, the corporation has a right to take over the litigation at any given time\(^{565}\) and the shareholders who brought the derivative action must join as parties.\(^{566}\) Regarding the expenses of the derivative action, the minority shareholders are well-protected. Only in case the judge declines to proceed with the derivative action on procedural grounds do the shareholders bear the costs, in all other cases, the corporation has to refund the costs of the suit to the shareholders.\(^{567}\) The introduction of the derivative suit and the facilitation of the litigation expenses has been viewed as a move towards more protection of the shareholders.\(^{568}\)

The United States has a long-standing tradition of derivative suits starting from the 19th century.\(^{569}\) In *Dodge v. Woolsey*, the first case on derivative actions in the U.S., the court recognized that the derivative action in fact is a combination of two suits – one enforcing the rights of the corporation against other persons; the other enforcing the obligation of the corporation to all shareholders and the plaintiff (who is a shareholder too).\(^{570}\) However, the court noted that the derivative action is not automatic – the shareholder has to exhaust all remedies within the corporation, for example by putting the matter before the Board of Directors, and only when he is unsuccessful there then may he

\(^{563}\) § 148(1) AktG, see also Latella, supra note 515, at 318.
\(^{564}\) Latella, supra note 515, at 318.
\(^{565}\) § 148(1) AktG.
\(^{566}\) Id.
\(^{567}\) Latella, supra note 515, at 318.
\(^{569}\) For more information on the history of derivative suits in the United States, see X. Li, supra note 556, at 1-9.
\(^{570}\) *Dodge v. Woolsey*, 59 U.S. 331 (1855), Li, supra note 556, at 91.
Derivative actions were highly popular in the United States until the 1980s, which can be explained by the fact that there were fewer corporate governance mechanisms, and the derivative action was the “chief regulator of corporate governance.” The rapid development of a market for corporate control, which started to take over the function of the “regulator” in the 1980s, led to a decline in the popularity and number of derivative suits and the imposition of certain restrictions, both substantive and procedural.

The derivative actions in the United States are a matter of both state and federal law, and have procedural and substantive requirements. With regard to the substantive criteria, the most common ones to distinguish the direct actions of the shareholders from the derivative actions are the “injury” and “right” criteria. The “injury” criterion is satisfied if the alleged injury is not personalized to the shareholder, but is suffered by the corporation and “only affects the shareholders incidentally.” The “rights” criterion is satisfied if the violation that led to the injury was a violation of the rights of the corporation, not of the shareholder.

Apart from the substantive criteria, the shareholder also has to meet the procedural criteria set out in the United States Rules of Federal Procedure 23.1, i.e., to introduce the derivative suit, the complaint must be verified by the judge and the shareholder bringing the derivative action must show:

- that he has held the title to the shares at the time or before the transaction took place;

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571 Id.
572 Li, supra note 556, at 98.
573 Cohen v. Beneficial Industrial Loan Corp 337 U.S. 541, 548 (1949), see also Li, supra note 556, at 98.
574 Li, supra note 556, at 98.
that the derivative action is not collusive to confer jurisdiction on the court;

- exactly what efforts the plaintiff has taken to remedy the alleged injury, and why his actions have failed.

Derivative suit in the United States is a complex procedure; while some claim that it is “expensive, hazardous and clumsy” and does not provide adequate protection for minority shareholders, others believe that the derivative suit is an important tool in the hands of the shareholders both to fight with and punish the directors, and deter managers’ dishonesty.

The Uzbek Law on Joint-Stock Companies provides that the holder of 1% of the shares of the corporation may bring an action against any member of the Supervisory Board and/or the Management Board in the court for their causing loss to the corporation. However, there are both substantive and procedural issues.

The court system of Uzbekistan strictly divides the courts into courts of general jurisdiction and commercial courts. Procedural bases for bringing the derivative actions are the following: article 48 of the Code of Civil Procedure states that enterprises and private persons may bring an action with the purpose of defending third person’s rights; article 1 of the Commercial Procedure Code provides that any interested party may bring a lawsuit in the commercial court. However, these are the only procedural norms, whereas neither the Code of Civil Procedure nor the Commercial Procedure Code provide for rules similar to the ones in Germany or United States, such as the requirement to put the matter

\(\text{576}^{*}\) Bainbridge, Corporation Law and Economics, supra note 40, at 368.
\(\text{577}^{*}\) Li, supra note 556, at 104.
\(\text{581}^{*}\) Art. 88 of Uzbek Law on Joint-Stock Companies.
\(\text{582}^{*}\) Art. 1 of the Law of the Republic of Uzbekistan on Courts, September 2, 1993, No 924-XII.
before the corporation and exhaust the intra-corporate means.

The procedural problem is that the same case can be introduced in two courts simultaneously, since specific rules on application for derivative suits have not been defined. Thus, depending on whether the shareholder is a legal entity or a private person, the case may be tried by commercial court, the court of general jurisdiction or both simultaneously\textsuperscript{583}, which creates inconsistency with respect to the outcome of the decision.

Moreover, if two suits are brought in two different courts simultaneously, the courts may, but are not obliged to, merge the suits. If the suits are merged and they fall under both courts’ jurisdiction, then the case will be tried by the court of general jurisdiction\textsuperscript{584}. However, if two actions on the same subject matter are brought before the commercial court and the court of general jurisdiction, these two courts may start simultaneous proceedings. Since disputes over the jurisdiction of a case are not allowed\textsuperscript{585}, and both courts of general jurisdiction and commercial courts have to reach a decision on the merits in case they have established jurisdiction\textsuperscript{586}, it is possible that the same issue will be tried by two courts simultaneously. Hence, the outcome of the derivative suit may be different depending on the situation, and there is no unified procedure for derivative actions.

Regarding the substantive bases of derivative suits, the requirement is that the loss should have been suffered by the corporation. Other substantive bases are not clearly defined: the definition of “loss” has not been provided; moreover, the legal system does not provide for fiduciary duties of members of Supervisory or the Management Boards. The


\textsuperscript{585} Art. 147 of Code of Civil Procedure of the Republic of Uzbekistan.

violation of substantive rules by the members of Supervisory or the Management Boards is dealt in detail further\(^{587}\).

Another problem that can be deterring the shareholders from bringing the derivative actions is the issue of expenses, when the shareholders are faced with “all-in” type of decision. According to the article 116 of the Code of Civil Procedure and the Commercial Procedure Code, the losing party is obliged to refund the litigation costs\(^{588}\), hence, the shareholders are refunded only if they win. If the shareholders lose the case in the court, the corporation is not under any obligation to reimburse the shareholders who brought the claim, thereby discouraging the shareholders from bringing such derivative suits in the court.

Despite the abovementioned problems, the fact that the derivative suit has been introduced in Uzbekistan is a step forward in protection of minority shareholders’ rights.

2.7. Obligations of the shareholders

The conflict between the shareholders appears when the interests of the shareholders having certain rights, such as a dominant or controlling block or a type of special right, diverge from the interests of the corporation in general or other shareholders. In this regard, the obligations of the shareholders are important in solving this problem, and by putting specific obligations onto the controlling shareholders, some of these issues could be resolved. In theory, the shareholders’ obligations are divided into two categories\(^{589}\):

\(^{587}\) See infra section 4.2.


\(^{589}\) However, in Germany, according to § 55(1) AktG, there is also a third category, ancillary obligations – obligations to provide special services to the corporation (or other special obligations) as per contract or company documents. “Ancillary obligations for shareholders are generally not admissible; the articles of association may, however, contain ancillary non-pecuniary obligations but only if the transfer of shares
• duty to pay the shares’ price (original contributions);
• duty of loyalty (or fiduciary duty\textsuperscript{590}).

In addition, the concept of piercing the corporate veil plays an important role, allowing the systems to hold the fraudulent shareholder liable for more than his contributions for the shares of the corporation.

\textbf{2.7.1. Duty to pay the shares’ price (original contributions)}

The concept of limited liability presumes that the shareholders are liable to the extent of their contributions; however, in order to become a shareholder, one has to fulfill the primary duty – pay the price of the shares.

In Germany, the primary obligation of the shareholders is to pay the price of the shares\textsuperscript{591}. The shareholders cannot be released from this obligation\textsuperscript{592}, and such obligation may not be set off with claims of the shareholders against the corporation\textsuperscript{593}. The shares in German corporations may not be transferred prior to the registration of the corporation in the commercial register\textsuperscript{594}, which ensures the distinction between the liabilities of founders, who might be jointly and severally liable, from the ones of shareholders, whose liability is limited to the extent of paying of the price of their shares. If the shareholders do not pay the subscription in time, they are required to pay a statutory interest for the due date at five per cent per annum\textsuperscript{595}, while the articles of association may provide for extra penalties for late

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{590} For the purposes of current section, with regard to the liabilities of the shareholders, the terms “duty of loyalty” and “fiduciary duty” are deemed equal and will be used interchangeably.
\item \textsuperscript{591} § 66 AktG.
\item \textsuperscript{592} Id.
\item \textsuperscript{593} Id.
\item \textsuperscript{594} § 41(4) AktG.
\item \textsuperscript{595} § 63(2) AktG.
\end{itemize}
\end{footnotesize}
payment for shares\textsuperscript{596}, and these penalties do not preclude the claim of the corporation for damages\textsuperscript{597}.

In the United States, under both MBCA and DelGCL, there is a division between pre-incorporation subscription and payment for later issuances; while the former is directly regulated by state law, the latter is left to parties’ agreement and is regulated by the general contract law\textsuperscript{598}. Under both MBCA and DelGCL, the pre-incorporation subscription can be made in the manner determined by the Board of Directors\textsuperscript{599}, and is irrevocable for six months, unless otherwise provided by the terms of subscription\textsuperscript{600}. The Board of Directors may call for payment, if the necessities of the business so require\textsuperscript{601}, and failure to pay the subscriptions after such a call\textsuperscript{602} may result in either legal action against the defaulting shareholders or the public sale of the unpaid part of the shares by the Board of Directors for the price including the original price of the shares, “interest and all incidental expenses”\textsuperscript{603}. If both of the possibilities fail to provide the result, the unpaid stock, as well as the paid stock will be forfeited to the corporation, i.e., taken back and cancelled\textsuperscript{604}.

In Uzbekistan, the shareholders’ primary obligation is to pay the price of the shares, and the law distinguishes between the payment for the first shares subscribed for upon foundation of the corporation and the additional shares issued afterwards. Regarding the first shares, shareholders have to pay the price of the shares within the time prescribed by

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596 § 63(3) AktG.
597 § 63(2) AktG.
598 Welch et al., supra note 349, at 393.
599 DeLGCL 152; MBCA 6.20(b), 6.21(b).
600 DeLGCL 165; for further explanation see Welch et al., supra note 349, at 393; MBCA, 6.20(a).
601 DeLGCL 163; MBCA 6.21(b).
602 The remedies described are subject to such call by the Board of Directors, see Welch et al., supra note 349, at 392.
603 DeLGCL 164; Welch et al., supra note 349, at 416.
604 DeLGCL 164; Welch et al., supra note 349, at 416.
\end{footnotes}
\end{footnotesize}
the foundation deed, but no later than a year from the date of subscription\textsuperscript{605}, in the manner prescribed by the corporate documents or the prospectus\textsuperscript{606}, and if not paid within the time prescribed, such shares are cancelled\textsuperscript{607}, thus, the shareholders can be released from their obligation to pay the subscription price. Additional shares have to be paid within the time prescribed by the prospectus; however, there is no provision on share revocation, and the shareholders cannot be released from the obligation to pay for additional shares. Although the statute does not provide for penalties for late payment, the articles of association may prescribe for such penalties both on the first issue and the further issues\textsuperscript{608}.

From the three legal systems, the German system is the most stringent one with regard to first issuance of shares, where the shareholders cannot be released from the obligation to pay. The United States give flexibility to the Board of Directors to choose the method of getting the price of the shares, allowing the Board to cancel the shares or pursue legal action against the shareholders. In Uzbekistan, however, the first shares unpaid within the time prescribed are automatically cancelled, thereby providing for the lowest level of shareholder obligations for the first issue.

2.7.2. Duty of loyalty (or fiduciary duty) of the shareholders

The conflict between the shareholders arises from the fact that the actions of some shareholders may be detrimental to the corporation in general or to specific minority shareholders; therefore, although the shareholders of a corporation have limited liability, a fiduciary duty of the shareholders may arise when they have the power to make decisions or

\textsuperscript{605} Art. 33 section 1 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{606} Art. 33 section 4 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{607} Art. 33 section 1 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{608} Art. 33 of Uzbek Law on Joint-Stock Companies.
take actions that would affect the corporation or other shareholders\textsuperscript{609}.

Most of the jurisdictions agree that controlling shareholders\textsuperscript{610} owe a duty of loyalty towards the minority shareholders due to the fact that they exert considerable control over the corporation, and may infringe the rights of minority shareholders\textsuperscript{611}. However, the issue of imposing a general fiduciary duty\textsuperscript{612} is controversial, and the countries substantially diverge regarding this issue.

In the case of Germany, all shareholders in German corporations, including controlling shareholders, have the general fiduciary duty to the corporation and to other shareholders\textsuperscript{613}, which has been recognized quite recently\textsuperscript{614}. In Germany, the fiduciary duties of shareholders are based on the duty of loyalty (\textit{Treuepflicht})\textsuperscript{615}, which belongs to the general principles of German law\textsuperscript{616} and is based on the case law of the Federal Supreme Court of Germany\textsuperscript{617} and the principle of good faith\textsuperscript{618}.

Under German law, the violation of duty of loyalty may lead to the liability of


\textsuperscript{610} The definition of “control” differs among the jurisdictions, see infra. The elaboration of this section refers to the issues of shareholders’ obligations as shareholders of public corporations as defined supra section 1.5.3, regardless of the legal form of the shareholder.


\textsuperscript{612} Fiduciary duties are “a set of rights and obligations that are independent of any contract and can only be limited in their assertion by contractual provisions when the claims based on fiduciary duties touch on the obligations created in the contract”, The ATR-KIM ENG Fin. Corp. v. Araneta, 2006 WL 3783520 (Del. Ch. Dec. 21, 2006), at note 1.

\textsuperscript{613} Maentysaari, Comparative Corporate Governance, supra note 36, at 363, Wirth, et al., supra note 87, at 93, Dornseifer, supra note 179, at 229.

\textsuperscript{614} Wirth, et al., supra note 87, at 93.

\textsuperscript{615} The duty of loyalty includes “a duty to promote the purpose of the Company [AG], a prohibition to cause the Company [AG] loss or damage, and a further duty to use shareholders’ rights and powers in a responsible manner”, Maentysaari, Comparative Corporate Governance, supra note 36, at 363.

\textsuperscript{616} Id.

\textsuperscript{617} See BGHZ 103, 184 at p 194 (Linotype), BGHZ 129, 136 at p 142 (Girmes) and BGHZ 142, 167 (Hilgers), cited in Maentysaari, Comparative Corporate Governance, supra note 36, at 363.

\textsuperscript{618} § 242 Bürgerliches Gesetzbuch, 1896 (hereinafter referred to as BGB); see also Maentysaari, Comparative Corporate Governance, supra note 36, at 363.
controlling shareholders\textsuperscript{619}, liability for damages to the corporation and shareholders for inducing the authorized person to act to the disadvantage to the corporation\textsuperscript{620}, and invalidity of general meeting resolution\textsuperscript{621}.

The German law of corporate groups (\textit{Konzernrecht}) provides for three types of groups depending on the form of control: integrated group, contractual group (both with a formal control agreement) and de facto group (without a formal control agreement)\textsuperscript{622}.

With regard to the liability of controlling shareholders\textsuperscript{623}, German law provides for such liability in all three groups\textsuperscript{624}. In case of integrated group and contractual group, the controlling shareholder possesses more powers and more liabilities compared to de facto group.

Both integrated group and contractual group are created by signing the “control agreement” (\textit{Beherrschungsvertrag}) where the controlling shareholder imposes its direction to the corporation\textsuperscript{625}. This agreement allows the controlling shareholder to issue instructions as to the management of the controlled corporation\textsuperscript{626}, and such instructions can be even disadvantageous to the controlled corporation, provided that they are beneficial for the controlling shareholder or members of its group\textsuperscript{627}, and provided that the controlled corporation is indemnified by the controlling shareholder (\textit{Verlustübernahme})\textsuperscript{628};

\textsuperscript{619} § 309 AktG. See BGHZ 103, 184, at p 194 (Linotype), BGHZ 129, 136, at p 142 (Girmes) and BGHZ 142, 167 (Hilgers), cited in Maentysaari, Comparative Corporate Governance, supra note 36, at 363.

\textsuperscript{620} § 117 AktG.

\textsuperscript{621} § 243 AktG.

\textsuperscript{622} Maentysaari, Comparative Corporate Governance, supra note 36, at 366.

\textsuperscript{623} The controlling shareholder “does not have to be an AG in order for the \textit{Konzernrecht} to be applicable. In the \textit{Autokran} [BGHZ 95, 330] case, the Federal Supreme Court held that even a natural person could be regarded as an undertaking for this purpose”, Maentysaari, Comparative Corporate Governance, supra note 36, at 366.

\textsuperscript{624} Maentysaari, Comparative Corporate Governance, supra note 36, at 325.

\textsuperscript{625} § 291 AktG.

\textsuperscript{626} § 308(1) AktG.

\textsuperscript{627} § 308(1)AktG.

\textsuperscript{628} “The price of the power to control an AG is special protection of the shareholders and creditors of the controlled company. Firstly, the representatives of the controlling undertaking have a duty of care. They can
and the management of the controlled corporation cannot reject such instructions. The control agreement has to be approved by at least three-fourths of the share capital represented at the general meeting of the controlled corporation.

In integrated group and contractual group, German law puts an explicit obligation for the controlling shareholder of being a “diligent and conscientious manager.” Violation of such duties by the controlling shareholders will lead to joint and several liability of the controlling shareholders for any resulting damage; moreover, the controlling shareholders will have the burden of proof to show the compliance with the duty. Importantly, in such a case, any shareholder of the controlled corporation has the right of action for demanding the compensation to be paid to the controlled corporation.

In case there is no formal control agreement, the relationship between the corporation and the controlling shareholder is a “de facto group” (faktischer Konzern). In this case, the controlling shareholder is defined as a legally separate enterprise (or a person) that is “able to exert, directly or indirectly, a controlling influence”, whereas the “majority owned enterprise shall be presumed to be controlled by the enterprise with a majority shareholding in it.” In a de facto group, the controlling shareholders can give mandatory instructions that are detrimental to the controlled enterprise only if any loss by the

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become personally liable to the controlled company. The controlling undertaking can become liable as their employer and contract party. Secondly, the controlling undertaking must pay the controlled company compensation for any losses incurred by the controlled company (Verlustübernahme). Thirdly, the creditors of the controlled company are protected by the obligation of the controlling undertaking to furnish a security at the expiry of the contract”, Maentysaari, Comparative Corporate Governance, supra note 36, at 369.

629 § 308(2) AktG.
630 § 291(1) 2 AktG.
631 § 309(1)AktG.
632 § 309(2)AktG.
633 § 309(4)AktG.
634 Maentysaari, Comparative Corporate Governance, supra note 36, at 325.
635 § 117(7)AktG.
controlled corporation will be compensated\textsuperscript{636}.

With regard to the general fiduciary duty\textsuperscript{637} of shareholders, they can be found liable for their actions at the general meeting, or for inducing the members of the Management Board, the Supervisory Board or registered authorized officer (Prokurist) to act to the disadvantage of the corporation.

If a shareholder has attempted to get special benefits by a resolution of the general meeting to the detriment of the corporation or other shareholders, any shareholder of the corporation can demand invalidation of this general meeting resolution\textsuperscript{638}. In such a case, the said resolution of the general meeting is either void or voidable\textsuperscript{639}.

Anyone — a shareholder, and even a third party — can be found liable for the damages caused to the corporation if he has induced a member of the Management Board or the Supervisory Board, a registered authorized officer (Prokurist) or an authorized signatory, to act to the disadvantage of the corporation\textsuperscript{640}. Such influence has to be intentional, and such claims can be asserted by the corporation or individual shareholders\textsuperscript{641}. In practice, however, such claims are awarded only in exceptional cases\textsuperscript{642}.

The German courts have gone even further, extending the scope of fiduciary duties beyond the statutory provisions, and defining general fiduciary duties as:

- “an obligation to promote the common goal of the corporation;
- an obligation not to cause damage to the corporation;
- an obligation to take into account the interests of the other shareholders;
- an obligation to exercise rights and exert influence on the corporation in a

\textsuperscript{636} § 311(1) 1 AktG.
\textsuperscript{637} Tønnesson Andenæs, Mads Andenas, Frank Wooldridge, European Comparative Company Law (Cambridge University Press. 2009), at 487.
\textsuperscript{638} § 243 (2) AktG.
\textsuperscript{639} See for example BGH II ZR 212/99, judgment of 18 June 2001, cited in Maentysaari, Comparative Corporate Governance, supra note 36, at note 1098, at 380.
\textsuperscript{640} § 117 (1) AktG, Maentysaari, Comparative Corporate Governance, supra note 36, at 380.
\textsuperscript{641} Wirth, et al., supra note 87, at 94.
\textsuperscript{642} Id.
responsible way”\textsuperscript{643}. In practice, the courts have held that the minority shareholder having the blocking minority is not allowed to block any resolution if such resolution is necessary for the success of the corporation\textsuperscript{644}. In another decision, the Federal Supreme Court held that exclusion of pre-emptive rights has to be properly justified\textsuperscript{645}, otherwise it is a breach of fiduciary duty. Breach of fiduciary duties can lead to claim for performance by the corporations, or claim for damages, as well as the actions to set aside the resolution of the general meeting\textsuperscript{646}.

In the United States, it has been generally agreed that the fiduciary duty\textsuperscript{647} is owed by the controlling shareholders\textsuperscript{648}, and the definition of controlling shareholder deserves attention, since Delaware General Corporation Law, MBCA, the Delaware courts have all provided their definitions of “control”.

The MBCA defines control as follows:

“Control” (including the term “controlled by”) means (i) having the power, directly or indirectly, to elect or remove a majority of the members of the board of directors or other governing body of an entity, whether through the ownership of voting shares or interests, by contract, or otherwise, or (ii) being subject to a majority of the risk of loss from the entity’s activities or entitled to receive a majority of the entity’s residual returns\textsuperscript{649}.

The MBCA stresses the “majority” requirement; however, it does not provide for a

\textsuperscript{643} Id.
\textsuperscript{645} Decision of the Federal Supreme Court, published in BGHZ, vol. 71, at 40,44 et seq. and in BGHZ, vol. 125, at 239,244., cited in Wirth, et al., supra note 87, at 94, note 618.
\textsuperscript{646} Wirth, et al., supra note 87, at 95.
\textsuperscript{647} Fiduciary duties are “a set of rights and obligations that are independent of any contract and can only be limited in their assertion by contractual provisions when the claims based on fiduciary duties touch on the obligations created in the contract”, The ATR-KIM ENG Fin. Corp. v. Araneta, 2006 WL 3783520, at *21 (Del. Ch. Dec. 21, 2006), at note 1.
\textsuperscript{649} MBCA 8.60(2).
definite quantitative threshold.

On the other hand, DelGCL defines controlling enterprise as the one possessing “directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise”. Importantly, unlike MBCA, it provides for a threshold, whereby any holder of more than 20% of outstanding voting stock is deemed to have the control, unless proven otherwise.

The Delaware case law also deals with the definition of “control”. In Kahn v. Lynch Communication Sys, the court has defined that a shareholder “owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation” [emphasis added]. The court further noted that less than 50% ownership does not imply dominant shareholding status and fiduciary duty, unless the plaintiff proves that there is a “domination by a minority shareholder though actual control of corporation conduct”.

The leading case in this regard is the Delaware case Sinclair Oil Corp. v. Levien, where the court has held that the fiduciary duty of the controlling shareholder is only implicated where such shareholder “has received a benefit to the exclusion and at the expense of the subsidiary” (i.e., the controlled corporation). In Sinclair, the court has used the Intrinsic Fairness Test, which has two elements:

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650 Except for holding as an agent, bank, broker, nominee, custodian or trustee. See DelGCL, 203(c)(4).
651 DelGCL 203(c)(4).
654 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).
• standard is high degree of fairness;
• burden shifting - a shift in the burden of proof to the defendant (the controlling shareholder) to show that the transaction was objectively fair, subject to strict judicial scrutiny\textsuperscript{656}.

In public corporations in the United States, the shareholders do not owe any duty to each other. In \textit{Sinclair} the court held that Sinclair, as the controlling enterprise, owed the duty to Levien, not to the minority shareholders: “[b]y reason of Sinclair’s domination, it is clear that Sinclair owed [its subsidiary] a fiduciary duty”\textsuperscript{657}.

In \textit{Rosenblatt}, the court has affirmed the Intrinsic Fairness Test, and also noted in its decision that in case the majority shareholder did not dictate the terms of the transaction, its actions are presumed to have been conducted at arm’s length\textsuperscript{658}. In \textit{Citron}, a later Delaware case, the court has concluded that a fiduciary duty of the controlling shareholder is implied when such shareholder is on both sides of the transaction, even though he did not “dictate […] the terms of the transaction”\textsuperscript{659}. From these cases, it can be concluded that in Delaware the controlling shareholder has the duty of loyalty towards the minority shareholders, although “control” can be defined differently.

Although the imposition of general duty of loyalty for all shareholders, including minority shareholders, still is a largely undecided issue, such duty can be imposed via the concept of self-dealing, and breaching the fiduciary duty by the directors, i.e., similar to the German provision of inducing the directors and officers. Such a connection has been

\textsuperscript{656} “[S]tandard burden is on Sinclair to prove, subject to careful judicial scrutiny, that its transactions ... were objectively fair”, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971), note 1; see also Heil v. Standard Gas & Elec. Co., 151 A. 303, 304 (Del. Ch. 1930) (controlling shareholder may “exercise wide liberality of judgment in the matter of voting and may admit personal profit or even whims and caprice into the motives which determine their choice, so long as no advantage is obtained, at the expense of their fellow stockholders”).

\textsuperscript{657} Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

\textsuperscript{658} Rosenblatt v. Getty Oil Co., 493. A.2d, at 937.

\textsuperscript{659} “The entire fairness standard flows from the principle that where a majority stockholder stands on both sides of a challenged transaction, it has the burden of demonstrating, after careful scrutiny by the court, that the transaction was entirely fair to the minority.” Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500 n.13 (Del. Ch. 1990).
established in ATR-KIM ENG Fin. Corp. v. Araneta\textsuperscript{660}, where the court noted that the shareholder is equally liable for violation of fiduciary duties by the director if he acted in bad faith, i.e., not in the interests of the corporation but upon the said shareholder’s instruction\textsuperscript{661}; due to the general principle that “the one who aids or instigates the breach of duty is also liable for the breach”\textsuperscript{662}.

In Uzbekistan, the liability of controlling shareholder is also clearly provided; however, the universal duty has not been imposed. The controlling shareholder may be liable in two limited cases: first, if the controlling shareholder has the right to give mandatory instructions to the controlled corporation\textsuperscript{663}, second, if actions of the controlling shareholder caused bankruptcy of the controlled corporation.

The Civil Code of the Republic of Uzbekistan defines two types of controlled enterprises: controlled enterprises and dependent enterprises\textsuperscript{664}. A corporation\textsuperscript{665} is deemed as controlled corporation if a shareholder of this corporation can exert enough influence by virtue of holding a (1) substantial amount of the shares, (2) by virtue of a special agreement with this corporation, or (3) otherwise\textsuperscript{666}; if a shareholder holds more than 20% of the voting stock of an enterprise, the latter is deemed as a dependent

\textsuperscript{661} Paula J. Dalley, \textit{Shareholder (and Director) Fiduciary Duties and Shareholder Activism}, 8 Houston Business and Tax Journal 3, 301-336 (2008), at 332.
\textsuperscript{662} Id.
\textsuperscript{663} Art. 9 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{664} Since the distinction between the controlled and dependent enterprises is provided in the Civil Code of the Republic of Uzbekistan, it is applicable to all business enterprises – applicable to all business entities – partnerships, limited partnerships, limited liability companies and joint-stock companies. Art. 58 of the Civil Code of the Republic of Uzbekistan.
\textsuperscript{665} Only for-profit enterprises, (i.e., limited liability companies, joint-stock companies, and additional liability companies) can be deemed as subsidiaries, any non-profit enterprise cannot be deemed as a subsidiary, see Rahmonqulov H. R. (ed.) Kommentariy k Grajdanskomu Kodeksu Respubliki Uzbekistan (Art Flex. 2010), Volume 1, at 189-190.
\textsuperscript{666} Art. 67 of the Civil Code of the Republic of Uzbekistan; art. 9 of Uzbek Law on Joint-Stock Companies, for more elaboration on the issue, see Rahmonqulov H. R. (ed.) Kommentariy k Grajdanskomu Kodeksu Respubliki Uzbekistan (Art Flex. 2010), Volume 1, Rahmonqulov et al., supra note 665, at 184-186.
enterprise.

With respect to holding the “substantial amount of shares” in a controlled corporation, such controlling influence is presumed if a shareholder possesses more than 50% of the voting stock of the corporation, since such shareholder would be able to control most of regular decisions of the corporation, including appointment and removal of majority of the Supervisory and Management Boards without regard for the other shareholders. When a controlling shareholder possesses less than 50% of the shares of the corporation, the controlling shareholder still must have a dominant influence when shareholdings of other blockholders in the same corporation are taken into account. For instance, if shareholder A possesses 40%, B possesses 30%, and C possesses 25% of the shares, and 5% are in free float, shareholder A cannot be deemed to have effective control of the corporation, since his proposals can be easily blocked by a joint effort of the other two shareholders. However, in the same hypothetical, if A possesses 40% and B possesses 25% of the voting shares, while the rest is in a free float, then shareholder A may be deemed to have the controlling influence, only if other factors contribute to a dominant position of this shareholder on the general meeting of shareholders, such as features structure of the share capital, voting caps, special rights to appoint and remove members of Supervisory Board of the corporation.

Neither the Civil Code nor the Uzbek Law on Joint-Stock Companies provide for types and nature of the “special agreements” which allow a shareholder to exert controlling influence on the corporation. Hence, any contract between a corporation and a shareholder can be deemed to give the shareholder controlling influence if the corporation

667 Rahmonqulov et al., supra note 665, at 190.
668 Id.
669 Id.
is obliged to follow the instructions of the shareholder in accordance with such contract. In particular, if functions of the Management Board of the corporation are given to the shareholder itself or its other subsidiaries, such contract may amount to a controlling influence\(^{670}\).

A possibility of the shareholder to determine the actions of the corporation “otherwise” is also not explained by either the Civil Code or the Uzbek Law on Joint-Stock Companies. Some scholars suggest that such influence may exist when the shareholder controls the corporation not through holding the corporation’s stock directly, but via its subsidiaries or affiliates\(^{671}\), none of which have the controlling block of shares\(^{672}\).

The default rule is that the controlling shareholder is not liable for the debts of the controlled corporation; however, the controlling shareholder will be liable for the debts of the controlled corporation if bankruptcy of the controlled corporation has been caused by the actions of the controlling shareholder.

Under the Uzbek Law on Joint-Stock Companies, the liability of the controlling shareholder may arise in two limited cases. First, the liability of controlling shareholder can be triggered only if the controlling shareholder has the right to give mandatory instructions to the corporation, and such right has to be provided in the articles of association of the corporation or in a separate agreement\(^{673}\); in the absence of such explicit provision, the shareholder cannot be held liable. The shareholder having the right to give mandatory instructions is jointly and severally liable with respect to the obligations undertaken by the controlled enterprise following the instructions of the controlling shareholder.

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\(^{670}\) Id.

\(^{671}\) For definition of an “affiliate” in Uzbek law, see infra, section 3.3.3.5.

\(^{672}\) Rahmonqulov et al., supra note 665, at 190.

\(^{673}\) Art. 9 of Uzbek Law on Joint-Stock Companies.
Second, the controlling shareholder can be found liable for causing the bankruptcy of the corporation\textsuperscript{674}. Actions of the controlling shareholder that led to bankruptcy have to be intentional, based on the mandatory instructions of the controlling shareholder, and the controlling shareholder must have had knowledge of the fact that such actions would lead to the bankruptcy of the corporation\textsuperscript{675}. The controlling shareholder in this case bears subsidiary liability, thereby ensuring that the rights of other shareholders, as well as the creditors of the corporation, are protected\textsuperscript{676}.

Regarding the general duty of the shareholders, it has not been anyhow defined; therefore, it is improbable that a court would invoke such a duty onto a shareholder.

To conclude, in all three jurisdictions, the controlling shareholder has fiduciary duty towards the corporation, while the shareholders have the right of action for the violation thereof. However, the jurisdictions differ with regard to the determination of the controlling shareholder, as well as the ability of the controlling shareholder to pursue his own interests. In the United States and Uzbekistan, the controlling shareholder cannot act in detriment to the controlled corporation; however, the German law allows the controlling shareholder to act in detriment of the controlled corporation, provided that it compensates the controlled corporation in the case of losses caused by its actions. The universal duty of loyalty of the shareholders is most widely provided in Germany, while Uzbekistan is at the other end of the scale.

\textbf{2.7.3. Lifting the corporate veil}

With regard to the liabilities of shareholders, the concept of “lifting the corporate

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\textsuperscript{674} Rahmonqulov et al., supra note 665, at 190.

\textsuperscript{675} Art. 4 of Uzbek Law on Joint-Stock Companies.

\textsuperscript{676} Rahmonqulov et al., supra note 665, at 185.
veil”\textsuperscript{677} when in certain cases, the creditors of the corporation can turn to the shareholders, has to be kept in mind. Although veil piercing is a useful tool, outcomes are highly fact-specific\textsuperscript{678}; therefore, it is difficult to make generalizations\textsuperscript{679}.

In the United States, veil piercing is a commonly accepted doctrine that can be based on “alter ego” doctrine\textsuperscript{680}, instrumentality doctrine\textsuperscript{681} or identity doctrine\textsuperscript{682}, and this is the classic statement that established the doctrine in 1905:

“A corporation will be looked upon as a legal entity, as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons; and, where one corporation was organized and is owned by the officers and stockholders of another, making their interests identical, they may be treated as identical when the interests of justice require it.”\textsuperscript{683}

The instrumentality doctrine, which provided for the liability of the parent enterprises, is concerned only with “wholly owned subsidiaries”\textsuperscript{684}; while if part of the shares of the controlled corporation was owned by other shareholders, the instrumentality doctrine could not be applied. The Deep Rock doctrine established in the \textit{Taylor v. Standard}

\textsuperscript{677} For a discussion of the liabilities of majority shareholders, see infra section 2.7.2
\textsuperscript{678} Bainbridge, Corporation Law and Economics, supra note 40, at 151.
\textsuperscript{679} Id., at 152.
\textsuperscript{680} Although the “alter ego” doctrine has been developed by the courts of California, it is widely used in all states. According to the “alter ego” doctrine, the corporate veil can be pierced if (1) the ownership and interests of the two corporations are not separate and the subsidiary can be considered as “alter ego” of the parent enterprise and (2) recognition of the enterprises as separate would lead to inequitable result. See K. Vandekerckhove, Piercing the Corporate Veil, (Kluwer Law International. 2007), at 83.
\textsuperscript{681} The Instrumentality doctrine has been developed in Frederick Powell, Parent and subsidiary corporations: liability of a parent corporation for the obligations of its subsidiary, (Callaghan and Company. 1931). The test contains three conditions: (1) excessive exercise of control, (2) some wrongful or inequitable conduct and (3) casual relationship between the plaintiff’s loss and parent enterprise’s actions. See Vandekerckhove, supra note 680, at 81.
\textsuperscript{682} The identity doctrine has also been proposed in Powell, supra note 681. Identity doctrine is a final variant of the two theories mentioned above, see Vandekerckhove, supra note 680, at 83.
\textsuperscript{683} U.S. v. Milwaukee Refrigerator Transit Co. 142 F. 247 (C.C.Wis. 1905), cited in Choper, et al., supra note 422, at 381.
Gas & Electric Company\textsuperscript{685} was an elaboration of the instrumentality doctrine\textsuperscript{686} and allowed to pierce to corporate veil\textsuperscript{687} even in cases where the subsidiary was not wholly owned.

The Deep Rock Oil Corporation, which was a subsidiary of Standard (which further was controlled by H.M. Bullesby & Company), was inadequately capitalized — the corporation had common voting stock at 1 USD par value, preferred stock at 100 USD par value and 10 million USD in notes\textsuperscript{688} held by 5,500 holders around the United States. The Standard owned all of the voting common stock, and only 2% of the preferred stock, and none of the notes. During fourteen years (from 1919 to 1933) of intercompany relations between Standard and Deep Rock, the Deep Rock became indebted to Standard in the amount of 20 million USD, mainly as a result of questionable transactions such as rentals, supervision fees, dividends, and interest charges\textsuperscript{689}. For instance, Deep Rock spent over two million USD for maintaining and improving the properties owned by Standard\textsuperscript{690}.

When Deep Rock became insolvent, Standard brought a claim for 20 million USD owed by the Deep Rock, which would absorb the 9,342,642 USD remaining on the balance of Deep Rock. In the proceedings, the Standard appeared not as a shareholder but a creditor. The court subordinated the claim of the Standard to claims of other creditors of the corporation, thereby establishing a doctrine, which can be summarized as follows:

“[w]here a showing can be made that a subsidiary corporation having public preferred stockholders was inadequately capitalized from the outset, and was managed substantially in the interest of its parent, rather than its own interests, the parent will not, in a bankruptcy or reorganization proceeding

\begin{footnotes}
\item[687] Id.
\item[688] A note is a “written promise by one party (the maker) to pay money to another party (the payee) or to bearer”, B.A. Garner, Black’s Law Dictionary (West. 2010).
\item[690] Id. at 46.
\end{footnotes}
affecting the subsidiary, be permitted to assert a claim as a creditor, except in subordination to the claims of preferred stockholders.\textsuperscript{691}

In Germany, the principle of piercing the corporate veil (\textit{Durchgriffshaftung}) is based on the corporate law (\textit{AktG}) and the corporate law of groups (\textit{Konzernrecht}), and legal rules and theories outside corporate law of groups (\textit{Konzernaussenrecht})\textsuperscript{692}.

In Uzbekistan, the corporate law of groups is not well-developed, and the corporate veil can only be pierced in limited circumstances, i.e., \textit{only} if the shareholder has a right to give mandatory instructions to the corporation\textsuperscript{693}, and such a right has to be explicitly provided in the articles of association of the corporation\textsuperscript{694}.

2.8. Conclusions

This chapter has analyzed the rights and obligations of the shareholder in Germany, the United States and Uzbekistan, insofar as they directly influence the internal governance of the corporations.

The analysis of ownership structure has shown that the German corporations are indeed tightly controlled, whereas the actual concentration of ownership in the United States is unclear due to the rise in institutional investors and the strong position of the management in the proxy solicitations. Collecting data on Uzbek corporations is ongoing; however, the preliminary results have shown that the ownership is highly concentrated.

The procedural rights of the shareholders are extremely important for the shareholders to be able to use their rights, for instance, a shareholder is not able to elect a director or member of the Supervisory Board if a person is not nominated. Similarly, a

\textsuperscript{692} Vandekerckhove, supra note 680, at 46. For a discussion of liability of controlling shareholders, see infra, section 2.7.
\textsuperscript{693} Art. 4 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{694} Id.
shareholder is not able to vote on an issue at the general meeting of shareholders unless such issue is on the agenda. In Germany and Uzbekistan, the shareholders have extensive statutory procedural rights, whereas in the United States, it is only the SEC rules that provide for such rights.

Regarding voting procedures, Germany employs one share-one vote principle, and all matters at the general meeting are decided by majority voting. The United States do not provide for such one share-one vote principle, allowing different classes of shareholders to have different voting rights; majority voting is the default rule, except for the election of directors, where plurality voting is the default rule. In Uzbekistan, the default rules are one share-one vote and majority voting, except for the election of the members of the Supervisory Board, where cumulative voting is used. Uzbekistan and the United States do not prohibit voting caps, whereas German corporations are not allowed to introduce such voting caps after 1998.

In terms of substantive rights, the shareholders in German corporations elect and remove the members of the Supervisory Board and vote on all fundamental transactions. In Uzbekistan, the shareholders have even more powers – they elect and remove both Supervisory and the Management Boards and vote on all fundamental transactions. In the United States, although the shareholders elect the Board of Directors, the management plays an important role in nominating the directors, and the decisions on fundamental transactions require consent of shareholders and the Board of Directors.

Special rights of the shareholders differ among the legal systems; in German corporations of an individual shareholder can have a right to appoint one or more members of the Supervisory Board, while such a right is neither prohibited nor expressly allowed in
Uzbekistan and the United States. Golden shares are allowed in neither Germany nor the United States; in Uzbekistan the government can have a golden share with veto right on fundamental transactions.

With regard to duties of the shareholders, all three legal systems impose a duty on controlling shareholders. The general fiduciary duty is imposed on shareholders of German corporations, issue of existence of such a duty in the United States is an undecided issue, and such a duty is not defined in Uzbekistan.
3. CHAPTER THREE: ALLOCATION OF POWERS AND GOVERNANCE STRUCTURE

It is better to fail in originality, than to succeed in imitation
(Herman Melville)

An important legal difference between the three legal systems compared is the allocation of powers within the corporation\(^{696}\), which can be viewed from two perspectives: first, election/appointment and removal of members of governing bodies; second, the decision-making rights, functions and the scope of the duties of the organs of the corporation. The first typology defines who can elect/appoint and remove the Management Board, the Supervisory Board and the Board of Directors of the corporation and the implications of such powers with regard to allocation of powers; the second typology describes which persons/bodies of the corporation have the right to make the decisions with regard to the business and other affairs of the corporation.

The general meeting of shareholders is deemed as a company organ in all three jurisdictions, while the status of the Management Board, the Supervisory Board and the Board of Directors of the corporations is not identical. However, given the fact that the United States is deemed to be moving closer to a \textit{de facto} two-tier system\(^{697}\) and there is a \textit{de facto} distinction between the management tier and the supervisory tier\(^{698}\), it is appropriate to differentiate between the supervisory and managing directors in the US corporations. Thus, for the purposes of the thesis, the independent directors that have the functions of supervision and oversight in one-tier system of the United States will be referred to as supervisory persons and be equaled with the Supervisory Board members in

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\(^{695}\) H. Melville, ‘Hawthorne and His Mosses’, \textit{The Literary World}, August 17 and 24, 1850, also available at \url{http://www.ibiblio.org/eldritch/nh/hahm.html}.

\(^{696}\) Cools, supra note 307, at 697.

\(^{697}\) Du Plessis et al., supra note 16, at 11.

\(^{698}\) Id.
Germany and Uzbekistan, while the executive directors (management) of the corporation in the United States will be referred to as management and will be equaled with the Management Boards in Germany and Uzbekistan.699

The chapter starts with a theoretical analysis of the systems employed in three jurisdictions dealt with in this thesis – one-tier, two-tier and triangular systems, followed by the analysis of the strengths and weaknesses of each system. Further, the chapter touches upon the role of banks and co-determination as idiosyncratic features of the German system; then the role and powers of the general meeting of shareholders as a company organ are discussed.

3.1. Types of internal governance structure

The internal governance structures in the three jurisdictions examined in this dissertation are different – the United States employ one-tier structure, Germany provides for a mandatory two-tier structure with co-determination700, and the Uzbek system employs a different version of a two-tier structure that will be referred to as triangular. The literature comparing one-tier and two-tier systems is considerable701, but the author was unable to

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699 For doctrinal basis of such comparison and definitions, see European Union Commission Recommendation of 15 February 2005 on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board (Text with EEA relevance), 2005/162/EC: Director – any member of any administrative, managerial or supervisory body of a company; Executive director – any member of the administrative body (unitary board) who is engaged in the daily management of the company; Non-executive director – any member of the administrative body (unitary board) of a company other than an executive director; Managing director – any member of the managerial body (dual board) of a company; Supervisory director – any member of the supervisory body (dual board) of a company.

700 Co-determination in German corporations is discussed later, see infra section 3.2.2.2.

701 Here are just a few of the sources dealing with the issue: Du Plessis et al., supra note 16, at B-15; Carsten Jungmann, The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems - Evidence from the UK and Germany, 3 European Company and Financial Law Review 4 (2006); Benedicte Millet-Reyes, Ronald Zhao, A Comparison Between One-Tier and Two-Tier Board Structures in France, 21 Journal of International Financial Management Accounting 3 (2010); Klaus J. Hopt, The German Two-Tier Board: Experience, Theories, Reforms, in Klaus J Hopt and others (eds), Comparative Corporate Governance: The State of the Art and Emerging Research (Oxford University Press. 1998) [hereinafter referred to as Hopt, Two-Tier Board: Experience, Theories, Reforms]; Klaus J. Hopt and Patrick C. Leyens, Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy,
find any analysis of the triangle as a system both in western and Uzbek literature. The primary question is whether these structures are different, and this section describes the three systems, and identifies the fundamental differences between them, as well as their strengths and weaknesses. Although the triangular structure may seem similar to the two-tier system, the section proves that these two are different and the former may legitimately be separated as a system. The one-tier system is most widespread worldwide\(^{702}\), while the two-tier system is accepted only in a handful of countries of Europe\(^{703}\) and transition economies\(^{704}\); the triangle is employed by several countries of Central and Eastern Europe\(^{705}\) and the Commonwealth of Independent States\(^{706}\). Comparative law scholars have criticized


702 The one-tier system is “the prevailing model of corporate governance around the world”, Franklin A. Gevurtz, The Historical and Political Origins of the Corporate Board of Directors, 38 Hofstra Law Review 89 (2004), at 92; one-tier system is employed in the USA, England, Canada, Australia, New Zealand, and South Africa, see Du Plessis et al., supra note 16, at 8, note 55; one-tier system is also employed in the majority of the EU member states, Saenger, supra note 104, at 151, note 13.

703 “The two-tier system is mandatory in continental states of Europe such as Germany, Austria, Denmark, Sweden, Finland, and in large companies in the Netherlands”, Du Plessis et al., supra note 16, at 8, note 56.

704 In the following countries, the law provides for a mandatory two-tier structure where the Supervisory Board appoints and removes the Management (Board):

- Estonia: article 309(1) of the Estonian Commercial Code, RT1 I 1995, 26/28, 355;
- Latvia: article 292(1) of The Commercial Law of Latvia, adopted on 21 December 2000;
- Kazakhstan: article 53(8) of the Law of the Republic of Kazakhstan on Joint-Stock Companies, of 13.05.2003 N 415-II;
- Ukraine: article 52(8) of the Ukrainian Law on Joint-Stock Companies, September 17, 2008 №514-VI;

705 The following countries of CEE also employ a triangular structure:

- Hungary: article 231 (d) of the Act CXLIV of 1997 on Business Associations (Companies Act);
- Czech Republic: article 185(1) of Obchodní Zákoník č. 513/1991 Sb. (Commercial Code);

706 The following countries of CIS employ a triangular structure:

- Belarus: article 79 of the Law of the Republic of Belarus on Entrepreneurial Societies, December 9, 1992 r. № 2020-XII.
the two-tier system and argued that it was inferior to one-tier system\textsuperscript{707}, and although such criticisms are still shared by some\textsuperscript{708}, general agreement is that it is not possible to assign superiority to neither of these systems\textsuperscript{709}. Current literature lacks analysis of the triangular structure; therefore, the analysis with regard to this structure belongs to the author.

Weaknesses and strengths of each system have to be viewed in the context of business and legal environments\textsuperscript{710}, as well as historical, societal and even cultural roots\textsuperscript{711}. Therefore, the discussion and comparison of the systems will start with a glimpse at the origins of the systems, and will be followed by the discussion of their strengths and weaknesses.

3.1.1. One-tier system

3.1.1.1. Origins

The origins of the one-tier system can be seen in the nature of the corporation and separation of ownership and control, where the corporation has numerous shareholders\textsuperscript{712}. Unlike partnerships, where by default rule the owners (partners) manage the firm, the shareholders of a corporation cannot directly manage it\textsuperscript{713}. Thus, the simple explanation for “board-centered model of corporate governance is that businesses with numerous owners
need ‘central management’”714, while the collective action problems would not otherwise allow for a corporation with numerous shareholders to function effectively715. With regard to the United States in particular, the absence of a separate supervising body can be attributed to a strong position of the managers in the corporation throughout the early history of development of corporate law716.

3.1.1.2. Main features

The main feature of one-tier system is delegation of all responsibilities to a single corporate body – the Board of Directors. The Board may exercise both the management of the corporation and oversight of the actions of the management, which is a dubious task at least. Although the recent changes in the US system have drawn the system closer to a de facto two-tier system717, significant differences remain.

3.1.1.3. Strengths

One of commonly cited strengths of one-tier model is equal access to information, i.e., all directors have access to the same information, and all the business issues are discussed and decided at the same table718. Second, the system allows a flexible division of duties among the directors, which can increase the effectiveness of the board719. Third,

714 Gevurtz, supra note 702, at 93.
715 Id.; for a discussion on the necessity of a board, Bainbridge, supra note 162.
717 Du Plessis et al., supra note 16, at 11; see infra section 3.1.1.5.
718 Jungmann, supra note 701, at 460.
there is a common responsibility of executive and non-executive directors. Fourth, decision-making in a one-tier system is swifter than in the two-tier system, especially with regard to strategy formation.

3.1.1.4. Weaknesses

Main criticisms of the one-tier system are related to supervision. First, the quality of supervision and neutrality of the directors in a one-tier system is questionable due to the fact that the directors face the dilemma of being on the same board and having to monitor the colleagues. Second, the separation between the executive and non-executive directors is not sufficient to ensure quality supervision. Last but not least, it is generally agreed that exercise of both supervisory and managerial duties by the same body creates more problems than it solves. As a result, in a one-tier system the personality and the functions of the chairman of the Board of Directors have the crucial role.

3.1.1.5. Emergence of the “monitoring model” in the US

The crisis on confidence in 1970s in the United States, triggered by the collapse of Penn Central, and followed by numerous corruption and mismanagement scandals,
mainly caused by the dual nature of the Board of Directors in the capacity of manager and its own supervisor\textsuperscript{729}. In response the academic society called for federal corporate law, which would provide for full-time professional directors and ensure greater accountability both to shareholders and the society\textsuperscript{730}. Apart from the call to federal legislator, in the 1970-s the SEC rule 10b-5\textsuperscript{731} was given very broad interpretation that could lead to federal common law of corporations\textsuperscript{732}; however, the Supreme Court of the United States in its \textit{Santa Fe} decision clearly stated that the rule 10b-5 was intended to assure full disclosure with regard to securities, and once such disclosure is made, other issues are part of state law\textsuperscript{733}.

While the discussion on federal corporate law was going on, the academics started to search for alternative options for reform. One of the most influential proposals was the so-called “monitoring model” suggested by Professor Eisenberg in his \textit{The Structure of the

\textsuperscript{729} Bainbridge, Corporate Governance after the Financial Crisis, supra note 424, at 51.
\textsuperscript{730} Ralph Nader, Mark Green, and Joel Seligman, Taming the Giant Corporation: How the Largest Corporations Control Our Lives (W. W. Norton & Company. 1977), at 62-65.
\textsuperscript{731} SEC Rule 10b-5 is one of most important rules promulgated by the SEC under the Securities Exchange Act of 1934 and prohibits any person (not only insiders such as directors and officers) from acting (or omitting to act) any act or omission resulting in fraud or deceit in connection with the purchase or sale of any security, see Louis Loss, Joel Seligman, \textit{Fundamentals of Securities Regulation} (Aspen Law & Business. 2001), at 855 et seq; \textit{Rule 10b-5: Employment of Manipulative and Deceptive Practices}

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

\begin{itemize}
  \item To employ any device, scheme, or artifice to defraud,
  \item To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
  \item To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
\end{itemize}

in connection with the purchase or sale of any security, The SEC Rule 10b-5, codified at 17 C.F.R. § 240.10b-5.
\textsuperscript{733} \textit{Santa Fe Industries Inc.} vs. \textit{Green}, 430 U.S. 462 (1977); see also, Bainbridge, Corporate Governance after the Financial Crisis, supra note 424, at 56, note 46.
Eisenberg argued that boards are dominated by the CEO and cannot perform their main function of election and supervision of the management. As a solution, he proposed that the executive directors perform the managerial tasks, while the independent directors are not involved in decision-making, and are limited to monitoring the performance of the management; moreover, increased shareholder influence was advocated, in particular, shareholder access to director nominations. Eisenberg’s monitoring model was in the heart of the model suggested by the Principles of Corporate Governance of the American Law Institute (ALI Principles) in 1982. The Principles provided for three committees of the Board of Directors that would be charged with oversight of the management: audit, nomination and compensation committees; all of them had to be comprised of independent directors. When it became obvious that there will be no federal corporate law, and the crisis was overcome, the ALI Principles lost their political significance and urgency, but remained as “conventional wisdom”.

Codification of monitoring model started as early as in 1977, when the NYSE amended its listing standards to require the Board of Directors to have an audit committee comprised solely of independent directors. Sarbanes-Oxley Act responded to structural deficiencies in the board composition and internal governance structure demonstrated by the Enron scandal, and provided for majority of independent directors and the board.
audit committee comprised of independent directors, financial literacy requirements for audit committee members, thus, the “monitoring model lies at the heart of the Sarbanes-Oxley Act”\(^\text{744}\). Dodd-Frank Act, which was a response to the global financial crisis, provided for compensation committees comprised of independent directors, granted the SEC power to adopt rules for shareholder access to director elections\(^\text{745}\). Thus, Eisenberg’s monitoring model has been effectively codified in the current US law.

3.1.2. Two-tier system

3.1.2.1. Origins

At the rise of the corporation in Germany, the Management (Board) was the sole agent of the shareholders; the Supervisory Board (if any) served the mere function of a shareholder committee\(^\text{746}\). The German law required the Supervisory Board in 1870\(^\text{747}\) as an exchange to abolition of charter requirements and state control, i.e., the Supervisory Board was deemed to be a “strictly separate outside board to control the management for the sake of the shareholder, but also to protect the public interest”\(^\text{748}\). The other core idea behind the two-tier model was to strictly separate the supervisors from the managers, and this separation of control and managerial tasks was regarded as one of the major advantages of the two-tier system\(^\text{749}\). The Aufsichtsratsfrage (supervisory law debate), which

\(^\text{744}\) Id. at 60.
\(^\text{745}\) The SEC adopted the new rule 14a-11 in accordance with Dodd-Frank Act, however, the DC Circuit Court struck down the rule, see supra section 2.2.2.
\(^\text{746}\) Hopt, Two-Tier Board: Experience, Theories, Reforms, supra note 701, at 230.
\(^\text{748}\) Hopt, Two-Tier Board: Experience, Theories, Reforms, supra note 701, at 230.
\(^\text{749}\) Jungmann, supra note 701, at 449.
started at the end of the 19th century\textsuperscript{750}, has not ended\textsuperscript{751}.

\subsection*{3.1.2.2. Main features}

The corporate governance system in Germany makes the Supervisory Board a crucial player in functioning of the corporation, and puts the Supervisory Board in the center of the system. AktG is mandatory and deviations from it are rarely allowed, therefore, the general meeting of shareholders elects and removes the Supervisory Board (insofar as they are not elected by employees under co-determination provisions or appointed by a specific shareholder in accordance with the articles of association of the corporation), which has the authority to appoint and remove the Management Board; the shareholders have no direct means of influencing the replacement of the Management Board\textsuperscript{752}. Thus, the Supervisory board has two core functions – appointment and removal, as well as supervision of the Management Board\textsuperscript{753}, moreover, it represents the corporation in all actions concerning the Management Board\textsuperscript{754}.

Management Board is an independent body of the corporation in charge of the day-to-day management of the corporation, and has the task of strategic alignment and operational management of the corporation\textsuperscript{755}. The Management Board is not bound by the instructions of the general meeting of shareholders (unless mandated in accordance with the law of corporate groups\textsuperscript{756}) or the Supervisory Board\textsuperscript{757}. Moreover, in the case of conflict between the Management Board and the Supervisory Board in any matter, the

\begin{footnotes}{\footnotesize
\textsuperscript{750} Hopt, Two-Tier Board: Experience, Theories, Reforms, supra note 701, at 229.
\textsuperscript{751} Merkt, supra note 141, at 259.
\textsuperscript{752} Jungmann, supra note 701, at 433.
\textsuperscript{753} Schulz & Wasmeier, supra note 139, at 41.
\textsuperscript{754} § 112 AktG.
\textsuperscript{755} Schulz & Wasmeier, supra note 139, at 41.
\textsuperscript{756} For a discussion of law of corporate groups in Germany, see supra section 2.7.2, and infra section 3.7.3.
\textsuperscript{757} Wirth, et al., supra note 87, at 72.
\end{footnotes}
Management Board can request approval from the general meeting of shareholders\textsuperscript{758}, and such decision of the general meeting will be mandatory for both boards\textsuperscript{759}.

3.1.2.3. \textit{Strengths}

Separation of management and supervision has always been regarded as the key advantage of the two-tier model\textsuperscript{760}, provided that there is an open discussion and trustful cooperation between the two boards\textsuperscript{761}. There is a clear delineation of duties and responsibilities of each board, which leads to a higher level of efficiency and neutrality\textsuperscript{762}; moreover, each member of the respective boards has the same set of rights, duties and liabilities\textsuperscript{763}. Moreover, in the law and economics theory, existence of a separate supervising body in German corporations “places the management under closer surveillance than it would be in the Anglo-American system”\textsuperscript{764}.

The Supervisory Board is a “control body” of the corporation\textsuperscript{765}, since “[m]etaphorically speaking, the Supervisory Board serves as a ‘sparring partner’ of the Management Board, as it is – besides its advisory function, supposed to act as counterbalance”\textsuperscript{766}; moreover, the Supervisory Board performs the functions of the intermediary between the general meeting of shareholders and the Management Board\textsuperscript{767}, thereby exerting considerable influence in the internal governance structure of the corporation.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{758} § 119(2) AktG.
\item \textsuperscript{759} § 83(2) AktG. For discussion of management-related decisions of the general meeting of shareholder, see infra, section 3.3.1.4.
\item \textsuperscript{760} Du Plessis et al., supra note 16, at 9. Jungmann, supra note 701, at 449.
\item \textsuperscript{761} Jungmann, supra note 701, at 449.
\item \textsuperscript{762} Du Plessis et al., supra note 16, at 9.
\item \textsuperscript{763} Id. at 9-10.
\item \textsuperscript{764} Wei, supra note 725, at 143.
\item \textsuperscript{765} Wirth, et al., supra note 87, at 72.
\item \textsuperscript{766} Du Plessis et al., supra note 16, at 9.
\item \textsuperscript{767} Johannes Adolff, Public Company Takeovers in Germany (Beck. 2002), at 34.
\end{enumerate}
\end{footnotesize}
3.1.2.4. Weaknesses

The weaknesses of the German two-tiered system can be viewed in two respects – the structural weaknesses and weaknesses caused by co-determination, since the latter significantly changes the circle of eligible persons, responsibilities, primary interests of members and the expert knowledge requirements for the members of the Supervisory Board. Such a distinction will also allow objectively assessing the two-tier model both with and without co-determination.

i. Structural weaknesses

First, it has been observed that in German corporations the employer representatives at the Supervisory Board are often de facto selected by the Management Board. As a consequence, only those persons who are “adequate” in the eyes of the Management Board become members of the Supervisory Board, and only those members who are “adequately” supervising remain in the office for re-election; hence, the Supervisory Board is not completely independent from the Managing Board. Second, it has been argued that the functions of the Supervisory Board are limited to mere ex post review of the actions of the Management Board, while any kind of ex ante decisions can be considered as instructions and therefore are not allowed under the existing law, thus reducing the effectiveness of the Supervisory Board as the monitor. The third argument raised by scholars is the bureaucratic and rigid nature of the Supervisory Board which

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768 Jungmann, supra note 701, at 451.
769 Id.
770 Hopt, Two-Tier Board: Experience, Theories, Reforms, supra note 701, at 250.
771 Jungmann, supra note 701, at 450.
772 Hopt & Leyens, supra note 701, at 93-94.
773 Schulz & Wasmeier, supra note 139, at 41.
reduces the speed of decision making, and is caused by low frequency of their meetings and little amount of time spent by members of the Supervisory Boards to fulfill their functions.

ii. Weaknesses caused by co-determination

Apart from the general criticisms of the two-tier board, scholars frequently criticize the effects of co-determination on the functioning of the corporation. However, while criticizing the negative effects of co-determination, one should keep in mind its positive effects as well.

The first problem is the information asymmetry, i.e., the shareholder representatives on the Supervisory Board may be reluctant to discuss confidential business issues with labour representatives, although the laws mandate the discussion by all members. The second disadvantage mentioned by scholars is the huge size of the Supervisory Board (18.38 members on average) which may lead to inefficiency of the Supervisory Board. Third, co-determination hinders the possibility of introducing universal expert knowledge requirements for all of the members of the Supervisory Board; although a high level of requirements would not be an obstacle for the shareholder representatives, putting the same level of requirements for the labour representatives may be considered as an impediment for employees that prevents them from freely choosing their

Prior to 1998, it was common for the Supervisory Board to meet only 3.8 times a year on the average, see Hopt, Two-Tier Board: A German View, supra note 701, at 9.

See supra section 3.2.2.

Jungmann, supra note 701, at 455.

Id.

Id., at 456.

representatives781.

3.1.3. Triangular structure

The section introduces the triangular system employed in Uzbekistan, by discussing the origins of the system, and well as its strengths and weaknesses. Although the corporate law of Uzbekistan is believed to have followed the German system782, in fact, it is based partly on the model law drafted by the team of professors Black, Kraakman and Tarassova783, which in turn, is based on the “self-enforcing model of corporate law” developed by professors Black and Kraakman784; however, neither of them propose a triangular structure. Although the German and Uzbek systems bear a close resemblance, the influence of the US law may be evidenced by the fact that the following features existing in the Uzbek law are not to be found in German law, but are accepted in the US law: cumulative voting in the election of directors785, appointment of the Management Board (CEO) by the general meeting of shareholders, and delegation of management of the corporation to a body other than the Board of Directors or the Management Board786. Hence, such a mix creates in fact a different system and presents unique challenges that are discussed in this thesis.

3.1.3.1. Origins

The origins of the triangular structure can be traced back to the 19th century787, when the Russian law provided for two separate governing bodies in case of large

782 Rahmonqulov & Gulyamov, supra note 10, at 275.
783 Black et al., supra note 11, at appendix I.
784 Black & Kraakman, supra note 452.
785 See supra section 2.3.3.
786 See infra section 3.7.
corporations – Sovet (Supervisory organ) \(^{788}\) and Pravlenie (Managing organ)\(^{789}\), both of which were elected by the shareholders\(^{790}\). Sovet was elected by and composed of shareholders and had the supervisory responsibilities, while Pravlenie exercised the management of the corporation\(^{791}\).

With regard to the current version of the triangular system, the reasons for the choice of such a system are not clear. In their article on self-enforcing model of corporate law, Black and Kraakman propose a flexible internal governance structure, allowing the choice between the one-tier and two-tier structures. The default rules provide for a one-tier structure, where the shareholders elect the board of directors by cumulative voting, and the board allocates the decision-making power and executive power by appointing the managers\(^{792}\). At the same time, the corporation can opt for a two-tier system and give the Board of Directors the power to appoint a “Board of Managers” and delegate the executive responsibilities to the latter\(^{793}\).

The self-enforcing model of corporate law was developed for the Russian parliament, and soon after the Russian Law on Joint-Stock Companies was accepted in 1995\(^{794}\),

\(^{788}\) Literal translation is “Council”, it fulfilled functions of the supervising body of the corporation, see id.

\(^{789}\) Literal translation is “Board”, it fulfilled managerial functions, see id.

\(^{790}\) Owen, supra note 787, at 11.

\(^{791}\) Id.

\(^{792}\) “We mediate between the weaknesses of each approach with a simple hierarchical governance structure that allocates managerial power to a board of directors, subject to shareholder review of particular actions. The shareholders elect the board of directors; the board chooses the managers (subject to shareholder review of its choice of top manager); and the board (sometimes a defined subset of the board) approves particular types of actions, including those that require shareholder approval. For all other actions, the board decides when the managers can act unilaterally and when they need board approval”, Black & Kraakman, supra note 452, at 1944.

\(^{793}\) “Our proposed structure has enough flexibility to allow a company largely to replicate the two-tier management structure if the board so chooses or the charter specifies. The ‘board of directors’ can hire a ‘board of managers’ and delegate to it day-to-day management responsibility. The board of managers will then be subject only to whatever oversight the board of directors chooses to exercise, except when the law or the charter requires approval by the board of directors. However, the board of directors remains responsible to the shareholders for the consequences of this choice; the board cannot blame a legal structure that limits its power over management”. Black & Kraakman, supra note 452, at 1944, note 62.

\(^{794}\) Federal Law of Russian Federation on Joint-Stock Companies, December 12, 1995, No 208-FZ.
Kraakman, Black and Tarassova published a commentary on the Russian Law on Joint-Stock Companies in 1998\(^{795}\), where a model law on joint-stock companies for the emerging post-soviet economies was also included\(^{796}\). The model corporate law provides for a rigid German-style two-tier internal governance structure, where the shareholders elect the members of the Supervisory Board, which in turn has the power to appoint and remove the members of the Management Board.

Given the lack of explanation for the choice of the triangle system for corporations, I propose that there are following possible rationales for the emerging post-soviet countries like Uzbekistan (as well as Russia and Belarus) to choose the triangle over the strict two-tier system.

First, after the collapse of the Soviet Union, the governments of the newly created states started to move towards the market economy and privatized government enterprises. In most of the cases the privatization went step by step, while the state retained significant shareholdings in the privatized corporations. It is possible that the state intended to retain as much control as possible by allowing the shareholders maximum control in the corporations. Second, due to the lack of an efficient dispute resolution system, the triangle could be chosen to provide for a more efficient system of protection of the investments of the shareholders by giving them the maximum power and flexibility, while the rigid rules regarding legal capital were intended to protect creditors. Third, the political and financial elite that emerged after the collapse of the Soviet Union could have lobbied to get as much control as possible in the newly established system. Fourth, the rigid German-style two-tier system would have been ineffective due to the lack of professional

\(^{795}\) Black et al., supra note 11.

\(^{796}\) Id. at appendix I.
managers that would perform the functions of management or supervision; this problem was duly noted in the Decree of the President of the Republic of Uzbekistan⁷⁹⁷, and the CER research⁷⁹⁸.

### 3.1.3.2. Main features

The triangular system puts the general meeting of shareholders to the center of the system. The shareholders are the “supreme authority” of the corporation and have the right to appoint and remove both the Supervisory and the Management Board, as well as the Inspection Committee of the corporation. Moreover, the shareholders have the final say on all fundamental transactions, such as mergers, reorganization of the corporation, and amendments of the articles of association.

### 3.1.3.3. Strengths

The strengths of the triangular system are related to the transition nature of the legal system. The creators of the self-enforcing model have duly noted the following problems that all transition countries have in common:

- weak and undeveloped markets (which cannot “fill the gaps” of the corporate law);
- weak institutional framework;
- slow and ineffective functioning of the courts⁷⁹⁹.

In order to compensate these flaws, the self-enforcing model provided for enforcement through actions of the direct participants (shareholders, managers, directors), rather than the indirect participants (judges, regulators), and greater protection of outside shareholders in order to contain self-dealing, as well as strong legal remedies on paper in

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⁷⁹⁷ President of the Republic of Uzbekistan, Decree On Measures for Cardinal Increasing Share and Value of the Private Sector in Economy of Uzbekistan, 24 January 2003, №UP-3202; see also supra section 1.6.
⁷⁹⁸ CER research, supra note 297, at 25.
⁷⁹⁹ Black & Kraakman, supra note 452, at 1913-1916.
order to compensate for low probability that sanctions will be applied in fact. Thus, given
the fact that the legal system and the institutional framework are not always capable of
ensuring effective functioning of the system and providing effective protection of
shareholders’ rights, giving maximum power to shareholder(s) was a way for the
shareholder as investor to protect his investment.

Then why does the triangular structure, unlike the self-enforcing model, mandate
the Supervisory Board? Why not give total flexibility for the shareholders to choose
between the one-tier and two-tier systems and allocate the decision-making powers
accordingly? In order to answer these questions, one needs to analyze the main strengths
and weaknesses of the one-tier and two-tier systems and see which of these would be more
applicable to an emerging post-soviet country.

The authors of the self-enforcing model note that it can only partially protect small
shareholders; as noted earlier, in a one-tier system the neutrality of the supervisors is
questionable “since monitoring, appointment and removal processes have overtones of
some kind of self-control and dubious self-organization ... thus, it can be asked if the
representation of the shareholders’ interests is really guaranteed”. Hence, the mandatory
Supervisory Board serves as an additional layer of protection for the shareholders (including
minority shareholders), having the following functions (most of these powers in the German

800 Id. at 1916.
801 Theoretically, the corporations in Uzbekistan can have a strict two-tier system by delegating the power to
appoint and remove the Management Board to the Supervisory Board, see art. 65 and art. 82 of the Uzbek Law
on Joint-Stock Companies. However, the thesis is based on the assumption that due to a dominant ownership
paradigm in Uzbekistan as a developing country, the dominant shareholders are not willing to delegate such
powers and the triangular structure is kept by overwhelming majority of corporations. Moreover, the
corporations in Uzbekistan can decide to abolish the Supervisory Board and delegate the powers of the latter
to the general meeting in case the number of shareholders is less than thirty holders of voting shares,
however, such a scenario is not possible in a large publicly owned corporation which would have a certain
amount of the shares in a free float. See art. 81 of the Uzbek Law on Joint-Stock Companies.
802 Black & Kraakman, supra note 452, at 1918.
system are in the hands of the Management Board)\textsuperscript{804}:

- approving the Management Board member’s serving on management or supervisory boards of other corporations\textsuperscript{805};
- approving related party transactions and transactions involving more than 25% of corporation’s assets;
- calling, organizing, preparing the agenda of the general meeting of shareholders, determining its date and place;
- determining the value of in-kind contributions;
- determining the usage of reserve funds;
- approving the corporation’s participation in the capital of other enterprises;
- opening branches and representative offices;
- recommending the amount of dividends to be distributed.

Powers of the Supervisory Board with regard to the general meeting of shareholders are central to the discussion, they allow the Supervisory Board to serve as an effective intermediary between the Management Board and the general meeting of shareholders\textsuperscript{806}. Moreover, financial and operational oversight with regard to approving participation in other enterprises, as well as opening the branches allows the Supervisory Board to control the flow of funds \textit{ex ante}.

\textbf{3.1.3.4. Weaknesses}

First, in the triangular structure, the Supervisory Board does not have the same authority over the Management Board as in the two-tier board due to inability of the Supervisory Board to appoint or remove any member of the Management Board by default rule; nonetheless, the Supervisory Board can remove any member of the Management Board for gross violations of articles of association and appoint an interim member of the Management Board to replace the removed member\textsuperscript{807}. Similarly, analysis of the Czech system (which also employs a triangular structure) has also noted that in case both the

\textsuperscript{804} Art. 82 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{805} Art. 86 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{806} CER research, supra note 297, at 24.
\textsuperscript{807} Wei, supra note 725, at 143.
Supervisory Board and the Management Board are appointed and removed directly by the general meeting, the role of the Supervisory Board as the monitor of the Management Board’s performance becomes limited\textsuperscript{808}.

Second, in the triangular structure the Supervisory Board becomes too expensive a monitor. One thing is to have a separate board that acts as a counterbalance; another thing is to have the supervisor and the actual executives in similar hierarchical position. Both one-tier and two-tier systems try to tackle the same issues, such as efficiency, accountability; however, each system has its own features, while having two distinct bodies enables better surveillance at greater cost of wasting time on going back and forth between the two boards.

Third, the system may become less stable than a classic two-tier system, since in this case, the existence of a separate and independent supervisor provides the counterbalance necessary for stability. Members of both the Supervisory Board and the Management Board in Uzbekistan are appointed for one year\textsuperscript{809} (as opposed to a up to five year term in Germany\textsuperscript{810}), and the general meeting can remove without cause any and all members of both boards. Just to provide an example, in 2003 in 3,368 joint-stock companies, 11,437 members of the Supervisory Board have been removed, and in 3,845 joint-stock companies, the composition of Management Boards have been revised and 495 CEOs have been removed\textsuperscript{811}. Such a constant change in the composition of boards does not allow the corporations to establish long-term objectives and pursue a stable policy.

3.1.3.5. Importance of minority shareholder protection

\textsuperscript{808} World Bank, Czech Republic: Capital Market Review (World Bank Publications. 1999), at 56.
\textsuperscript{809} Art. 83 and 86 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{810} §§ 84(1), 102(1) AktG.
\textsuperscript{811} Gulyamov S.S. Pravovie Problemi Korporativnogo Upravleniya: Teoriya i Praktika (Tashkent State Institute of Law. 2004), at 115.
In the triangular structure, since the shareholders have all the rights with regard to
the appointment and removal of the governing bodies of the corporation, and all of the
fundamental decisions; given the dominant shareholder paradigm, the protection of the
minority shareholders plays an important role. Protection of the shareholders’ voice and
exit\textsuperscript{812} rights become important, since the role of the Supervisory Board as the liaison
between the Management Board and the general meeting of shareholders is more limited.

Given the ownership structure in Uzbekistan\textsuperscript{813}, the dominant shareholder has the
power to appoint and remove members of both boards, and minority shareholders are not
able to exert much influence apart from appointing some of the members of the
Supervisory Board by using cumulative voting (these persons can be again removed by the
dominant shareholder at the first possible moment\textsuperscript{814}). Moreover, the dominant
shareholder is able to dilute the shareholding of the minority shareholder and delay the
payment of dividends\textsuperscript{815}. Consequently, providing for an efficient exit for the unsatisfied
minority shareholder becomes important.

3.2. German idiosyncrasies: co-determination and dominance of banks

The analysis of the German corporate governance system shows that there are two
distinctive idiosyncratic features of the German corporate governance system – the
influence of banks and co-determination\textsuperscript{816}, therefore, before starting in-depth analysis of
the three legal systems, it is necessary to introduce these two features.

\textsuperscript{812} For a discussion of exit, see Hirschman Albert O., Exit, Voice and Loyalty: Responses to Decline in Firms,
\textsuperscript{813} See supra section 2.1.
\textsuperscript{814} For a discussion of removing the members of Supervisory Boards elected by cumulative voting in
Uzbekistan, see supra section 2.3.3.
\textsuperscript{815} For instance, in 2004, from 146 bln USZ of declared dividends for all joint-stock companies, only 32,5 bln
UZS (22.2\%) were paid, moreover, there were declared and unpaid dividends remaining from previous years in
the amount of 5,3 bln UZS, see CER research, supra note 297, at 36.
\textsuperscript{816} Hopt, Two-Tier Board: Experience, Theories, Reforms, supra note 701, at 245.
3.2.1. Dominance of banks

One of most widely cited and criticized phenomena of the German system is the dominance of banks in German public corporations\(^{817}\); indeed, the German public opinion polls found that most Germans believe that the banks have accumulated too much power and influence\(^{818}\). Historically, there have been three particularly powerful German banks (Grossbanken): Deutsche Bank, Dresdner Bank, and Commerzbank; in the meantime, Commerzbank has acquired Dresdner Bank, thereby leaving only 2 largest banks\(^{819}\). The literature on influence of banks is abundant, and it usually illustrates the cross-shareholdings of the banks and major industrial corporations\(^{820}\), the voting power held by the banks both in capacity of shareholders and proxy holders\(^{821}\), and the conflicts of interest when the banks act as shareholders, creditors and proxy holders at the same time\(^{822}\).

3.2.2. Co-determination

Co-determination – employee representation on the board of the corporation – is a

\(^{817}\) In the large publicly held companies especially, banks dominate the shareholders’ meetings. In 1992, for instance, banks cast on average more than 84% of all votes present at the meetings of the 24 largest stock corporations with widely dispersed ownership. This influence rests on equity holdings, the votes cast by their subsidiary investment funds and, above all, their role as proxies for their clients who have deposited their shares with them. This position enables them to ensure their representatives’ presence on supervisory boards. Theodor Baums, *Corporate Governance Systems in Europe - Differences and Tendencies of Convergence, Crafoord Lecture*, available at: [http://www.jura.uni-frankfurt.de/ifaw1/baums/Bilder_und_Daten/Arbeitspapiere/a0896.pdf](http://www.jura.uni-frankfurt.de/ifaw1/baums/Bilder_und_Daten/Arbeitspapiere/a0896.pdf) (last visited March 1, 2012), at 8; Vitols, Sigurt, *Changes in Germany’s Bank-Based Financial System: Implications for Corporate Governance, 13 Corporate Governance: An International Review 3*, (May 2005), at 386.


\(^{820}\) For a chart depicting the cross-shareholding of major players such as Deutsche Bank, Dresdner Bank, Commerzbank, Allianz, Daimler-Benz, MAN, RWE, Siemens, see Kaserer, Christoph and Wenger, *Ekkehard, German Banks and Corporate Governance - A Critical View*, in Klaus J Hopt and others (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (OUP, Oxford 1998), at 506.

\(^{821}\) Vitols, Sigurt, *Changes in Germany’s Bank-Based Financial System: Implications for Corporate Governance, 13 Corporate Governance: An International Review 3*, (May 2005), at 388; the actual voting power of banks and other custodians is higher than reported, Goergen, et al., supra note 27, at 175.

way of protecting the interests of the labour by placing the representatives of the labour into the corporate body\textsuperscript{823}. Co-determination is a relatively widespread phenomenon in Europe\textsuperscript{824}, while the extent of co-determination in Germany is unique and makes the German case even more interesting and compelling\textsuperscript{825}. Co-determination is not just an “experiment”\textsuperscript{826} of the German legislature, on the contrary, it has a long history of successful development\textsuperscript{827}, and should be viewed in the context of such development and be regarded as an integral part of the German corporate governance system\textsuperscript{828}, therefore, inclusion of co-determination in any study including the German company law and corporate governance is beyond question\textsuperscript{829}.

\textbf{3.2.2.1. History}

The idea of co-determination in Germany can be traced back to the first half of the 19\textsuperscript{th} century\textsuperscript{830}, when the labour had almost no rights before the employer\textsuperscript{831}. Although the

\textsuperscript{823} Andreas Cahn, David C. Donald, Comparative Company Law, Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA (Cambridge University Press. 2010), at 308.

\textsuperscript{824} “There are 11 Member States where significant formal participation can be said to exist: the Nordic countries of Denmark, Finland and Sweden (plus Norway as a non-EU Member State), the central and eastern European countries of Slovakia, the Czech Republic, Slovenia and Hungary, as well as Austria, Germany, Luxembourg and the Netherlands”, Norbert Kluge, \textit{Corporate governance with co-determination — a key element of the European social model}, 11 European Review of Labour and Research 2, (May 2005), 163-177, at 169.

\textsuperscript{825} Schulz & Wasmeier, supra note 139, at 23.

\textsuperscript{826} Michael E. Murphy, \textit{The Nominating Process for Corporate Boards of Directors: a Decision-Making Analysis}, 5 Berkeley Business Law Journal 131 (Fall, 2008), at 190; “This German form of ‘codetermination’ has been the most far-reaching experiment with employee participation”, Hansmann & Kraakman, supra note 154, at 446; Detlev F. Vagts, \textit{Reforming the “Modern” Corporation: Perspectives from the German}, 80 Harvard Law Review (1966), at 66.

\textsuperscript{827} For a discussion of history of co-determination, see John T. Addison, The Economics of Codetermination, (Palgrave Macmillan, 2009), at 5-14; see also Cahn & Donald, supra note 823, at 308-309.

\textsuperscript{828} Cahn & Donald, supra note 823, at 8; “[T]he German reform agenda excludes co-determination almost as a matter of political principle. ... co-determination was excluded from the KonTraG reform of 1998, and not part of the mandate conferred to the \textit{Regierungskomission Corporate Governance}”, Hopt & Leyens, supra note 701, at 9.

\textsuperscript{829} Cahn & Donald, supra note 823, at 10.

\textsuperscript{830} “As early as 1835, Professors Robert von Mohl, Wilhelm Roscher, and Bruno Hildebrand from the University of Tübingen proposed to create ‘workers committees’ in business firms”, Svetozar Pejovich, \textit{The Economics of Property Rights: Towards a Theory of Comparative Systems} (Springer. 1990), at 67.

\textsuperscript{831} Vagts, supra note 826, at 66.
first legislative attempt to provide for co-determination in 1848 was not successful\textsuperscript{832}, in 1890 voluntary formation of labour councils was permitted at the factory level, and such councils became mandatory in 1916\textsuperscript{833}. After the First World War and the fall of the German Empire, the labour was in a better position to advance its demands\textsuperscript{834}; as a result, the Weimar Constitution of 1919 guaranteed the right of employees to cooperate with employers on equal basis in the regulation of wages and working conditions; in particular, the Works Council Act of 1920 provided for representation of employees at the factory level, and the Act on the Representation of Works Council Members in the Supervisory Boards of 1922\textsuperscript{835} provided for representation of employees on the supervisory boards\textsuperscript{836}.

Modern co-determination started in the post-war mining, steel and iron industries with \textit{Montan-Mitbestimmungsgesetz}\textsuperscript{837} in 1951, when the parity representation on the supervisory boards and appointment of a labour director to the management boards was accepted by the Parliament only after a heated controversy\textsuperscript{838} and the threat of a general strike\textsuperscript{839}. In 1952, co-determination took a step beyond the industry of mining, steel and iron, when the Labour Management Relations Act (\textit{Betriebsverfassungsgesetz}) provided for election of one-third of supervisory boards by employees in companies with more than 500

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{832} “A draft trade law introduced in a workers congress in Berlin provided for labor participation in setting wages, deciding on termination and choosing supervisory personnel. The draft trade legislation failed, as did most of the other legislation submitted during the 1848 attempt to unite Germany in a constitutional republic, as under Bismarck Germany instead sought unity under Prussian hegemony”, Andreas Cahn & David C. Donald, supra note 823, at 308; “[I]n 1848, the first elected German parliament … intended to pass the legislation called \textit{Reichsgewerbeordnung} … the law did not pass”, Pejovich, supra note 830, at 67.
\item \textsuperscript{833} Cahn & Donald, supra note 823, at 308.
\item \textsuperscript{834} Vagts, supra note 826, at 66.
\item \textsuperscript{835} This was the first law on co-determination in Germany, see Pejovich, supra note 830, at 68.
\item \textsuperscript{836} Raiser, Thomas, and Veil, Rüdiger, Mitbestimmungsgesetz und Drittelbeteiligungsgesetz. (Walter de Gruyter 5\textsuperscript{th} ed. 2009), at introduction, cited in Cahn & Donald, supra note 823, at 308.
\item \textsuperscript{837} Law on Co-Determination of Employees in the Supervisory Boards and Management Boards of Enterprises Engaged in the Mining, Iron and Steel Industries of 21 May 1951 (\textit{Montan-Mitbestimmungsgesetz}).
\item \textsuperscript{838} Manfred Weiss, Marlene Schmidt, Labour Law and Industrial Relations in Germany, (Kluwer Law International. 2008), at 248.
\item \textsuperscript{839} Otherwise, the Parliament intended to pass one-third representation, see Cahn & Donald, supra note 823, at 308.
\end{itemize}
\end{footnotesize}
employees in other industries; this Act was further amended throughout the history with the final revision in 2004\textsuperscript{840}. In 1976, the Co-Determination Act (\textit{Mitbestimmungsgesetz}) was passed by overwhelming majority of Bundestag\textsuperscript{841} and provided for a “quasi-parity” representation on the supervisory boards of corporations and limited liability companies having more than 2,000 employees\textsuperscript{842}.

3.2.2.2. \textit{Status quo}

Co-determination, in a broad sense, refers to structures under which the employees are able to influence the corporate decision-making process\textsuperscript{843}, and these structures fall into two broad categories: shop-level co-determination (\textit{betriebliche Mitbestimmung}) and board-level co-determination (\textit{gesellschaftrechtliche Mitbestimmung}).

\textbf{A. Shop-level co-determination}

Shop-level co-determination gives an opportunity to the employees to participate in the decisions made with regard to the management of the individual unit where they are working\textsuperscript{844}, thus management has an obligation to consult with the representative body of the employees (i.e., works council\textsuperscript{845}) before making decisions\textsuperscript{846}.

\textbf{B. Board-level co-determination}

With regard to corporate governance, board-level co-determination is the most relevant type; thus, hereinafter, only board level co-determination will be referred to as “co-determination” in current thesis.

\textsuperscript{840} Drittelbeteiligungsgesetz (Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat) G. v. 18.05.2004 BGBl. I S. 974.
\textsuperscript{842} “[a]t the time of enactment, the act covered no fewer than 476 companies employing 4.1 million persons”, Kommers, supra note 841, at 267.
\textsuperscript{843} Adolff, supra note 767, at 35.
\textsuperscript{844} Schulz & Wasmeyer, supra note 139, at 67.
\textsuperscript{845} “[T]he works council is the main employee representative body vis-à-vis the employer”, Stefan Lingemann, Robert von Steinau-Steinrück, Anja Mengel, Employment & Labor Law in Germany (C.H. Beck 3\textsuperscript{rd} ed. 2012), at 2.
\textsuperscript{846} Adolff, supra note 767, at 35-36.
The German law provides for three regimes of board-level co-determination, which differ in the legal bases, scope of application and the extent of employee participation.\(^{847}\) The following are exempted from the requirements of co-determination: partnerships, companies that can appeal to the constitutional freedoms of faith and free press (e.g., the publishing company Springer),\(^{848}\) companies engaged in the business of television, radio, churches, education, and charitable institutions.\(^{849}\)

\textit{i. Coal and Steel Co-determination Act of 1951}

Co-determination pursuant to the Coal and Steel Co-Determination Act of 1951 applies to the corporations with more than 1,000 employees and engaged in the mining, iron and steel sectors. The Supervisory Board of such corporations consists of eleven board members, five of whom are appointed by the shareholder, five by the employees, and one of the members must be neutral.\(^{850}\) If the registered capital of such corporation exceeds 10 million Euros or 25 million Euros, the size of the Supervisory Board must be increased to 15 and 21 members respectively.\(^{851}\) In each case there is one neutral member who is nominated by other Supervisory Board members and is elected by the special committee.\(^{852}\)

\textit{ii. One-Third Co-determination Act of 2004 (Drittelbeteiligungsgesetz)}

One-Third Co-determination Act of 2004, which replaced the Act of 1952, applies to corporations in all areas of industry (other than coal, steel, and mining, and apart from the exempted industries), provided that such corporations have more than 500 but less than 2,000 employees. Under this Act, one-third of the Supervisory Board has to be elected by

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\(^{847}\) Schulz & Wasmeier, supra note 139, at 69.
\(^{848}\) Goergen et al., supra note 25, at 184.
\(^{849}\) Herbert Wiedemann, \textit{Codetermination by Workers in German Enterprises}, 28 The American Journal of Comparative Law 1 (Winter, 1980), at 88; Kommers, supra note 841, at 267.
\(^{850}\) Section 4(1), 4(2) and 8 of the \textit{Montan-Mitbestimmungsgesetz}, cited in Lingemann, supra note 845, at 72.
\(^{851}\) Lingemann, supra note 845, at 72.
\(^{852}\) Id.
the employees.

**iii. Co-determination Act of 1976**

The Co-determination Act of 1976 applies to all corporations with more than 2,000 employees in all industries other than coal, steel, and mining, and apart from the exempted industries. Under this Act, the shareholders elect half of the Supervisory Board, while the other half is elected by the employees and the trade union representatives. The chairman of the Supervisory Board is elected by shareholders and vice-chairman by the employee representatives; and in case of a tie vote in the Supervisory Board, the chairman has a casting vote.

**3.2.2.3. Constitutional challenge**

After the passing of the Co-Determination Act of 1976, nine corporations and twenty-nine employer associations brought a case in Federal Constitutional Court of Germany alleging violation of property rights of the shareholders under the article 14 of the German Federal Constitution. Peculiarity of the case lies in the fact that the employers were not hostile towards co-determination in general, and their objection was not directed against co-determination per se; rather, the purpose of the complaint was to cause the Federal Constitutional Court to examine whether the new co-determination system violated the capitalist economic order. The position of the employers was that in the future bargaining agreements the fact that the employees are on both sides of the

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853 For a discussion of the procedure for election of the employee representatives, see infra section 3.4.1.1; for a discussion of the status, rights and obligations of the employee representatives, see infra section 3.5.1.
854 Lingemann, supra note 845, at 72.
855 Here it is important to note the difference between the wide constitutional understanding of property rights and the property rights in the narrow sense of having the actual rights over the property, see Wiedemann, supra note 849, at 88; Kommers, supra note 841, at 267.
856 BVerfGE 50, 290, for English translation see Wiedemann, supra note 849, at 88; Kommers, supra note 841, at 267.
857 Wiedemann, supra note 849, at 84.
858 Id.
negotiating table will lead to labour domination.\(^{859}\)

The case was decided on March 1, 1979 by rejecting the employers’ contentions and upholding the law. The court held that the Act of 1976 did not lead to an actual parity situation\(^ {860}\) and the shareholders still retained the slight edge in the voting power, i.e., in case of a tie vote, the chairman of the Supervisory Board (who is elected by shareholders) would have the casting vote; thus, provided that there is an agreement among the shareholders themselves, the system does not lead to labour domination.\(^ {861}\) Regarding the assumption that the Act violated the economic order, the court held that the Federal Constitution does not guarantee a particular economic order, thus, it is up to the legislature to choose such an order within the limits of the Constitution.\(^ {862}\)

3.3. General meeting of shareholders as a company organ

This section does not discuss the rights of individual shareholders; rather, it discusses the powers and position of the shareholders at the general meeting as an organ of the corporation in the internal governance structure, where the shareholders can enforce their rights.\(^ {864}\)

The approach of corporate law in three countries of study is different – AktG does not allow deviations from its provisions unless expressly allowed, MBCA and DelGCL law are the “enabling” laws granting extreme flexibility, and Uzbekistan is in between. Most of the powers of the general meetings are divided into regular decisions and fundamental decisions; moreover, the general meeting in Germany can also be involved in taking

\(^{859}\) Id.
\(^{860}\) Id., at 89.
\(^{861}\) Id., at 85; Kommers, supra note 841, at 269.
\(^{862}\) Wiedemann, supra note 849, at 90.
\(^{863}\) Individual rights of the shareholders are discussed in the Chapter 2.
\(^{864}\) Wirth, et al., supra note 87, at 131.
decisions on management matters, and has implied powers as defined by courts; in the United States the general meeting also votes on conflict of interest transactions and can vote for ex post ratification of director actions; powers of the Uzbek general meeting include conflict of interest and related party transactions, importantly, some of the powers can be delegated to the Supervisory Board.

### 3.3.1. Germany

The general meeting of shareholders is one of the three mandatory corporate bodies, and while some authors challenge the supremacy of the general meeting of shareholders, the prevailing opinion is that the general meeting is the highest corporate organ in Germany. The general meeting has several groups of competences: regular decisions, fundamental decisions, decisions related to management of the corporation, and implied powers.

#### 3.3.1.1. Regular decisions

The general meeting in Germany regularly decides on the following matters:

- appointment and removal of shareholder representatives on the Supervisory Board;
- appropriation of profit;
- ratification of acts of the Management Board and the Supervisory Board;
- appointment of the auditor for review of annual statements;
- appointment of special auditors;
- “say on pay”;

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865 Schulz & Wasmeier, supra note 139, at 39; Adolff, supra note 767, at 13.
866 “[i]t is doubtful, however, that whether the general meeting can in fact be referred to as the highest body”, Wirth, et al., supra note 87, at 132; “[T]he prevailing opinion no longer regards the general meeting as the ‘highest body’ … [T]oday, in Germany, the management board is the most important body”, Siems, supra note 463, at 151-153; Baums & Wymeersch, supra note 504, at 115.
867 Adolff, supra note 767, at 15; Jungmann, supra note 701, at 433.
868 This division originates from the ideas expressed in: Baums & Wymeersch, supra note 504, at 115; Wirth, et al., supra note 87, at 131-136.
869 § 119(1) AktG.
870 § 103(2) AktG.
871 § 142(2) AktG.
• determining remuneration for members of the Supervisory Board\(^{872}\);
• squeeze-out of minority shareholders\(^{873}\);
• asserting and waiving certain claims for damages\(^{874}\).

One of the most important powers of the general meeting of shareholders is the power to elect and remove the members of the Supervisory Board. However, the powers of the shareholders are strongly influenced by the requirements of co-determination, where third or half of the members of the Supervisory Board are elected by the employees\(^{875}\). The members elected by shareholders are called shareholder representatives, and members elected by employees are called labour representatives.

In German corporations, the shareholders are required to “ratify” the actions of the Supervisory and Management Boards of the corporation on annual general meetings\(^{876}\). The ratification of acts of the boards is a decision that approves the way in which the corporation has been administered by the members of the Management and the Supervisory Boards. Although it is considered as a formal measure that has symbolic significance\(^{877}\) and it does not entail a waiver of the claim for damages, withholding ratification by the general meeting may result in formal resolution of non-confidence which has substantial consequences for the Management Board; such formal resolution of non-confidence is a basis for the Supervisory Board to dismiss the member(s) of the Management Board in question\(^{878}\).

Remuneration of the members of the Supervisory Board is determined by the

\(^{872}\) § 113(2) AktG.
\(^{873}\) § 327a et seq. AktG.
\(^{874}\) §§ 50, 93(4), 116, 117(4), 147 AktG.
\(^{875}\) See supra section 3.2.2.2.
\(^{877}\) Wirth, et al., supra note 87, at 133.
\(^{878}\) Id.
general meeting of shareholders directly; however, the power to determine the remuneration of the Management Board was entirely in the hands of the Supervisory Board prior to 2009. Appropriateness of Management Compensation Act\textsuperscript{879}, which was based on similar “say on pay” provisions in the US\textsuperscript{880}, amended the AktG to include a non-binding vote of the general meeting on the compensation of Management Board members\textsuperscript{881}. In 2010, 26 of 30 DAX corporations used this vote; in 23 corporations the compensations were approved with 80% vote\textsuperscript{882}, a few corporations – Deutsche Bank AG, TUI AG, and Siemens AG received negative votes\textsuperscript{883}.

\textbf{3.3.1.2. Fundamental decisions}

The general meeting also takes the decisions whenever the fundamentals of the corporation are altered, in particular:

- amendments of the articles of association\textsuperscript{884};
- increase or decrease of the registered share capital\textsuperscript{885};
- merger, spin-off or change of legal form (under the Transformation Act\textsuperscript{886});
- the transfer of the entire assets of the company\textsuperscript{887};
- approval for enterprise agreements\textsuperscript{888};
- integration\textsuperscript{889} and dissolution of the company\textsuperscript{890}.

The fundamental decisions require qualified majority of at least three fourths of registered share capital\textsuperscript{891}, although for changes in the articles of association the

\begin{itemize}
\item \textsuperscript{879} Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG). G. v. 31.07.2009 BGBl. I S. 2509 (Nr. 50).
\item \textsuperscript{880} Du Plessis et al., supra note 16, at 58.
\item \textsuperscript{881} Id.
\item \textsuperscript{882} Id. at 59.
\item \textsuperscript{883} Id.
\item \textsuperscript{884} §§ 119(1), 179 AktG.
\item \textsuperscript{885} § 119(1) AktG.
\item \textsuperscript{886} Umwandlungsgesetz (UmwG). G. v. 28.10.1994 BGBl. I S. 3210, 1995 I S. 428.
\item \textsuperscript{887} § 179a AktG.
\item \textsuperscript{888} § 293 AktG.
\item \textsuperscript{889} § 319 AktG.
\item \textsuperscript{890} §§ 119(1), 262 AktG.
\item \textsuperscript{891} Wirth, et al., supra note 87, at 134; Adolf, supra note 767, at 16-19.
\end{itemize}
requirement may be lowered\textsuperscript{892}.

### 3.3.1.3. Decisions related to the management of the corporation

As a rule, only the Management Board has the power to make decisions related to the management of the corporation\textsuperscript{893}, however, the general meeting of shareholders may be directly involved in taking such decisions when requested so by the Management Board under certain circumstances.

First, such a decision may be taken only if requested so by the Management Board\textsuperscript{894}, and the initiative to decide on a measure related to management cannot be taken by the general meeting\textsuperscript{895} or the Supervisory Board\textsuperscript{896}, thus the right of initiative belongs to the Management Board. Second, the Management Board can bring a matter before the general meeting if the Supervisory Board refuses to grant consent to a specific transaction or action in accordance with the articles of association of the corporation\textsuperscript{897}. Third, the decision of the general meeting in such a case requires at least three fourths of the votes, while the articles of association cannot provide for different or additional requirements\textsuperscript{898}. Fourth, when the general meeting takes a decision with regard to such matter, the Management Board is obliged to follow even if the decision differs from the proposal of the Management Board\textsuperscript{899}. If the Management Board fails to follow the decision, it may be held liable for damages by the corporation\textsuperscript{900}.

### 3.3.1.4. Implied powers

\textsuperscript{892}§ 182(2) AktG; Wirth, et al., supra note 87, at 134.
\textsuperscript{893}§ 76(1) AktG.
\textsuperscript{894}§ 119(2) AktG.
\textsuperscript{895}Wirth, et al., supra note 87, at 135.
\textsuperscript{896}“There is no right of the Supervisory Board to involve the shareholders’ assembly in a matter of the operative management”, Adolff, supra note 767, at 19.
\textsuperscript{897}§ 111(4) AktG.
\textsuperscript{898}§ 111(4) AktG.
\textsuperscript{899}§ 83(2) AktG.
\textsuperscript{900}Wirth, et al., supra note 87, at 135.
As noted earlier, AktG is mandatory; hence the balance of powers in the German corporations is fixed. However, the German courts have made their contributions to changing this balance in favor of shareholders by creating implied powers of the general meeting of shareholders. The implied powers are granted under the Holzmüller doctrine, which is developed by the German Federal Supreme Court in Holzmüller case, later confirmed by the court in Gelatine case, and supplemented by Macroton case.

In Holzmüller case, the Management Board executed a spin-off and transferred approximately 80% of the total assets to a wholly owned subsidiary. The shareholders applied to the court for violation of their rights, since the Management Board did not get the approval of the general meeting of shareholders to do so. The Management Board claimed that it had acted in accordance with the AktG and the articles of association of the corporation. The court held that the shareholders should be protected from the danger that the structure of corporate groups will be exploited by the Management Board, which uses a spin-off to eliminate the right of the shareholders to participate in the decision-making. The court found that this gap in the Konzernrecht should be closed by the courts in accordance with the aims and design of the AktG.

According to the Holzmüller doctrine, which was later confirmed by the Federal
Supreme Court in \textit{Gelatine} case\textsuperscript{908}, and supplemented by \textit{Macroton} case\textsuperscript{909}, the Management Board has a duty to seek shareholder approval when the material structural measure taken by the Management Board has a significant impact on the business of the corporation. According to the court:

“There are ... fundamental decisions that ... so deeply affect the membership rights of the shareholders ... that the Vorstand [Management Board] may not reasonably assume it can make them exclusively under its own supervision without consulting the shareholders’ meeting. In such cases, the Vorstand [Management Board] breaches its duty of care if it does not take recourse to §119(2) AktG”\textsuperscript{910}.

Although the \textit{Holzmüller} doctrine did not establish clear-cut rules with regard to the specific instances when the Management Board should consult the general meeting, academics and practitioners have attempted to define the scope of the doctrine and have suggested that the following are included\textsuperscript{911}:

- transfer of a material part of the assets of the corporation to its subsidiary as a contribution in kind;
- sale of material part of the assets of the corporation;
- acquisition and sale of material subsidiary;
- termination of a material part of the corporation’s activities;
- going public by listing shares on a stock exchange, or going private by delisting the shares\textsuperscript{912}.

The issues outlined above still do not provide a clear answer to the question in what core competences of the shareholders’ meeting to determine the constitution of the company, and have consequences that approach a state of affairs that can only be reached by an amendment of the Satzung. Consequently, the exceeding of one of the various thresholds specified in the academic literature – they are based on various parameters and range from 10\% to 50\% – cannot be sufficient”, Decision of the Federal Supreme Court, published in BGHZ, vol. 159, pp. 30 et seq., cited in Cahn & Donald, supra note 823, at 716-717.

\textsuperscript{908} Decision of the Federal Supreme Court, published in BGHZ, vol. 159, pp. 30 et seq; for an English translation of the case, see Cahn & Donald, supra note 823, at 710.
\textsuperscript{909} Decision of the Federal Supreme Court, published in BGHZ 153, 47 et seq., cited in Wirth, et al., supra note 87, at 135.
\textsuperscript{910} Cahn & Donald, supra note 823, at 701.
\textsuperscript{911} Adolff, supra note 767, at 20.
\textsuperscript{912} The Federal Supreme Court has also decided in the \textit{Macrotron} case that the delisting of a listed company requires the approval of the general meeting, Decision of the Federal Supreme Court, published in BGHZ 153, 47 et seq., cited in Wirth, et al., supra note 87, at 136.
matters the Management Board must seek shareholder approval, since “materiality” as the key issue has not been defined by the court. The legal literature offers variety of thresholds, however, it has been noted that any transaction involving more than 25% of the turnover, earnings, or market value of the corporation (including subsidiaries) will fall under the requirement of the Holzmüller doctrine\(^{913}\), although in case of acquisition, the threshold might be higher\(^{914}\). Still, many practitioners prefer to err on the side of caution in such issues\(^{915}\), therefore, Holzmüller resolutions are taken on a wider variety of transactions\(^{916}\).

With respect to the legal bases of the Holzmüller doctrine, the court had noted that this “unwritten right” of the shareholders is based neither on § 119(2) AktG nor on an analogy to other principles of law, “[r]ather, … this special competence of the shareholders’ meeting should be understood as the product of freely developing case law”\(^{917}\).

Although the Holzmüller doctrine provides for implied powers of the general meeting of shareholders, it is only the Management Board that has the exclusive right of initiative to prepare and implement Holzmüller resolutions\(^{918}\). With regard to the majority requirements of the general meeting of shareholders, the Gelatine decision provided that decision of the general meeting called to decide on a matter falling under the Holzmüller doctrine will require 75% majority\(^{919}\).

### 3.3.2. United States

In the United States, the allocation of powers has long been in favor of the Board of Directors; however, the last 20 years have seen a considerable increase in the power of

\(^{913}\) Adolff, supra note 767, at 20.
\(^{914}\) Id. at 21.
\(^{915}\) Id. at 21.
\(^{916}\) Id. at 21.
\(^{918}\) Wirth, et al., supra note 87, at 136.
\(^{919}\) Cahn & Donald, supra note 823, at 710; Adolff, supra note 767, at 20.
shareholders to act via the general meeting. The section discusses the scope of powers of the general meeting, including effects of ex-post shareholder ratification, amendments of the corporate charter and bylaws, election and removal of Board of Directors, voting on fundamental decisions, director conflict of interest transactions, and say-on-pay.

The universal rule in the United States has been that the shareholders do not have the general power to manage the corporation, and have only those powers that are specifically conferred upon them, either by statute, or by courts\textsuperscript{920}. In \textit{Continental Securities Co. v. Belmont}, the court noted:

\begin{quote}
"As a general rule, stockholders cannot act in relation to the ordinary business of a corporation. The body of stockholders have certain authority conferred by statute which must be exercised to enable the corporation to act in specific cases, but except for certain authority conferred by statute, which is mainly permissive or confirmatory, such as consenting to the mortgage, lease, or sale of real property of the corporation, they have no express power given by statute. They are not by any statute in this state given general power of initiative in corporate affairs. Any action by them relating to the details of the corporate business is necessarily in the form of an assent, request, or recommendation. Recommendations by a body of stockholders can only be enforced through the board of directors, and indirectly by the authority of the stockholders to change the personnel of the directors at a meeting for the election of directors"\textsuperscript{921}.
\end{quote}

\subsection{3.3.2.1. Effects of ex-post shareholder ratification}

The section discusses the effects of ex-post shareholder ratification in all cases except for conflict of interest transactions, which are discussed separately.

The general rule is that the shareholder ratification cures any defect which may have occurred with regard to a transaction of the corporation or an act of the directors of officers of the corporation in their official capacity. Under Delaware law, the doctrine of shareholder

\begin{footnotesize}

\textsuperscript{921} Continental Securities Co. v. Belmont, 206 N.Y. 7, 99 N.E. I38, 141 (I912).
\end{footnotesize}
ratification does not apply in the cases where shareholder approval is statutorily required. In *Gantler v. Stephens*, the court clarified that shareholder ratification is limited to “circumstances where a fully informed shareholder vote approves director action that does not legally require shareholder approval to be effective.” Generally, fully informed shareholder suffices in case of voidable acts, such as director misconduct. However, in case of void acts, such as fraud, gift or waste of corporate assets, and *ultra vires* acts, only unanimous and fully informed shareholder approval will cure the deficiency.

For instance, in *Lofland v. Di Sabatino*, the annual meeting was improperly called and the directors of the corporation were elected on this meeting. The court held that improper procedure of calling the meeting causes the elections to be voidable, but not void; hence ex-post ratification by the majority shareholders of the corporation at a special meeting would cure the defect.

In *Lewis v. Vogelstein*, the Delaware court declined to approve the stock option plan even though it was approved by the majority of shareholders, stating that “although fully informed shareholder ratification is usually effective to preclude judicial review, it is not effective in cases of ‘waste’ unless the shareholder approval was unanimous.”

### 3.3.2.2. Election and removal of Board of Directors

The section will touch upon the issue of election and removal shortly, since it is

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922 Gantler v. Stephens, 965 A.2d 695, 714 (Del. 2009); Welch et al., supra note 349, at 147.
924 Welch et al., supra note 349, at 149.
925 “The only species of claim that shareholder ratification can validly extinguish is a claim that the directors lacked the authority to take action that was later ratified”, Gantler v. Stephens, 965 A.2d 695, 714 (Del. 2009).
926 “It is only where a claim of gift or waste of assets, fraud or ultra vires is asserted that a less than unanimous shareholder ratification is not a full defense”, Michelson v. Duncan, 407 A.2d 211, 219 (Del. 1979).
928 In Lewis v. Vogelstein, 699 A. 2d 327 (Del. Ch. 1997)
elaborated later in considerable length\textsuperscript{929}. The courts in the United States have held in a line of cases that the shareholders have the inherent power to elect\textsuperscript{930} and remove\textsuperscript{931} directors, who can be elected on general meeting of shareholders or by written consent. The Board of Directors does not have the power to elect and remove directors unless specifically empowered by the charter or bylaws, and even in that case, the shareholders retain the power to appoint and remove the directors\textsuperscript{932}.

3.3.2.3. Amendment of charter and bylaws of the corporation

As noted earlier, the charter\textsuperscript{933}, as well as any amendment to the charter, has to be registered with the secretary of the state\textsuperscript{934}, while the bylaws and amendment to bylaws are not registered with any government authority. Hence, the charter usually contains most basic provisions, such as the name and address of the corporation, types and number of authorized shares; while most corporate governance related provisions are contained in the bylaws. In \textit{Gow v. Consolidated Coppermines Corp.}, the Delaware court has drawn the line between the charter and the bylaws:

“the charter is an instrument in which the broad and general aspects of the corporate entity’s existence and nature are defined, so the bylaws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for its convenient functioning to be laid down. Our statute in its original as well as in its present form is framed in harmony with this conception of the purpose which the bylaws are designed to serve”\textsuperscript{935}.

Concerning the amendments to the charter, the MBCA and DelGCL take the position

\textsuperscript{929} See infra chapter 4.
\textsuperscript{932} Bruch v. National Guarantee Credit Corporation 116 A. 738, 742 (Del.Ch. 1922); Welch et al., supra note 349, at 38.
\textsuperscript{933} DelGCL 104 defines the “articles of incorporation”, i.e., the charter of the corporation to include a number of documents that are filed with the secretary of the state in accordance with the legal provisions, see Welch et al., supra note 349, at 38.
\textsuperscript{934} DelGCL 242(b); MBCA 10.03.
\textsuperscript{935} Gow v. Consolidated Coppermines Corp. 19 Del.Ch. 172, 180-181, 165 A. 136, 140 (Del.Ch.1933).
of the so-called “bilateral veto” between Board of Directors and shareholders\textsuperscript{936}, where the Board of Directors proposes, and the general meeting votes on the amendments. Under this system, neither can decide on its own – consent of both general meeting of shareholder and the board of directors is required.

Amendments to bylaws are regulated differently. Under the MBCA, the directors can change the bylaws of the corporation without shareholder consent\textsuperscript{937}; however, the directors cannot change the bylaws if the shareholders, either in bylaws or in the charter, have provided that a decision right is reserved to the shareholders. Under DelGCL, the shareholders can adopt, amend and repeal bylaws; however, the Delaware courts have not provided a clear answer whether the Board of Directors can amend or repeal the bylaws adopted by shareholders\textsuperscript{938}.

\textbf{3.3.2.4. Fundamental decisions}

The decisions that are fundamental to the existence of the corporation, such as merger, sale of all assets, or dissolution, require approval of the general meeting, since the shareholders as investors in the corporation must have a voice when their investment is being substantially altered.

The MBCA in 1999 was amended with respect to the rules on approval of fundamental transactions. Now, any action with respect to issuance of new shares, amendment of charter, mergers share exchanges, acquisitions and sale of assets, must be approved at a general meeting where at least majority of the shareholders entitled to vote are participating, and the transaction must be approved by the plurality of the votes\textsuperscript{939}.

\textsuperscript{936} Kraakman et al., supra note 35, at 187.
\textsuperscript{937} MBCA 10.20(a).
\textsuperscript{938} Welch et al., supra note 349, at 45.
\textsuperscript{939} Model Business Corporation Act Annotated, supra note 16, Volume 1, at xxii.
Under DelGCL, the general meeting votes on the following issues: approval of merger or consolidation\textsuperscript{940}, sale of substantially all assets\textsuperscript{941}, and dissolution of corporation\textsuperscript{942}. With respect to mergers, the plan of the merger has to be approved by the Board of Directors, with a subsequent ratification by the general meeting\textsuperscript{943}; without shareholder approval, the merger is ineffective\textsuperscript{944}.

### 3.3.2.5. Director conflict of interest transaction

In early cases in the United States, the courts had established an inflexible rule that all transactions involving director conflict of interest are void per se, however, in the late 19\textsuperscript{th} century, the courts started allowing such transactions subject to scrutiny by the courts\textsuperscript{945}.

MBCA defines the director conflict of interest transaction as a transaction effected by the corporation or its subsidiary where:

- the director is a party;
- directors or a related person\textsuperscript{946} had material financial interest, and such interest was known to the director at the time of the transaction\textsuperscript{947}.

MBCA puts “material financial interest” in the center of the rule, and does not define when a financial interest becomes material, but provides for an objective test\textsuperscript{948}, stating that such interest would “reasonably impair the objectivity of the director’s judgment when

\textsuperscript{940} DelGCL 251 (c).
\textsuperscript{941} DelGCL 271 (a).
\textsuperscript{942} DelGCL 275 (b).
\textsuperscript{943} Welch et al., supra note 349, at 65.
\textsuperscript{944} Welch et al., supra note 349, at 65; 251 DelGCL.
\textsuperscript{945} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-483.
\textsuperscript{946} The term “related person” is defined extremely broadly, see Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-490.
\textsuperscript{947} MBCA 8.60 (1).
\textsuperscript{948} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-487.
participating in action on the authorization of the transaction”.

DelGCL does not have a provision on director conflict of interest transactions in the manner provided by the MBCA, hence only Delaware courts have addressed this issue.

In *Cinerama, Inc. v. Technicolor*, the Delaware court ruled that a material financial interest of a director is not imputed to other directors unless said interested director controls the Board of Directors. Also, Delaware courts have made a distinction between the shareholders conflict of interest and director conflict of interest, while the latter requires shareholder approval, the former does not. In *Fliegler v. Lawrence*, the court explicitly ruled that the Delaware statute requires approval of director conflict of interest transactions by shareholders, but does not expressly require that the shareholders be “disinterested”. If majority of the shareholders approve the transaction, the burden of proof shifts to the person claiming a waste of corporate assets.

### 3.3.2.6. Say on pay

As noted earlier, Dodd-Frank Act, which became a federal law in 2010, has given the general meeting the power to have an advisory vote on the compensation of the directors. Essentially, the bill requires that the issue of executive compensation shall be put to a non-binding shareholder vote no less than every three years. Although the real impact of say-on-pay is to be seen, the early results evidence that the say-on-pay recommendations by the shareholders are drawing enough attention from the proxy.

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949 MBCA 8.60 (4).
951 *Fliegler v. Lawrence* 361 A.2d 218 (Del. 1976).
952 Welch et al., at 71.
advisors such as Institutional Shareholder Services\(^\text{954}\).

### 3.3.3. Uzbekistan

In Uzbekistan, the legal requirements with regard to delegation of the general meeting’s powers are more flexible than in Germany, but more restrictive than in the United States. The general meeting of shareholders has exclusive powers which cannot be delegated and powers that can be delegated solely to the Supervisory Board; under no circumstances can any of these powers be delegated to the Management Board. This allows the shareholders to form the internal governance structure fitting their needs, by retaining all the powers, or delegating the part to the Supervisory Board, thereby making the system closer to the classic two-tier system.

#### 3.3.3.1. Election and removal of corporate bodies

Uzbek corporations have the following corporate bodies: general meeting of shareholders, the Supervisory Board, the Management Board and the Inspection Committee, members of each of these bodies are elected for one year term. The general meeting of shareholders is the supreme authority of the corporation\(^\text{955}\), since it has the power to elect and remove the Supervisory Board, the Management Board and the Inspection Committee\(^\text{956}\), as well as to decide on their size and composition. Although the power to appoint and remove the Management Board can be delegated to the Supervisory Board\(^\text{957}\), due to the ownership structure in Uzbekistan\(^\text{958}\), current thesis is based on the assumption that the dominant shareholder will not be willing to give up this power; hence, the general meeting retains the power to elect and remove the Management Board.


\(^{955}\) Art. 65 of the Uzbek Law on Joint-Stock Companies.

\(^{956}\) Id.

\(^{957}\) Id.

\(^{958}\) See supra section 2.1.
3.3.3.2. **Regular decisions**

The general meeting regularly decides on the following matters:

- approval of annual business plans, annual financial reports, deciding on distribution of profits;
- deciding on conducting external audit, determining the auditing organization and its remuneration;
- receiving reports of the Supervisory and the Management Board with regard to the functioning of the corporation, achievement and plans for future development;
- squeeze-out, share buybacks, splitting and consolidation of shares, exclusion of preemptive rights of shareholders on new issues of shares and securities convertible into shares;
- approval of the procedures/bylaws of the general meeting\(^{959}\).

All these decisions require simple majority of the votes at the general meeting. The annual business plan of the corporation serves as the basis for the actions of the Management Board, which is obliged to report on its implementation to the Supervisory Board and the general meeting of shareholders\(^{960}\). The dividends distributed to the shareholders cannot exceed the amount recommended by the Supervisory Board\(^{961}\).

3.3.3.3. **Fundamental decisions**

The general meeting also decides when the fundamentals of the corporation are altered, such as:

- amendment of the articles of association;
- approval of merger, reorganization and liquidation of the corporation;
- approval of increase and decrease of the authorized share capital;
- transactions involving more than 50% of the assets of the corporation\(^{962}\).

The fundamental decisions require at least three fourths of votes, while the articles of association cannot lower the requirements\(^{963}\).

3.3.3.4. **Related party transactions**

\(^{959}\) Art. 65 of the Uzbek Law on Joint-Stock Companies.

\(^{960}\) Art. 86 of the Uzbek Law on Joint-Stock Companies.

\(^{961}\) Art. 55 of the Uzbek Law on Joint-Stock Companies.

\(^{962}\) Art. 65 of the Uzbek Law on Joint-Stock Companies.

\(^{963}\) Art. 69 of the Uzbek Law on Joint-Stock Companies.
Uzbek Law on Joint-Stock Companies provides for elaborate requirements with regard to related party transactions\(^{964}\). Although generally such transactions are approved by the Supervisory Board, the general meeting has to vote if it involves more than 5% of assets of the corporation, or involves sale of voting shares (or securities convertible into voting shares) in the amount exceeding 5% of the total amount of voting shares.

In order to understand the related party transactions, it is necessary to provide the definitions. First, the definitions of affiliate and dependent entity are provided, which lay down the basis for the definition of a related party; a transaction involving a related party is called a related party transaction.

A legal entity is considered as an affiliate of a shareholder – natural person in following cases\(^{965}\):

- shareholder (and/or his/her spouse, parents or other close relatives\(^{966}\)) has control over more than 20% of registered share capital (including in the capacity of representative or trust manager\(^{967}\)) or more than 20% of votes (including in the capacity of representative or trust manager) in the highest corporate organ\(^{968}\) of a legal entity;
- shareholder (or his spouse, parents, other close relatives) holds the position of a member of the Supervisory Board, the CEO or member of the Management Board of a legal entity;
- shareholder performs the functions of the Chief Executive Officer of a legal entity.

Regarding legal entities as shareholders, if a legal entity possesses more than 20% of

\(^{964}\) A loan by the interested party to the corporation is not a conflict of interest transaction. Art. 93 of the Uzbek Law on Joint-Stock Companies.

\(^{965}\) Art. 5 of the Regulation on Affiliated Persons, on Keeping the Records and Disclosure of Affiliated Persons in the Joint Stock Companies, Order of the Center for Coordination and Control over the Securities Market and State Property Committee of November 20, 2002, № 2002-14, Ministry of Finance №131, the State Antimonopoly Committee №7, registered at the Ministry of Justice 29.01.2003 №1212 (hereinafter referred to as Regulation on Affiliated Persons).

\(^{966}\) Close relatives for the purposes of this provision are: parents, brothers, sisters, spouse, children (including adopted), grandchildren, and spouse’s parents, brothers, and sisters. Art. 4.2 of Regulation on Affiliated Persons.

\(^{967}\) Trust manager is the person managing the property under the “contractual trust” for the benefit of the owner or beneficiary, see art. 849 et seq. of the Civil Code of the Republic of Uzbekistan, contractual trust is different from the concept of “Managing Company”.

\(^{968}\) In the case of joint-stock companies, the general meeting of shareholders is the highest corporate organ. Art. 64 of the Uzbek Law on Joint-Stock Companies.
the voting shares in another legal entity, the latter is deemed as a dependent entity.\footnote{Art. 68 of the Civil Code of the Republic of Uzbekistan.}

A related party is defined as a member of the Supervisory Board, the Management Board or the Inspection Committee of the corporation; or as a shareholder possessing, together with his affiliates or dependent entities, more than 20% of corporation’s shares, when such persons or their affiliates:

- are a party to the transaction, representative of other party, or intermediary;
- hold (together with his/her affiliates) more than 20% of shares of the legal entity that is a party to the transaction, representative of such party or intermediary;
- hold positions in the governing bodies (the Supervisory Board and the Management Board) of the legal entity that is a party to the transaction, representative of such party or intermediary.

Thus, the legislation effectively provides for a decision of the general meeting of shareholders if a transaction involves more than 5% of the assets or the voting shares (including convertible securities) with participation of interested parties\footnote{Art. 65 of the Uzbek Law on Joint-Stock Companies.}, moreover, the shareholders, which are related parties, do not have the right to vote on related party transactions.\footnote{Art. 93 of the Uzbek Law on Joint-Stock Companies.}

### 3.3.3.5. Powers that can be delegated to the Supervisory Board

As noted earlier, the corporate law in Uzbekistan is flexible and allows the general meeting to delegate certain power to the Supervisory Board, thereby making the latter a crucial player in functioning of the corporation.

The most important power that can be delegated is the power to appoint and remove the Management Board; and such delegation will bring the corporation to a strict German style two-tier system, with different implications as discussed above. Moreover, the Supervisory Board can be delegated the power to increase the registered capital of the corporation by issuing new shares or increasing the par value of existing shares within the

\footnote{Art. 68 of the Civil Code of the Republic of Uzbekistan.}
\footnote{Art. 65 of the Uzbek Law on Joint-Stock Companies.}
\footnote{Art. 93 of the Uzbek Law on Joint-Stock Companies.}
limits of the authorized capital approved by the general meeting of shareholders. The change in the registered capital requires amendment to the articles of association, thus, the Supervisory Board, with the power to increase the registered capital, can have the power to amend the articles of association with regard to the change of the registered capital.\textsuperscript{972} Last, the Supervisory Board can be delegated the power to approve the annual business plan of the corporation.

3.4. Conclusions

The chapter has analyzed the corporate governance structures employed in the three countries examined here – similarities and differences between these structures are the cornerstone of this thesis. As expected, each of the structures has its strengths, weaknesses, and peculiarities; however, the analysis shows that each model fits into the general picture in its own way.

The one-tier system, which is a board–centered model, emerges from the requirement to have central management of corporation’s affairs given the dispersion of shareholder ownership and rational shareholder apathy caused by such dispersion. Though emergence of the “monitoring model” in fact drew the one-tier system closer to two-tier system, the fundamental differences still remain.

The two-tier system has its roots in XIX century, when the introduction of mandatory Supervisory Board was seen as the buffer to compensate for removing the state oversight, as well as the view of protecting the public interest. The analysis of German idiosyncrasies, such as influence of banks and co-determination, evidences the strength of the Supervisory Board in German two-tier system. These idiosyncrasies have a both positive and negative

\textsuperscript{972} Art. 21 read together with articles 16, 65 and 82 of the Uzbek Law on Joint-Stock Companies.
impact on the functioning of the corporation due to large involvement of labour, and dubious position of the banks as both shareholders and creditors.

The triangular structure also has its origins in XIX century, where the holders of large amount of capital had the ability to shape both managerial and supervisory organs of the corporation as they saw fit. Though literature lacks the explanation on the reasons for choosing the triangular structure during the reforms after the collapse of the Soviet Union, I believe that the lack of efficient dispute resolution infrastructure precluded the option of one-tier system, while the rigidity of German two-tier system did not provide enough flexibility to the newly established holders of large capital. The triangular structure gave the investors/shareholders the ability to hold most of the power and shape the internal structure of the corporation. Mandating the Supervisory Board was intended to serve as a cushion to play the role of liaison between shareholders and management, as well as more efficient supervision of management. The triangular structure has its deficiencies, such as decreased stability and lower job security of top management, and lower influence of the Supervisory Board due to inability to appoint the Management Board members. Nonetheless, this trade-off between allocating more power to the Supervisory Board or shareholders pays off in increased control and confidence of the shareholders in the corporations.

The chapter included the analysis of the general meeting of shareholders as a company organ. The second chapter has provided the analysis of the rights of individual shareholders and shareholders as a group in their interactions with the corporation. The general meeting of shareholders, however, is not to be viewed solely as a group of shareholders – this is an organ of the corporation in charge of the most important decisions
regarding the life of the corporation, while its competencies may be exercised only in a formal setting. All three jurisdictions provide that the fundamental decisions of the corporation are to be resolved by the general meeting of shareholders, however, the differences lie in the degree of involvement that the general meeting of shareholders may have with respect to regular decisions. In the United States, the focus is mostly on ratification in cases when the Board of Directors has either taken the decision or is unable to do so due to conflicts of interest. In Germany, though the general meeting of shareholders may not directly be involved in managerial decisions, the Management Board is to receive shareholder approval in case the decision substantially affects the rights of the shareholders, and the Management Boards of German corporations prefer to err on the side of caution in this matter. In Uzbekistan, general meeting of shareholders is both de jure and de facto “supreme authority” of the corporation, having extremely wide array of decision making powers. Most importantly, the general meeting of shareholders by default appoints and removes both Boards, and is able to delegate a number of competences to the Supervisory Board, and take them back if need be. This allows the general meeting of shareholders to increase or later decrease the influence of the Supervisory Board, which significantly changes the balance of powers within the corporation, which makes the general meeting of shareholders the ultimate decision maker of the corporation.

The analysis of the internal governance structure provided in the third chapter requires deeper analysis of the power dynamics within the corporation from the viewpoint of appointment and removal rights. Also, one should be wary of procedural issues, as well as practical considerations.

The chapter provides in-depth analysis of the procedural and substantive issues surrounding appointment and removal of members of the Management Board and the Supervisory Board in Germany, as well as the election of the Board of Directors in the United States, the Management Board and the Supervisory Board in Uzbekistan.

4.1. Appointment and removal of Supervisory Board in Germany

4.1.1. Nomination

In Germany, the nominations for the appointment of the members of the Supervisory Board may be made by the Supervisory Board, shareholders, and in certain cases by the Management Board.

Members of the ordinary Supervisory Board are nominated by the Supervisory Board itself\(^{973}\), or individual shareholders, provided that such request by shareholder(s) is sent to the corporation at least 24 days (30 days in listed corporations) prior to the date of the general meeting\(^{974}\). In co-determined Supervisory Boards, shareholder representatives of the Supervisory Board are nominated by the shareholders as described earlier; however, the employee representatives on the Supervisory Board are entitled to participate in any debate

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\(^{973}\) § 124(3) AktG.

\(^{974}\) § 127 AktG, referring to § 126 AktG.
on nominations to the Supervisory Board\textsuperscript{975}. In case certain shareholders are given the right to appoint and remove member(s) of Supervisory Board\textsuperscript{976}, nominations for such members are not made.

The nominations for the employee representatives on the Supervisory Board under the One-Third Co-Determination Act are made by members of the works council and the employees\textsuperscript{977}, under the Act of 1976 such nominations are made by the works councils and trade unions\textsuperscript{978}. The nominations for appointment by the court can be made by the Management Board, the Supervisory Board or a shareholder; in this case, the court is not obliged to choose from the given nominations\textsuperscript{979}. The nomination has to contain: name, profession, place of residence\textsuperscript{980}, additionally, in listed corporations the nomination has to contain posts in other Supervisory Boards and similar posts in foreign and domestic enterprises held by the nominee\textsuperscript{981}.

Although the members of the Management Board do not have the power to nominate candidates for the Supervisory Board\textsuperscript{982}, in fact, they heavily influence the selection and appointment of the Supervisory Board members\textsuperscript{983}.

Last, forming a nomination committee is expected by the corporate governance code\textsuperscript{984}.

\textbf{4.1.2. Appointment}

\textsuperscript{975} Dryander & Riehmer, supra note 781, at 96.  
\textsuperscript{976} For discussion of such right, see supra section 2.5.1.  
\textsuperscript{977} Such a nomination has to be signed by at least 100 employees or one-tenth of all eligible voters, see section 6 Dritteltbeteiligungsgesetz; Dryander & Riehmer, supra note 781, at 106.  
\textsuperscript{978} Dryander & Riehmer, supra note 781, at 106.  
\textsuperscript{979} Id. at 107.  
\textsuperscript{980} § 124(3) AktG.  
\textsuperscript{981} § 125 (1) AktG.  
\textsuperscript{982} Du Plessis et al., supra note 16, at 94.  
\textsuperscript{984} Du Plessis et al., supra note 16, at 94.
The members of the Supervisory Board in Germany are elected by the general meeting of shareholders, unless appointed by specific shareholders as defined in the articles of association, by employees, and in certain cases, by the court.

As a general rule, the general meeting elects the members of the Supervisory Board by simple majority of votes, unless the articles of association provide for a higher majority. If a right to appoint certain number of members is granted to specific shareholder(s), the general meeting does not participate in the appointment of such members.

Employee representatives in the corporations with more than 8000 employees are elected in two steps. The employees of each unit (e.g., separate factory) of the corporation elect their own candidate by secret ballot on the principle of proportional representation, the elected employees act as delegates and elect the employee representatives to the Supervisory Board. In corporations with more than 2000 but less than 8000 employees, the employee representatives are elected directly, however, the employees can opt for election by delegates. The employee representatives in the corporations with less than 2000 employees are directly elected by the employees by secret ballot.

In case of urgency or lack of quorum, the local court where the corporation has its registered office may step in and appoint the member(s) of the Supervisory Board. The court is obligated to appoint the member(s) to meet the quorum requirements, or when

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985 See supra section 2.5.1.
986 See supra section 3.2.2.
987 § 133 AktG.
988 § 133 AktG.
989 § 101(2) AktG, Dryander & Riehmer, supra note 781, at 107.
990 Id. at 106.
991 Id. at 106.
992 Id. at 106.
993 Section 5.1 of the Drittelbeteiligungsgesetz; Dryander & Riehmer, supra note 781, at 106.
994 Dryander & Riehmer, supra note 781, at 107.
the post on the Supervisory Board has been incomplete for more than three months. Additionally, the court appoints one or more members of the Supervisory Board in case of urgency; in co-determined corporations with parity representation, such urgency is presumed. Moreover, the court frequently appoints members of the Supervisory Board in post-takeover situations, when a significant number of the Supervisory Board members resign from the office. Regarding the process of appointment by the court, the court is not obliged to follow the nominations provided by the interested parties, however, in the majority of the cases, the Management Board will propose the candidates and frequently the court will appoint the person thus proposed. Status of the member appointed by the court is equal to interim – his/her mandate expires as soon as the regular member is appointed according to the rules.

In ordinary supervisory boards, as well as the corporations falling under the One-Third Co-Determination Act, the chairman of the Supervisory Board is elected by the Supervisory Board itself among its members by simple majority, while in corporations falling under the 1976 Act, the chairman is elected by the shareholders, and the vice-chairman is elected by the employees.

4.1.3. Requirements

The German law provides for strict and elaborate requirements for the members of the Supervisory Board, particularly with regard to holding multiple Supervisory Board and/or

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995 Id.
996 Id.
997 Id. at 108.
998 Id.
999 Du Plessis et al., supra note 16, at 95.
1000 Id.
1001 § 104(5) AktG; Dryander & Riehmer, supra note 781, at 108.
1002 § 107(1) AktG.
1003 Dryander & Riehmer, supra note 781, at 108.
Management Board positions in other enterprises.

Only a natural person with full legal capacity can become a member of the Supervisory Board\textsuperscript{1004}, and legal competence is presumed after 18\textsuperscript{th} birthday\textsuperscript{1005}; AktG does not put nationality or residence requirements\textsuperscript{1006}.

A member of the Management Board, Prokuristen, and holder of power of attorney, i.e., any person having the power to represent the corporation vis-à-vis third parties cannot be a member of the Supervisory Board of the same corporation; the same applies to the legal representative of a company which is controlled by the corporation\textsuperscript{1007}. AktG limits the number that an individual can hold in the Supervisory Boards to ten\textsuperscript{1008}, a position as a chairman of the Supervisory Board counts as two\textsuperscript{1009}. Moreover, the Corporate Governance Code recommends for the Management Board members of listed companies not to hold more than three Supervisory Board positions outside the Management Board member’s group of companies\textsuperscript{1010}. Interlocking posts are also disallowed, i.e., a legal representative of unaffiliated corporation cannot become a member of Supervisory Board of the corporation if the Supervisory Board of the unaffiliated corporation includes a member of the Management Board of the corporation in question\textsuperscript{1011}; the rationale of this rule is that such arrangement may result in two persons controlling each other, which would undermine the very purpose of separation of two boards\textsuperscript{1012}. Moreover, in listed corporations, the former member of the Management Board cannot be elected as a member of the Supervisory Board.\textsuperscript{1013}

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\textsuperscript{1004} § 100(1) AktG.
\textsuperscript{1005} §§ 2, 106 BGB.
\textsuperscript{1006} Dryander & Riehmer, supra note 781, at 97.
\textsuperscript{1007} § 100(2) AktG; Dryander & Riehmer, supra note 781, at 99.
\textsuperscript{1008} § 100(2) AktG; Dryander & Riehmer, supra note 781, at 97.
\textsuperscript{1009} § 100(2) AktG; Dryander & Riehmer, supra note 781, at 97.
\textsuperscript{1010} Section 5.4.5 of the German Corporate Governance Code. It is common for the members of the Management Board of the parent corporation to hold positions of Supervisory Board members in the companies belonging to the parent, Dryander & Riehmer, supra note 781, at 13.
\textsuperscript{1011} § 100(2) AktG; Dryander & Riehmer, supra note 781, at 100.
\textsuperscript{1012} Dryander & Riehmer, supra note 781, at 15.
Board of the same corporation for two years after expiration of his term on the Management Board\textsuperscript{1013}, unless such member is elected upon a nomination by shareholders having more than 25\% of voting shares of the corporation\textsuperscript{1014}.

While the AktG does not provide for professional requirements for the Supervisory Board members, section 5 of article 100 of AktG provides that in listed corporations at least one member must be independent and have expert knowledge in the fields of accounting or auditing\textsuperscript{1015}. The Corporate Governance Code defines independent member of the Supervisory Board as the one without any relation, business or personal, to the company or its Management Board that could potentially lead to a conflict of interests\textsuperscript{1016}. Special requirements may be provided in the articles of association only with regard to shareholder representatives on the Supervisory Board\textsuperscript{1017}.

If the corporation creates an Audit Committee as per the German Corporate Governance Code, the chairman of the Audit Committee must be experienced in international accountancy, and must also be independent, may not be a former member of the Management Board of the corporation within the last two years\textsuperscript{1018}.

\textbf{4.1.4. Size and composition}

The ordinary Supervisory Board must have at least three, but no more than 21 members\textsuperscript{1019}, in any case, the number must be divisible by three\textsuperscript{1020}. If the corporation does

\begin{footnotesize}
\begin{enumerate}
\item Dryander & Riehmer, supra note 781, at 14.
\item Id.
\item § 100(5) AktG.
\item Dryander & Riehmer, supra note 781, at 101.
\item Id.
\item Section 5.3.2 of the German Corporate Governance Code; Article 41.2 of 8th EU Directive on company law 2006/43/EC.
\item The maximum number of members of the supervisory board for companies with a share capital of: up to 1,500,000 euros – nine members, more than 1,500,000 euros – fifteen members, more than 10,000,000 euros – twenty-one members, § 95(1) AktG.
\item § 95(1) AktG.
\end{enumerate}
\end{footnotesize}
not fall under co-determination, the Supervisory Board is entirely composed of shareholder representatives\textsuperscript{1021}.

Size and composition of the co-determined Supervisory Board is determined by the applicable law on co-determination. As noted earlier, according to One-Third Co-determination Act, one-third of the corporations falling under the requirements have to be elected by the employees, and the size of the Supervisory Board is governed by the general rules. The Co-determination Act of 1976 provides for election of half of the Supervisory Board by the employees, its size in such case depends on the number of employees: in corporations with over 2,000 employees – 12 members, over 10,000 – 16 members, over 20,000 – 20 members respectively; nevertheless, any corporation falling under the requirements of the Act of 1976 can provide for a Supervisory Board consisting of 16 to 20 members in the articles of associations\textsuperscript{1022}. The Co-determination Act of 1976 does not provide for genuine parity – the chairman has a casting vote in case of tie, moreover, such cases are an exception rather than a rule\textsuperscript{1023}.

According to section 5 of the European Commission Recommendation of 15 February 2005 on the role of Non-executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board, formation of the following three committees within the Supervisory Board is recommended:

1. Nomination committee
2. Remuneration committee
3. Audit committee

This European Commission Recommendation is implemented in Germany in the Corporate Governance Code. The Audit Committee is mandated in Germany under the

\textsuperscript{1021} Dryander & Riehmer, supra note 781, at 96.
\textsuperscript{1022} Id., at 97.
\textsuperscript{1023} Such tie votes are damaging to the atmosphere in the Board, thus the system effectively forces the parties to reach a compromise long before a controversial vote arises, see Dryander & Riehmer, supra note 781, at 97.
German Corporate Governance Code\textsuperscript{1024}, and almost every listed corporation in Germany has an audit committee\textsuperscript{1025}. Creation of nomination committee composed exclusively of shareholder representatives is also recommended by the German Corporate Governance Code\textsuperscript{1026}, such committee recommends suitable candidates for Supervisory Board positions to the General Meeting of Shareholders\textsuperscript{1027}. A separate compensation committee may be created, however, is not mandatory\textsuperscript{1028}.

4.1.5. Term of office

In Germany, the members of Supervisory Board are elected for a term not exceeding five years\textsuperscript{1029}. German law does not allow holdover directors resembling the United States system\textsuperscript{1030}; hence, expiration of director’s term effectively ends his term of office.

4.1.6. Removal

The member of the Supervisory Board can cease to hold his post for three reasons: expiration of his office, removal from office by the person(s) who appointed him to the office or the court, and resignation. The member of the Supervisory Board has to leave his office if he is not re-elected and his appointment has ended, since unlike the United States, German law does not allow holdover directors.

The members of the Supervisory Board that are elected by the shareholders can be removed by the general meeting at any time without cause, however, removal from office

\textsuperscript{1024} Section 5.3.2 of German Corporate Governance Code.
\textsuperscript{1025} Dryander & Riehmer, supra note 781, at 97.
\textsuperscript{1026} Section 5.3.3 of German Corporate Governance Code.
\textsuperscript{1027} Id.
\textsuperscript{1028} Section 5.3.4 of German Corporate Governance Code.
\textsuperscript{1029} The members of the Supervisory Board may not be appointed for a period extending beyond the annual general meeting deciding on ratification of the acts of management for the fourth fiscal year after commencement of their term, the fiscal year in which their term started is not taken into account, § 102(1) AktG; Dryander & Riehmer, supra note 781, at 97.
\textsuperscript{1030} For a discussion on the holdover directors in the United States, see infra, section 3.4.3.4.
requires three-fourths of the votes\textsuperscript{1031}. This requirement may be lowered by the articles of association\textsuperscript{1032}, and many listed corporations provide for simple majority\textsuperscript{1033}. The employee representatives on the Supervisory Board can be removed from office by the employees directly or indirectly, depending on the procedure of election\textsuperscript{1034}.

The court where the company has its registered office can remove the member of the Supervisory Board for a due cause upon a motion by the majority of the Supervisory Board\textsuperscript{1035}, in case the member in question is appointed by specific shareholder(s), shareholder(s) possessing more than 10\% of the share capital or more than 1 milion EUR of share capital of the corporation can also file a motion\textsuperscript{1036}. Due cause exists in case of conflict of interest between the interests of the member of the Supervisory Board and the corporation\textsuperscript{1037} and gross violation of duties or any legal provisions, such as insider trading and direct interference in the actions of the Management Board\textsuperscript{1038}. Reduction of the size of the Supervisory Board is also a reason for a removal of the member of the Supervisory Board.

The member of Supervisory Board can resign before the end of his term at any time; the resignation does not require approval and is valid once declared to the Management Board. Moreover, the Corporate Governance Code requires resignation of the Supervisory Board member if there is a major conflict of interest\textsuperscript{1039}.

4.2. Appointment and removal of the Management Board in Germany

\textsuperscript{1031} 103(1) AktG.
\textsuperscript{1032} Id.
\textsuperscript{1033} Dryander & Riehmer, supra note 781, at 110.
\textsuperscript{1034} For the procedures of electing the employee representatives see supra section 3.1.2.
\textsuperscript{1035} § 103(3) AktG.
\textsuperscript{1036} § 103(3) AktG.
\textsuperscript{1037} Section 5.5.3 of the German Corporate Governance Code; Dryander & Riehmer, supra note 781, at 110.
\textsuperscript{1038} Dryander & Riehmer, supra note 781, at 110.
\textsuperscript{1039} Section 5.5.3 of the German Corporate Governance Code.
4.2.1. Service agreement

It is generally agreed that the members of the Management Board perform their functions under the service contract within the meaning of sections 611 and 675 of the German Civil Code. For the purposes of labour law, since the members of the Management Board act as employers, they are not considered as employees, thus, the employee protection regulations of German labour law do not apply to members of the Management Board.

The members of Management Board have two legal relationships with the corporation: appointment to the management as an act of corporate law (Bestellung), and the service agreement which creates the contractual relationship between the corporation and the board member (Anstellungsvertrag). The first agreement serves as a legal basis for a person to become a Management Board member and thereby represent the corporation vis-à-vis third parties, while the latter stipulates the terms outside of mandatory statutory provisions. The service agreement may cover compensation, benefits, covenants not to compete after expiration of contract, D&O insurance and outside activities of the Management Board member.

The two legal acts usually coincide, but since they are legally separate, termination...
of one of the agreements does not automatically lead to termination of the other. Nonetheless, it is a usual practice in drafting such legal acts to provide for a correlation, i.e., termination of the appointment automatically terminates the service agreement.

4.2.2. Appointment (election)

The members of the Management Board in Germany are appointed by the Supervisory Board; no other persons may have such right, only in urgent cases, the court may appoint an interim member.

Appointment of the Management Board members is made by a resolution of the Supervisory Board as a whole by a simple majority. This power cannot be delegated to any committee of the Supervisory Board or any other third person; furthermore, the appointment by the Supervisory Board cannot be subject to approval of any third person including controlling shareholder or parent enterprise.

In co-determined corporations, the members of the Management Board are elected by two-third majority of the Supervisory Board, if such appointment is not successful, then the nominations are presented at the next meeting of the Supervisory Board by a special mediation committee consisting of the chairman, deputy chairman, one shareholder representative and one employee representative of the Supervisory Board. The nominees proposed by the mediation committee are then elected by simple majority of

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1047 Id., at 11.
1048 Id., at 12.
1049 Id., at 14.
1050 However, ordinarily the majority shareholder is consulted before such appointment is made, see Dryander & Riehmer, supra note 781, at 15.
1051 Id.
1052 Id.
1053 Du Plessis et al., supra note 16, at 64.
votes\textsuperscript{1054}, and in case of deadlock, the chairman of the Supervisory Board, who is a shareholder representative, has the casting vote\textsuperscript{1055}.

In urgent cases, upon application of interested parties, provided that the Supervisory Board is unable to fill the vacancy of member of the Management Board quickly enough, the competent local court may appoint member(s) of the Management Board\textsuperscript{1056}. The test is whether it is necessary to fill the position for the corporation to be managed properly or to be able to act \textit{vis-à-vis} third parties\textsuperscript{1057}, for instance in the case of resignation or death of a member. The status of court-appointed members is the same as the status of other members with regard to rights and duties, however, their term of office ends automatically without dismissal as soon as the vacancy filled by the court-appointed member is properly filled by the Supervisory Board.

The Supervisory Board also appoints the chairman\textsuperscript{1058} and may appoint deputy members of the Management Board\textsuperscript{1059}. According to the 1976 Act, the Supervisory Board also appoints a labour director (\textit{Arbeitsdirektor}), responsible for all personnel matters and social issues, who cannot be appointed, however, against the vote of the employee representatives on the Supervisory Board\textsuperscript{1060}.

\section*{4.2.3. Requirements}

Only a natural person with full legal capacity can become a member of the Supervisory Board.

\begin{footnotes}
\item[1054] Dryander & Riehmer, supra note 781, at 15.
\item[1055] Id.
\item[1056] § 85 AktG; Dryander & Riehmer, supra note 781, at 15.
\item[1057] §§ 81 et seq. AktG; Dryander & Riehmer, supra note 781, at 15.
\item[1058] § 84(2) AktG.
\item[1059] Dryander & Riehmer, supra note 781, at 11.
\item[1060] Id., at 10.
\end{footnotes}
Management Board\textsuperscript{1061}; although no nationality or residence requirements are provided, it is advised that the person is able to freely reside and work in Germany\textsuperscript{1062}. The German Corporate Governance Code provides that the corporations must specify an age limit for the members of Management Board\textsuperscript{1063}.

With regard to criminal convictions, a person convicted of certain offences with regard to insolvency and misrepresentation\textsuperscript{1064} cannot be a member of the Management Board for five years after the conviction has become binding\textsuperscript{1065}; moreover, the persons barred by the court to conduct activities similar to ones performed by the corporation also cannot be members of the Management Board for the period specified so by the court\textsuperscript{1066}.

Simultaneous appointment of the same person in Management and Supervisory Board of the same corporation is also not allowed, since such appointment would conflict with the two-tier structure of the German corporation\textsuperscript{1067}. A person cannot hold more than one position in Management Boards\textsuperscript{1068}; for multiple appointments, the Supervisory Boards of both (or all) corporations must consent to such appointment\textsuperscript{1069}. The disadvantage of holding multiple positions is, \textit{inter alia}, the inability to vote in case of conflict of interest transactions\textsuperscript{1070}. Limitations on multiple positions held by the member of Management Board in Supervisory Boards of other enterprises have been discussed before\textsuperscript{1071}.

Special rules apply in case of corporate groups – a member of the Management Board...
Board of the controlled corporations cannot be a member of the Supervisory Board of the controlling corporation, while the reverse is allowed. It is a common practice to provide for additional requirements for the members of the Management Board in the articles of association.

### 4.2.4. Size and composition

The Management Board can consist of one or more persons, while the articles of association must provide for the number of members, or rules on determining such number. It is also possible to provide for minimum and maximum number in the articles of association and allow the Supervisory Board to determine the number within the given range. For corporations with more than three million Euros of registered share capital, the Management Board has to be composed of two members, unless the articles of association provide for one member. Since co-determined corporations falling under the 1976 Act are required to appoint a labour director (Arbeitsdirektor), co-determined corporations in any case will have at least two members of the Management Board. Banks, financial firms and insurance companies have to have at least two members regardless of their co-determination status. The German Corporate Governance Code also requires the corporations to respect diversity, in particular with respect to including women in the Management Boards of listed corporations.

The average size of the Management Board in German corporations was 5.1

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1072 Dryander & Riehmer, supra note 781, at 13.
1073 Id.
1074 Id., at 9.
1075 Id.
1076 § 76(1) AktG.
1077 Dryander & Riehmer, supra note 781, at 10.
1078 Id., at 9.
1079 Section 4.1.5 of the German Corporate Governance Code; see also Du Plessis et al., supra note 16, at 63.
members in 1979 and 4.8 in 2004\textsuperscript{1080}, the Management Board had more than eight members only in 4\% of the corporations\textsuperscript{1081}. The difference in the size of the Management Board between co-determined and not con-determined corporations is not significant\textsuperscript{1082}.

4.2.5. Term of office

The term of office of the member of the Management Board starts at the time mentioned in the appointment resolution, while the registration in the commercial register may take effect later\textsuperscript{1083}.

While AktG does not provide for a minimum term of office\textsuperscript{1084}, the maximum term cannot exceed five years\textsuperscript{1085}. Reappointment of a member will require a new resolution by the Supervisory Board\textsuperscript{1086}; in case the member is appointed for less than five years, the Supervisory Board can provide for an extension of the term up to five years in total\textsuperscript{1087}. The German Corporate Governance Code suggests that the appointment of the Management Board for the first time should be less than 5 years, having a type of a probation period\textsuperscript{1088}.

4.2.6. Removal

The members of the Management Board can cease to hold their post for three reasons: expiration of the term of his office, resignation, and removal from office. A person ceases to be a member of the Management Board when his/her term of office expires and he/she is not re-appointed by the Supervisory Board\textsuperscript{1089}, since German law does not allow holdover directors.

\textsuperscript{1080} Du Plessis et al., supra note 16, at 61.
\textsuperscript{1081} Id.
\textsuperscript{1082} Id.
\textsuperscript{1083} Id.
\textsuperscript{1084} Id.
\textsuperscript{1085} § 84(1) AktG.
\textsuperscript{1086} Id.
\textsuperscript{1087} Id.
\textsuperscript{1088} Section 5.1.2 of the German Corporate Governance Code; see also Du Plessis et al., supra note 16, at 63.
\textsuperscript{1089} Du Plessis et al., supra note 16, at 66.
With regard to removal of Management Board members, the members of the Management Board are removed by a resolution of the Supervisory Board accepted by simple majority\textsuperscript{1090}. In order to ensure the independence of the Management Board\textsuperscript{1091}, the members of the Management Board may be removed only for cause\textsuperscript{1092}. The “cause” for removal of Management Board member is widely defined, and does not require that the Management Board member “has acted culpably in the sense of being personally responsible; cause may also be based upon the Management Board member’s conduct outside of board activities or prior to taking office” \textsuperscript{1093}.

The AktG provides for a non-exhaustive list of causes for removal: gross violation of duties, inability to manage the AG properly, and vote of no-confidence by the general meeting. The Stuttgart Court of Appeals held that writing unauthorized checks is a gross violation of duties and is a good reason for removal of a Management Board member\textsuperscript{1094}. If a corporation exercises a crisis that cannot be resolved by the current members of the Management Board, it is an example of inability or incompetence of the Management Board member(s) and is considered as a cause to remove the member(s) of the Management Board\textsuperscript{1095}. A vote of no-confidence by the general meeting is also a cause for the Supervisory Board to remove the member of the Management Board, unless such vote is apparently unfounded\textsuperscript{1096}.

In addition, due cause exists if there are irrevocable differences between the

\textsuperscript{1090} Dryander & Riehmer, supra note 781, at 18.
\textsuperscript{1091} Id.
\textsuperscript{1092} 84(3) AktG.
\textsuperscript{1093} Dryander & Riehmer, supra note 781, at 19.
\textsuperscript{1095} Du Plessis et al., supra note 16, at 65.
\textsuperscript{1096} Id.
Supervisory Board and the Management Board with regard to fundamental decisions, such as company policy or the business direction of the corporation\textsuperscript{1097}; however, the Supervisory Board cannot remove member(s) of the Management Board solely because the Supervisory Board does not agree with the decision of the Management Board\textsuperscript{1098}. Moreover, the grounds for removal cannot be circumvented by including a term in the contract providing for removal without cause\textsuperscript{1099}.

The labour director of the corporation is appointed and dismissed in the same way as other Management Board members\textsuperscript{1100}. The workers of the corporation, trade unions and employee representatives on the Supervisory Board do not have special veto rights with respect to removal of the labour director\textsuperscript{1101}.

A member of the Management Board can resign from his position; such resignation is effective from its receipt by the Supervisory Board and does not require approval by the Supervisory Board, Management Board or any other organ\textsuperscript{1102}.

4.3. Appointment and removal of the Board of Directors in the United States

As noted earlier, the corporate laws in the United States are “enabling” laws, and not all aspects of internal governance structure are regulated by state laws\textsuperscript{1103}. Hence, the section will cover the provisions and requirements of the state law, as well as the case law interpreting these laws, and, where necessary, the SEC rules and listing standards will be

\textsuperscript{1097} Id., at 66.
\textsuperscript{1098} Id.
\textsuperscript{1099} Id.
\textsuperscript{1100} AktG 84 (4); Dryander & Riehmer, supra note 781, at 11.
\textsuperscript{1101} Dryander & Riehmer, supra note 781, at 11.
\textsuperscript{1102} Id., at 17.
\textsuperscript{1103} “[S]tate corporation statutes are silent on the issue of board composition, issues such board size, director qualifications and independence are left to private ordering”, see Bainbridge, Corporate Governance after the Financial Crisis, supra note 424, at 79.
4.3.1. Service agreement

Since a director of the corporation serves as an employer with regard to the employees of the corporation, he/she is not an employee of the corporation merely by the virtue of his/her position. With respect to the officers of the corporation, an officer is not an employee of the corporation as a matter of law by virtue of his office, and whether a corporate officer is an employee depends on the nature of the relationship between the corporation and the officer.

4.3.2. Appointment (election)

The directors in the United States corporations can be elected to their office by the shareholders or the Board of Directors; the powers of the court with regard to corporate elections are limited to rejection or approval of the election of directors, and do not include power to appoint directors directly. With respect to election of directors an important distinction should be made between annual re-election or election of directors, and filling the newly created directorship or vacancies. All directors are re-elected annually (unless the board is staggered), while the new directorships may be created with increase in the size of the Board of Directors, and vacancies may appear if one or more directors resign from their office prior to the expiration of their term of office.

At common law, the election of directors was an exclusive function of the

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1104 “[M]any mandatory details of corporate governance now come from exchange listing standards rather than the more vague and enabling state law”, see Bainbridge, Corporate Governance after the Financial Crisis, supra note 424, at 81.


1106 Id.

1107 Id.
shareholders, and the Board of Directors could not elect directors\textsuperscript{1108}. The courts in the United States for more than a century have held that shareholders have the inherent power to elect directors\textsuperscript{1109}; even if the charter or the bylaws give the Board of Directors the power to appoint directors, such provision does not preclude the shareholders to overrule this provision and appoint directors on their own\textsuperscript{1110}. Moreover, election ex-post shareholder ratification of a voidable election by majority of the shareholders cures the defects\textsuperscript{1111}. The Board of Directors may, in certain cases, appoint directors when there is a vacancy or a directorship created via increase in the size of the Board of Directors, although even in this case the shareholders retain the inherent right to appoint directors for newly created directorships\textsuperscript{1112}. Under the MBCA, the Board of Directors has a right to appoint directors to fill the newly created directorships or vacancies only if an explicit provision existing in the charter or bylaws of the corporation\textsuperscript{1113}. Under DelGCL, while the Board of Directors may fill vacancies, the power to fill vacancies resides inherently with the shareholders\textsuperscript{1114}.

Under both MBCA and DelGCL, the directors can be elected by all shareholders collectively, or by a certain class of shareholders; each class can be given a right to elect a specified number of directors\textsuperscript{1115}. Thus, e.g., in \textit{Insituform of North America, Inc. v. Chandler}, the court upheld the right of one class of shareholders to elect 2/3 of the Board of Directors,

\textsuperscript{1108} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-101.
\textsuperscript{1110} DiEleuterio v. Cavaliers of Delaware, Inc., C.A. No. 8801, slip op. at 16 (Del. Ch. Feb. 9, 1987).
\textsuperscript{1112} DiEleuterio v. Cavaliers of Delaware, Inc., C.A. No. 8801, slip op. at 16 (Del. Ch. Feb. 9, 1987).
\textsuperscript{1113} “Absent an explicit provision allowing the Board of Director to fill vacancies or newly created directorships, it is probable that only the shareholders may fill the vacancy or newly created directorships”, see Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-101; “[S]hareholders have the power under the New York law to elect directors to fill newly-created directorships”, Campbell v. Loew’s, Inc., 36 Del. Ch. 563; 134 A.2d 852 (1957).
\textsuperscript{1115} MBCA 8.04, DelGCL 141(b).
while the other class could elect the remaining 1/3 of the Board\textsuperscript{1116}.

\textit{Appointment by the court}

Neither MBCA nor DelGCL allow appointment of directors by the court. DelGCL provides that if a vacancy appears on the Board of Directors, the Board of Directors fills the vacancy\textsuperscript{1117}. If the Board of Directors does not have a quorum\textsuperscript{1118} or even if no directors are left in the office, a general meeting must be held and directors should be elected accordingly\textsuperscript{1119}.

In \textit{Jacobs v. Ostow & Jacobs, Inc.}, the court has held that the powers of the court with respect to the election of the directors of the corporation are limited to confirming the election or requiring a new election; even if a deadlock occurs, the court may not neither order election of a director nor appoint a director\textsuperscript{1120}.

\textbf{4.3.3. Requirements}

\textit{State law requirements}

Elimination of mandatory qualifications for directors in the state corporation laws is universal in the United States\textsuperscript{1121}. The MBCA does not provide, and has never provided for any requirements with regard to qualifications of directors\textsuperscript{1122}. DelGCL provides that only a natural person may be a member of a Board of Directors; with regard to any other qualifications, the Delaware court has ruled that:

“fitness or unfitness of individuals to become directors of the corporation [is] a matter for the stockholders. . . and it would be highly improper . . . for the court

\textsuperscript{1116} Insituform of North America, Inc. v. Chandler, 534 A.2d 257 (Del. Ch. 1987).
\textsuperscript{1117} DelGCL 223(d).
\textsuperscript{1118} DelGCL 223(C).
\textsuperscript{1119} DelGCL 223(a).
\textsuperscript{1121} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-26.
\textsuperscript{1122} Id., at 8-27.
to pay and heed whatever to charges and counter charges concerning the
fitness of either one group or the other of the two factions” 1123.

Under both MBCA and DelGCL, a director need not be a resident of the state of
incorporation 1124 or a shareholder of the corporation, unless the articles of incorporation or
the bylaws so require 1125. Under the MBCA, however, the court may bar the directors from
reelection for a certain period prescribed by the court 1126.

4.3.4. Size and composition

Both MBCA and DelGCL provide that the Board of Directors of the corporation shall
consist of one or more members, each of whom is a natural person 1127. Similarly, both
statutes provide for a possibility to fix a number, or establish a manner in which such
number can be determined in the charter or bylaws 1128.

In the case when the Board of Directors has the power to change the number of
directors, the Delaware court has held that it is inappropriate to change the size of the
board with the primary purpose of maintaining control or defeating a particular candidate
to the Board of Directors 1129.

With regard to corporate matters, the shareholders can act on general meetings
(both annual and extraordinary), or act via written consent 1130. Shareholder actions via non-
unanimous written consent are common in public corporations, and are used to elect and

1123 In re Gulla, 115 A. 317, 320 (Del. Ch. 1921).
1124 Welch et al., supra note 349, at 265.
1125 MBCA 8.02; Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-26; DelGCL 141(b),
see also Welch et al., supra note 349, at 265.
1126 MBCA 8.09(c).
1127 MBCA 8.03(a), DelGCL 141(b).
1128 MBCA 8.03(a), see also Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-32-33;
DelGCL 141(b), see also Welch et al., supra note 349, at 263.
1129 Blasius Industries, Inc. v. Atlas Corp. 564 A.2d 651 (Del.Ch. 1988), for elaboration see Model Business
Corporation Act Annotated, supra note 16, Volume 3, at 8-33.
1130 DelGCL 228(a).
remove directors of the corporation. In the case of shareholder action taken by non-unanimous written consent, the directorships that are to be filled need to be vacant. In a recent case, the Delaware court has ruled that the decision to reduce the size of the Board of Directors taken by non-unanimous consent does not equal to removal of directors, i.e., if the number of directors is lowered by a bylaw or charter amendment, it does not end the incumbent director’s term; the shareholders, who wish to end the incumbent’s term, should first remove the directors in the appropriate manner. Moreover, under the MBCA, the decrease in the number of directors does not shorten the term of the incumbent director. The Securities Exchange Act requires that every listed corporation must have an audit committee entirely composed of independent directors.

4.3.5. Term of office

Under both DelGCL and MBCA, directors are elected each year at the annual general meeting of shareholders, however, their terms may be staggered (classified), and in which case only a fixed proportion of the total number is elected every year. Most commonly, the staggered boards consist of three classes, each elected on annual basis;
hence each director holds the office for three years. The purpose of the staggered boards is to assure the continuity and stability of the corporate strategies and policies, and staggered boards are frequently used in public corporations in the United States.

According to holdover doctrine, the term of office of the incumbent director does not automatically end at the end of his appointment, and such director remains in office until his successor is elected. The holdover doctrine is supported by the DelGCL, MBCA and the case law decided under both statutes.

In North Fork Bancorp., Inc. v. Toal, the court considered whether the incumbent directors would serve as holdovers in a staggered board of directors for a full term of three years, rather than till the next annual general meeting. Since the court held that incumbent directors were not properly re-elected at the general meeting due to mistreatment of proxy cards, the judge clearly stated:

“I reject any suggestion that the five holdover directors should stay in office for an additional 3-year term. To hold otherwise would be inconsistent with the conclusion that they were not elected at the 2000 Meeting.”

Hence, the incumbent director, regardless of the staggered nature of the Board Directors, may not hold the office for a full term, and shall be replaced by a new director (or re-elected in a proper manner) at the next general meeting of shareholders.

4.3.6. Removal

DelGCL 141(b)
However, the articles of incorporation can change the holdover rule, see MBCA 8.05(e).
This general rule that directors “hold over” in office until their successors are validly elected was stated in Halle & Stieglitz, Filor, Bullard, Inc. v. Empress International, 442 F. Supp. 217 (D. Del. 1977); Blue Ridge Property Owners Association, Inc. v. Miller, 216 Va. 611, 221 SE2d 163 (1976); Dillon v. Scotten, Dillon Co., 335 F. Supp. 566 (D. Del. 1971); Western Cottage Piano & Organ Co. v. Burrows, 144 111. App. 350 (1908); New York, Bridgeport & Eastern Railway Co. v. Motil, 81 Conn. 466 71 A. 563 (1908).
North Fork Bancorp., Inc. v. Toal, 825 A.2d 860 (Del. Ch.); Welch et al., supra note 349, at 266.
A director may cease to hold office for three reasons – expiration of the term of his office, removal from office, and resignation\textsuperscript{1146}, and the section will discuss the last two issues in detail, since the first one was discussed above. With regard to expiration of office, as noted earlier, holdover rule applies for all directors, and they remain in office until they are re-elected, removed, or their successor is elected to the office. Although the MBCA and DelGCL diverge on the issue of removal, resignation is treated similarly.

\textit{Removal for cause and without cause}

In common law, the directors had a statutory entitlement to their office and could be removed only for cause: gross abuse of office amounting to a breach of trust or similar conduct\textsuperscript{1147}. The power to remove the directors for cause was viewed as the inherent power of the shareholders\textsuperscript{1148}, since “no stockholder should be forced to suffer governance by a director whose malfeasance or neglect of duty rises to the level sufficient to justify a for cause removal”\textsuperscript{1149}. Moreover even if the articles of incorporation give the Board of Directors the power to remove the directors, the shareholders retain the inherent right to remove the directors for cause\textsuperscript{1150}.

The common law principles relating to removal of directors were enumerated in \textit{Abberger v. Kulp}\textsuperscript{1151}:

- regardless of provisions in the charter or bylaws, a director may be removed for cause arising from his acting contrary to the interests of the corporations;
- during his term of office a director may not be removed without a cause unless a bylaw so providing existed when he took office, in which case, he took office subject to bylaw;

\textsuperscript{1146} DelGCL 141(b); Welch et al., supra note 349, at 264.
\textsuperscript{1147} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-77-78.
\textsuperscript{1148} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-77-78.
- a corporation may adopt a bylaw providing for removal without cause, but that bylaw will not affect directors then in office;
- a director elected when there was no bylaw for removal without cause has a vested right to continue in office unless he is removed for cause;
- if a bylaw provides for removal, the provisions of the bylaw must be followed before removal can be effected.\textsuperscript{1152}

Even if the articles of incorporation give the board of directors the power to remove the directors, the shareholders retain the inherent right to remove the directors for cause.\textsuperscript{1153}

MBCA\textsuperscript{1154} and DelGCL\textsuperscript{1155} have allowed removal without cause (unless provided otherwise in the charter) with certain exceptions. Under MBCA and DelGCL, the directors can be removed only for cause if the director is elected by cumulative voting.\textsuperscript{1156} In case of staggered boards, under the DelGCL, the directors can be removed only for cause, unless the charter provides otherwise.\textsuperscript{1157}

\textit{Removal by shareholders}

Under the MBCA, a director may be removed by the shareholders,\textsuperscript{1158} in case the director is elected by a separate class of shares, such director may be removed only by the majority of the shareholders of that class of shares\textsuperscript{1159} and only if the purpose of removing a director was explicitly stated in the agenda of the general meeting.\textsuperscript{1160}

Under the DelGCL, any director or the entire board may be removed by the majority of the shares, unless the Board of Directors is classified or certain directors are elected by

\begin{footnotes}
\item \textsuperscript{1152} Abberger v. Kulp, 156 Misc. 210, 281 N.Y.S. 373 (Supp. Ct. 1935); Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-87.
\item \textsuperscript{1153} Auer v. Dressel 306 N.Y. 427, 118 N.E.2d 590 (N.Y. 1954); Toledo Traction, Light & Power Co. v. Smith, 205 F. 643 (D. Ohio 1913).
\item \textsuperscript{1154} DelGCL 141(k).
\item \textsuperscript{1155} DelGCL 141(k)(2); MBCA 8.08(c).
\item \textsuperscript{1156} DelGCL 141(k)(1).
\item \textsuperscript{1157} DelGCL 141(k)(1).
\item \textsuperscript{1158} MBCA 8.08(a).
\item \textsuperscript{1159} MBCA 8.08(a).
\item \textsuperscript{1160} J. M. Clayton v. Martin, 339 SE2d 280 (Ga. App. 1985).
\end{footnotes}
the shareholders using cumulative voting. Delaware courts have recognized the power to elect and remove directors of the corporation as “fundamental element of stockholder authority.” In Bruch v. National Guarantee Credit Corp, the Delaware court held that the directors do not have any vested rights to hold their office; hence the power to remove a director ultimately rests within the shareholders, and not the Board of Directors. With respect to removing directors on the staggered board, in Roven v. Cutler, the Delaware court ruled that shareholders may amend the certificate of incorporation to remove a director that is on a staggered board, since no director has a vested right to hold his office.

Both MBCA and DelGCL pay special attention to removal of directors elected by cumulative voting. In order to protect the representatives of the minority shareholders, both MBCA and DelGCL provide for special requirements for removal of such directors. Under both statutes, the directors elected by cumulative voting cannot be removed without cause if number of votes cast against his removal would be enough to elect the same director by using cumulative voting. This provision protects the directors from the influence of the majority shareholders, and ensures effectiveness of the cumulative voting provision.

Nonetheless, the directors elected by cumulative voting can be removed for cause. In Campbell v. Loew’s, Inc., the Delaware court held that regardless of the cumulative voting

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1161 DelGCL 141(k)(1).
1165 MBCA 8.08(c), DelGCL 141(k)(2).
provision, the shareholders retain the right to remove the directors for cause\textsuperscript{1166}.

\textit{Removal by Board of Directors}

The Board of Directors may be given a right to remove one or more directors by the charter or bylaws, although the shareholders retain the inherent right to remove the directors for cause\textsuperscript{1167}. Delaware courts have ruled that if a Board of Directors would be allowed to remove one of its own directors without cause, it would be “completely violative of shareholder rights, Delaware statutes and public policy”\textsuperscript{1168}.

\textit{Removal by the court}

While the MBCA provides for grounds for removal by the court\textsuperscript{1169}, the DelGCL does not have a comparable provision empowering the court to remove a director\textsuperscript{1170}.

MBCA 8.09 allows removal of a director of the corporation in very limited circumstances, since it is originally designed to interfere as little as possible with the internal affairs of the corporation, and is applied only if other remedies are inadequate to constrain the director. Hence, if shareholders, with full knowledge of the facts that are described above, have chosen to re-elect the director, or declined to remove this director, the court cannot remove a director of the corporation\textsuperscript{1171}.

 Nonetheless, in certain cases, the general meeting of shareholders is not capable of effectively removing a director charged with serious misconduct due to substantive or

\textsuperscript{1166} Campbell v. Loew’s, Inc., 36 Del. Ch. 563; 134 A.2d 852 (1957); see also Model Business Corporation Act Annotated, supra note 16, Volume 2, at 7-222
\textsuperscript{1169} “[I]n the absence of fraud or statutory authority, court no inherent equitable power to remove a director”, Feldman v. Pennrod Corp., 60 F. Supp. 716, 719 (D. Del. 1945), affirmed, 155 F.2d 773 (3d Cir. 1946), cert, denied, 329 US 808 (1947).
\textsuperscript{1170} Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-96.
\textsuperscript{1171} Id., at 8-92.
procedural difficulties, including but not limited to the cases when:

- the director in question controls a number of shares enough to block removal;
- the director in question was elected by voting group or cumulative voting, and the shareholders holding sufficient shares to block his removal are acting contrary to the best interests of the corporation;
- calling a general meeting will require substantial amount of time or money, which will be contrary to the corporation’s best interests.

Thus, in such cases, removal of a director by the general meeting of shareholders may not be an appropriate remedy, and under the MBCA, the court may remove one or more directors on the basis of application by shareholder(s) or the Board of Directors if

“the director engaged in fraudulent conduct with respect to the corporation or its shareholders, grossly abused the position of director, or intentionally inflicted harm on the corporation; or considering the director’s course of conduct and the inadequacy of other available remedies, removal would be in the best interest of the corporation.”

Resignation

Both MBCA and DelGCL allow resignation of the directors currently in the office at any given time, and such resignation is effective when delivered, unless expressly mentioned so in the resignation. MBCA requires “written notice”; DelGCL allows notice in writing as well as sent by electronic means of communication, moreover, the

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1173 MBCA 8.09(a).
1174 MBCA 8.09(b); “A proceeding under this section may be brought by the board of directors or by a shareholder suing derivatively”, Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-92.
1175 MBCA 8.09(a).
1176 MBCA 8.07(a), DelGCL 141(b).
1177 MBCA 8.07(b), DelGCL 141(b).
1178 A resignation may specify “a later effective date or an effective date determined upon the happening of an even or events. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable”, see MBCA 8.07(a), DelGCL 141(b).
1179 MBCA 8.07(b); see also Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-68-69.
1180 DelGCL 141(b); Welch et al., supra note 349, at 267.
Delaware court even has ruled oral resignation to be effective\textsuperscript{1181}. Director’s resignation must be unequivocal, must be communicated to the corporation\textsuperscript{1182}, and does not require an approval of the Board of Directors or any other person to be effective\textsuperscript{1183}. In the following cases, the validity and effect of the resignation were challenged.

In \textit{Smith v. Great Basin Grain Co.}\textsuperscript{1184}, the argument was made before the court that the resignation of directors was invalid, as no successors had been elected; hence, the resigned directors may serve as holdover directors. The court rejected the argument holding that the resignation is effective immediately, unless a later effective date or a happening of an event were explicitly conditioned, and it is sufficient that a director give notice of intent to resign\textsuperscript{1185}.

In \textit{Dillon v. Berg}\textsuperscript{1186}, a director secretly gave an undated letter of resignation only to the chairman of the Board of Directors of the corporation as a part of the deal, when the undated letter of resignation was required from the director by the chairman as a prerequisite for running the said director’s nomination for re-election. Later, the director withdrew his resignation; however, the chairman dated the resignation letter prior to withdrawal. The court held that the resignation of the director cannot be deemed effective, and cannot constitute a notice delivered to corporation when the agent of the corporation, to whom such resignation was delivered, had personal interests in the matter that were

\begin{itemize}
  \item \textsuperscript{1181} Dionisi v. De Campli, C.A. No. 9425 (Del. Ch. June 28, 1995), cited in Welch et al., supra note 349, at 267, note 741.
  \item \textsuperscript{1182} “[N]otice to the corporation ... means actual written notice to each and every member of board of directors or actual written notice to agent of corporation, such as its chairman of the board, president, or secretary”, see Dillon v. Berg, 326 F. Supp. 1214, 1224 (D. Del. 1971), affirmed, 453 F.2d 876 (3d Cir. 1971), at note 6.
  \item \textsuperscript{1183} “Under Delaware law acceptance is no longer essential to effect valid resignation by director”, see Dillon v. Berg, 326 F. Supp. 1214, 1224 (D. Del. 1971), affirmed, 453 F.2d 876 (3d Cir. 1971), at note 4.
  \item \textsuperscript{1184} In Smith v. Great Basin Grain Co., 98 Idaho 266, 281, 561 P.2d 1299, 1314 (1977).
  \item \textsuperscript{1185} In Smith v. Great Basin Grain Co., 98 Idaho 266, 281, 561 P.2d 1299, 1314 (1977); see also Model Business Corporation Act Annotated, supra note 16, Volume 3, at 8-73.
\end{itemize}
substantially adverse to corporation’s interests as well\textsuperscript{1187}.

4.4. Appointment and removal of the Supervisory Board in Uzbekistan

4.4.1. Nomination

In Uzbekistan, the body having the default power to nominate members for the Supervisory Board is not explicitly provided. Nonetheless, due to the fact that the Supervisory Board is in charge of preparing the agenda of the general meeting\textsuperscript{1188}, and the information sent to the shareholders before the general meeting has to contain the nominations for members of the Supervisory Board\textsuperscript{1189}, it can be inferred that the Supervisory Board has the default power to nominate members for the Supervisory Board. Moreover, the shareholders having more than 1\% of the voting shares of the corporation have the right to propose their own candidates directly\textsuperscript{1190}. In case the general meeting is called by person(s) other than the Supervisory Board\textsuperscript{1191}, these persons have the right to prepare the agenda, and hence include their own nominees for the Supervisory Board; in this case the acting Supervisory Board cannot change the agenda of the general meeting.

A nomination has to include: name, number and types of shares that belong to the nominee (if any), and names of the shareholders advancing the nominee, as well as the number and types of shares belonging to such shareholders\textsuperscript{1192}. Nomination of members of the Supervisory Board and the Inspection Committee are governed by the same rules, hence the rules described above apply to the nomination of the Inspection Committee members.

\textsuperscript{1188} Art. 71 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1189} Art. 69 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1190} Art. 72 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1191} Shareholder(s) having more than 10\% of voting shares and the Inspection Committee, see Art. 71 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1192} Art. 70 of the Uzbek Law on Joint-Stock Companies.
4.4.2. Appointment (election)

In Uzbekistan, the members of the Supervisory Board are elected by the general meeting of shareholders\textsuperscript{1193} using cumulative voting\textsuperscript{1194}. The government representative on the Supervisory Board is appointed by the relevant government institution and his appointment does not require consent of the general meeting\textsuperscript{1195}. Moreover, the law does not prohibit delegation of power to appoint members of the Supervisory Board to specific shareholders.

If the quorum of the Supervisory Board is not reached, i.e., the number of members of the Supervisory Board falls below 75\%\textsuperscript{1196}, the Supervisory Board has a duty to call the general meeting of shareholders to fill the vacancies. The court or a government authority is not allowed to appoint members of Supervisory Board\textsuperscript{1197}.

The chairman of the Supervisory Board is elected by the Supervisory Board from the current members by a simple majority\textsuperscript{1198}, however, the articles of association can provide for different rules with respect to election of the chairman\textsuperscript{1199}.

4.4.3. Requirements

In Uzbekistan, following persons cannot be elected as members of the Supervisory Board: members of the Management Board and the Inspection Committee of the corporation in question, and any other person having a labour contract with the

\textsuperscript{1193} Art. 65 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1194} Art. 76 and 83 of the Uzbek Law on Joint-Stock Companies. For a discussion on cumulative voting see supra section 2.5.2.
\textsuperscript{1195} Art. 83 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1196} The quorum of the Supervisory Board has to be at least 75\%, see art. 85 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1197} Government bodies and other organs, as well as courts are not allowed to interfere with the activities of the corporations, including appointment of Supervisory and Management Board members. Art. 113 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1198} Art. 84 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1199} Art. 84 of the Uzbek Law on Joint-Stock Companies.
corporation\textsuperscript{1200}, thereby eliminating possibility of one person holding multiple positions in bodies charged with oversight of the management of the same corporation.

With respect to holding multiple positions, the law does not provide for the maximum number of the Supervisory Board positions held by one person, i.e., one can hold unlimited number of such positions. Moreover, the law does not limit number of posts that a Supervisory Board member can hold in Management Boards of other enterprises and vice-versa. Nonetheless, two requirements apply: first, information on any position in Supervisory or Management Board (or any other governing body) of another enterprise held by the person has to be included in the nomination information for the election of the member of the Supervisory Board, and a member of the Management Board may hold a position in Supervisory or Management Board (or any other governing body) of another enterprise only if an express permission is granted by the Supervisory Board of the corporation\textsuperscript{1201}.

Moreover, if a person is convicted of a crime\textsuperscript{1202}, the court can bar such person from holding a position of a member in a Supervisory Board for up to five years\textsuperscript{1203}.

4.4.4. Size and composition

The size and composition of the Supervisory Board is determined by the general meeting of shareholders\textsuperscript{1204}, and can be provided either in articles of association or bylaws of the corporation. The law requires that in case the corporation has more than 500 or 1000 holders of voting shares, the Supervisory Board must consist of at least 7 or 9 members,

\begin{itemize}
  \item \textsuperscript{1200} Art. 83 of the Uzbek Law on Joint-Stock Companies.
  \item \textsuperscript{1201} Art. 86 of the Uzbek Law on Joint-Stock Companies.
  \item \textsuperscript{1202} The following list is not exhaustive: conducting entrepreneurial activity without registration (Art. 188 of the Criminal Code of the Republic of Uzbekistan) or license (Art. 190), false entrepreneurship (Art. 179) false bankruptcy (Art. 180), concealment of bankruptcy (Art. 181), violation of antimonopoly legislation (Art. 183).
  \item \textsuperscript{1203} Art. 45 of the Criminal Code of the Republic of Uzbekistan.
  \item \textsuperscript{1204} Art. 83 of the Uzbek Law on Joint-Stock Companies; section 3 of the Model Bylaw on the Supervisory Board in Uzbekistan.
\end{itemize}
respectively\textsuperscript{1205}.

4.4.5. Term of office

In Uzbekistan the members of Supervisory Board are elected for one-year term, and they may be re-elected on the annual general meeting\textsuperscript{1206}. The extraordinary general meeting called by the shareholders can remove the members of the Supervisory Board, provided that the issue of removal of Supervisory Board members is put on the agenda.

4.4.6. Removal

The members of the Supervisory Board cease to hold office for three reasons: end of their term of office, removal by shareholders, or resignation.

Uzbek law does not provide for United States style holdover directors, hence the end of the Supervisory Board member’s term effectively terminates the post of this member, unless he/she is re-elected by the general meeting of shareholders. Due to the fact that the Supervisory Board is in charge of determining the date of the annual general meeting, and the Supervisory Board members are appointed for one year term, the situation when terms of all Supervisory Board members have expired before the annual general meeting has been held should not occur.

With respect to removal of the members of the Supervisory Board, the power to remove resides with the general meeting of shareholders\textsuperscript{1207}; the Supervisory Board may not remove one of its members in any circumstances. Moreover, the courts cannot remove a member of the Supervisory Board, since interference with the internal affairs of the

\textsuperscript{1205}Section 3 of the Model Bylaw on the Supervisory Board in Uzbekistan.
\textsuperscript{1206}Art. 83 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1207}Art. 65 of the Uzbek Law on Joint-Stock Companies.
corporation by the government bodies is not allowed. The Uzbek law does not specify whether the members of the Supervisory Board can be removed for cause or without cause; hence it can be presumed that the general meeting can remove the members of the Supervisory Board without cause.

Resignation of the member of the Supervisory Board does not require approval of the Supervisory Board or the general meeting, delivery of an official letter of resignation is sufficient.

4.5. Appointment and removal of the Management Board in Uzbekistan

4.5.1. Service agreement

Unlike for Management Board members in Germany and the members of the Board of Directors in the United States, the Uzbek law does not make a distinction between labour contract and service contract; the contract between the member of Management Board and the corporation in Uzbekistan is deemed as a labour contract. The Model Contract Hiring the Head of Managing Organ is explicitly named as “labour” contract, thus, the CEO, and by analogy every member the of Management Board, is considered as an employee of the corporation.

The legal nature of the relationship between the member of Management Board and the corporation also falls under the agency contract concept, since the Management Board is the statutory agent of the corporation and represents the corporation before third parties without a power of attorney. However, in case the responsibilities of Management Board are delegated to a Managing Company, the legal relationship between

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1208 Art. 113 of the Uzbek Law on Joint-Stock Companies.
1209 Rahmonqulov et al., supra note 665, at 115.
1210 Id.
a natural person and a legal entity will change to a relationship between two legal entities, hence, such a relationship cannot fall under a labour contract\textsuperscript{1211}. The nature of the said relationship is mixed – falls under both fee-based service agreement\textsuperscript{1212} and agency contract\textsuperscript{1213}.

4.5.2. Nomination

The rules on nomination of the CEO and the members of the Management Board are similar to the rules applicable to nomination of Supervisory Board members. By default rule, the Supervisory Board nominates the new CEO and the members of Management Board\textsuperscript{1214} or recommends re-election of the current CEO and members of the Management Board\textsuperscript{1215}.

However, if a general meeting is called upon request of other persons or bodies, i.e., the Inspection Committee or a shareholder possessing more than 10\% of the voting shares\textsuperscript{1216}, they have the right to nominate the CEO and any or all members of the Management Board\textsuperscript{1217}. Besides, the CEO of the corporation also has the power to nominate members of the Management Board\textsuperscript{1218}. The law does not provide for requirements with regard to the information that has to be included in the nominations, such requirements can be provided in the articles of association.

4.5.3. Appointment (election)

The rules on formation of the Management Board in Uzbekistan are quite

\textsuperscript{1212} Articles 703-708 of the Civil Code of the Republic of Uzbekistan.
\textsuperscript{1213} Articles 817-825 of the Civil Code of the Republic of Uzbekistan.
\textsuperscript{1214} Section 4.1 of the Model Bylaw on Management Board in Uzbekistan.
\textsuperscript{1215} Art. 69 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1216} Art. 72 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1217} Art. 71 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1218} Section 3.5 of the Model Bylaw on the Managing Organ of Joint-Stock Company, Cabinet of Ministers of the Republic of Uzbekistan, Resolution on Measures for Improving Governing System of Joint-Stock Companies, 22 August 1998 (№361), appendix 3 (hereinafter referred to as Model Bylaw on Management Board in Uzbekistan).
complicated; there are four possible options to whom the executive function in a corporation in Uzbekistan can be delegated: to an Individual Executive Organ (CEO), a Collegial Executive Organ (Management Board), a sole proprietor (Manager) or another organization (Managing Company)\textsuperscript{1219}.

First, the management can consist of an Individual Executive Organ (i.e., the CEO) who is solely responsible for the management of the corporation\textsuperscript{1220}. Second, the corporation can also have both an Individual Executive Organ and a Collegial Executive Organ, in such a case, the scope of duties and responsibilities of each of them have to be provided in the articles of association, and the Individual Executive Organ is the chairman of the Collegial Executive Organ (i.e., the Management Board)\textsuperscript{1221}. The corporation can also choose to delegate the managerial functions to an external legal entity – a sole proprietor or another enterprise\textsuperscript{1222}; the problems that arise in connection with such delegation are out of scope of current thesis. For the purposes of simplicity, all abovementioned will be collectively referred to as the Management Board.

As a general rule, the Management Board is elected and removed by the general meeting of shareholders on annual basis\textsuperscript{1223}, however, this power can be delegated by the general meeting of shareholders to the Supervisory Board of the corporation as well\textsuperscript{1224}. Due to unavailability of the data with respect to number of corporations that have used this option in Uzbekistan, an assumption is made that due to controlling shareholder paradigm, the controlling shareholder will not be willing to give up the power to directly appoint and remove the Management Board at any given time, hence, the general meeting of

\textsuperscript{1219} Art. 86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{1220} Art. 86.2 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1221} Id.
\textsuperscript{1222} Art. 86.3 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1223} Art. 86.8 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1224} Id.
shareholders, at least in the majority of instances, will retain this power.

With respect to the contract between the corporation and the member(s) of the Management Board, the Supervisory Board represents the corporation\textsuperscript{1225}.

4.5.4. Requirements

The Uzbek Law on Joint-Stock Companies does not provide for specific personal or professional requirements with respect to the persons nominated to the Management Board. If a person is convicted of a crime\textsuperscript{1226}, the court can bar such person from holding a position of a member of the Supervisory Board for up to five years\textsuperscript{1227}.

In Uzbekistan, following persons cannot be elected as members of the Management Board: the members of the Supervisory Board\textsuperscript{1228} and the Inspection Committee\textsuperscript{1229} of the corporation in question, thereby eliminating the possibility of the member of the Management Board to supervise the Management Board at the same time. With respect to holding multiple positions, the law does not provide for the maximum number of the Management Board or Supervisory Board positions in other enterprises held by the member of the Management Board, i.e., he/she can hold unlimited number of such positions, only if an express permission is granted by the Supervisory Board of the corporation\textsuperscript{1230}.

4.5.5. Size and composition

The number of members of the Management Board is by default determined by the Supervisory Board, unless the articles of association of the corporation confer such power to

\textsuperscript{1225} Art. 86.9 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1226} The following list is not exhaustive: conducting entrepreneurial activity without registration (Art. 188 of the Criminal Code of the Republic of Uzbekistan) or license (Art. 190), false entrepreneurship (Art. 179) false bankruptcy (Art. 180), concealment of bankruptcy (Art. 181), violation of antimonopoly legislation (Art. 183).
\textsuperscript{1227} Art. 45 of the Criminal Code of the Republic of Uzbekistan.
\textsuperscript{1228} Art. 83.3 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1229} Art. 110.7 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1230} Art. 86 of the Uzbek Law on Joint-Stock Companies.
the general meeting of shareholders\textsuperscript{1231}.

4.5.6. **Term of office**

All members of the Management Board are appointed for one-year term, but may be re-elected on the next general meeting of shareholders\textsuperscript{1232}. Re-election of the current members or election of the new members of the Management Board is one of the issues to be included mandatorily in the agenda of the annual general meeting\textsuperscript{1233}. Hence, the staggered boards are not possible under the current Uzbek law.

4.5.7. **Removal**

The member of the Management Board of the corporation can cease to hold his post for three reasons: expiration of the term, removal and resignation. As noted earlier, the contract between the corporation and the members of the Management Board is a labour contract; therefore, labour law rules are applicable with respect to these issues.

The Labour Code of the Republic of Uzbekistan provides that labour contracts may be concluded for a specific term up to five years. Such a fixed-term contract ends upon expiration of the period indicated in the contract, unless the person in question is still performing his obligations and neither party has expressed their interest in ending the contact\textsuperscript{1234}.

With respect to the removal, in order to ensure the independence of the Management Board, a member of the Management Board can be removed only for cause, and due cause exists in the following circumstances:

\textsuperscript{1231} Section 2.1 of the Model Bylaw on Management Board in Uzbekistan.
\textsuperscript{1232} Art. 86 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1233} Art. 64 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1234} Art. 105 of the Labour Code of the Republic Uzbekistan.
• violation of terms of contract concluded between the member of the Management Board and the corporation\textsuperscript{1235};
• violation of articles of association\textsuperscript{1236};
• causing loss to the corporation\textsuperscript{1237};
• substantial change in the ownership of shares of the corporation (including merger and reorganization)\textsuperscript{1238}.

The member of Management Board can be removed by the general meeting of shareholders, or the Supervisory Board, if such power has been delegated to the Supervisory Board\textsuperscript{1239}. The right to remove of the members of Management Board for violation of articles of association or causing loss to the corporation belongs to the Supervisory Board regardless of delegation of general power to appoint and remove the Management Board members\textsuperscript{1240}. The Labour Code of the Republic of Uzbekistan also provides that if the ownership structure significantly changes, the new controlling shareholder is able to remove the Management Board\textsuperscript{1241}.

The courts of the Republic of Uzbekistan cannot interfere with the internal affairs of the corporation; hence, courts are not allowed to remove members of the Management Board\textsuperscript{1242}.

4.6. Conclusions

The right to appoint and remove the members of the managerial and supervisory bodies plays a crucial role in the power balance within the corporation. The chapter provides an in-depth analysis of the issues surrounding appointment and removal of the

\textsuperscript{1235} Art. 86.12 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1236} Art. 86.13 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1237} Id.
\textsuperscript{1238} Art. 98 of the Labour Code of the Republic of Uzbekistan.
\textsuperscript{1239} Art. 86.12 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1240} Art. 86.13 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1241} Art. 98 of the Labour Code of the Republic of Uzbekistan.
\textsuperscript{1242} Art. 113 of the Uzbek Law on Joint-Stock Companies.
members of the managerial and supervisory bodies.

Since the AktG is mandatory, the balance of powers in German system is quite steady – general meeting of shareholders elects the members of the Supervisory Board and the Supervisory Board appoints the members of the Management Board. This setup is complicated by the co-determination requirements to have either 1/3 or half of the Supervisory Board members elected by the employees, which also significantly increases the number of the members of the Supervisory Board. Significant difference is the ability of the court to interfere and appoint member(s) of the Supervisory Board in case of urgency or lack of quorum, and even appoint member(s) of the Management Board on temporary basis. Members of both Supervisory Board and Management Board are elected for terms not exceeding five years, which substantially strengthens their position. In order to assure the independence of the Management Board and protect it from direct interference by the general meeting of shareholders or the Supervisory Board, members of the Management Board may be removed only for cause, and only by the Supervisory Board.

The situation in the United States differs significantly – while the shareholders elect the members of the Board of Directors, newly created directorships and vacancies may be filled by the Board of Directors until the next general meeting is called. The power of the courts is limited to approval or rejection of an election or appointment to the office, and does not include the power to appoint the directors. Combined with the holdover doctrine, control over the proxy machinery and the procedures of the general meeting of shareholders, this gives the Board of Directors extremely wide powers. The directors can be removed without cause (except for staggered boards and directors elected by cumulative vote), however, the wide powers mentioned above may preclude the shareholders from
removing the director in question. In cases when neither the Board of Directors nor the shareholders are unable to remove the director(s), the court may interfere and remove a director if a serious misconduct is proven.

In Uzbekistan, the shareholders appoint and remove both Supervisory Board and Management Board, even though the power to appoint the members of the Management Board may be delegated to the Supervisory Board, it is assumed that the dominant shareholder will not be willing to give up such power. The members of the Supervisory Board are elected solely by the shareholders and by cumulative voting, courts or any government agencies do not have such power. The members of the Supervisory Board are elected for one-year terms, and may be removed without cause by the general meeting of shareholders; neither the courts nor the Supervisory Board itself may remove any member of the Supervisory Board. Similar to Germany, in order to assure the independence of the members of the Management Board, they may be removed only for cause by the general meeting of shareholders. However, given that the situation may require immediate action to remove a member of the Management Board before a general meeting may be convened, in certain cases where the member of the Management Board has committed a gross violation of his duties, he may be removed by the Supervisory Board.
5. CHAPTER FIVE: FUNCTIONS AND DUTIES OF CORPORATE BODIES

The internal division of powers and responsibilities plays an important role in establishing a proper system of governance and supervision of corporate activities. The previous chapter had viewed the division of powers from the perspective of election/appointment and removal, this chapter focuses on the particularities of decision-making authority as well as the duties and liabilities for not performing such duties.

The chapter starts with discussing the functions of corporate organs, in particular, management, supervision, reporting and representation. Further the chapter discusses the fiduciary duties of directors, Supervisory Board and Management Board members of corporations.

The chapter discusses specific division of functions within and/or between the organs of the corporation. As discussed in the previous chapters, the Boards in the three countries examined here are not equivalent; in fact, even the Supervisory Board in Germany is substantially different from its Uzbek counterpart, let alone the Board of Directors in the United States. Hence, in order to have a complete picture of the internal dynamics within the corporation, detailed analysis of functions of each Board is necessary.

Until 1965, the AktG did not define the functions of the German corporate bodies in detail; hence the Supervisory Board was dependent on the general meeting to define the scope of its functions. The AktG, and later, the German Corporate Governance Code, have been describing and clarifying the functions of the corporate organs, vis-à-vis both the corporation and other corporate constituencies.

In the United States, the Board of Directors has been traditionally charged with managing the business and affairs of the corporation, determining corporate policies, appointing and removing the officers, i.e., performing the duties of both managing and supervising organ. Both MBCA and DelGCL still provide that the Board of Directors is in charge of all duties. However, in practice of large public corporations, the Board of Directors is not capable of fulfilling both roles; hence, the widespread consensus is that in such corporations the management function is vested with the executives, while the Board of Directors is in charge of supervision and oversight of management.

In Uzbekistan, the functions of the Supervisory Board were developed in accordance with the triangular structure; hence the functions of the two boards differ from their German counterparts, specifically in terms of representation and appointment.

The section discusses the following functions of the Boards: appointing and removing the management and officers of the corporation, supervision, representation of the corporation before third parties, shareholders and the management.

5.1. Management

In all three countries examined here, the managerial functions reside in the managers, and the supervisory bodies/persons are not allowed to interfere directly with the managerial duties. The notion of management may encompass various duties, rights and obligations; the scope varies from country to country, and depends on the legal system and the provisions in the articles of association (charters) of the corporations.


1245 DelGCL 141 (c), Model Business Corporation Act Annotated, supra note 16, at 8-322.


1247 Id.

In Germany, the Management Board is responsible independently for managing the corporation both under the AktG\textsuperscript{1249} and the German Corporate Governance Code\textsuperscript{1250}, i.e., the Management Board is the sole body authorized to conduct business in the name of the corporation. The scope of managerial duties include taking day-to-day business decisions, as well as formulating and implementing the corporate strategy — corporate policy\textsuperscript{1251}, business development, decisions on business and financial risks\textsuperscript{1252}.

In the United States, the Board of Directors hires and fires the corporate officers\textsuperscript{1253} who are in charge of managing the corporation’s day-to-day activities, are also in charge of hiring and firing the employees, and entering into contracts\textsuperscript{1254}. Any decisions which are out of ordinary course of business have to be submitted to the Board of Directors for approval\textsuperscript{1255}. According the language of the DelGCL and MBCA, the Board of Directors plays a significant role in management of the corporation, since the “business and affairs of the corporation” are to be “managed under the direction” of the Board of Directors. However, the main duty of the Board of Directors is supervision, while the officers are in fact in charge of the actual “management” of the corporation.

In Uzbekistan, the Management Board is in charge of day-to-day activities of the corporation\textsuperscript{1256}, which includes all decisions except for the ones within the competence of the Supervisory Board or the general meeting of shareholders\textsuperscript{1257}. The following decisions are in the competence of the Management Board: appointment and removal of the staff.

\textsuperscript{1249} § 76(1) AktG.
\textsuperscript{1250} Section 4.1.1 of the German Corporate Governance Code.
\textsuperscript{1251} Wirth, et al., supra note 87, at 101.
\textsuperscript{1252} Dryander & Riehmer, supra note 781, at 35.
\textsuperscript{1253} Rafael Chodos, The Law of Fiduciary Duties: With Citations to the California Authorities, (Blackthorne Legal Press, 2000), at 17.
\textsuperscript{1254} Id.
\textsuperscript{1255} Id.
\textsuperscript{1256} Art. 86.1 of the Uzbek Law on Joint-Stock Companies.
\textsuperscript{1257} Id.
(employees), issuing order mandatory for all employees of the corporation\textsuperscript{1258}.

As noted earlier, in all three countries the management is independent in its decision making powers from both the supervisory organs and the shareholders, however, the management’s powers have limitations vis-à-vis the supervising body and the general meeting of shareholders.

### 5.1.1. Limitations viz-a-viz the supervising body

Generally the Management Board members are independent and free from any influence and are not obliged to follow the instructions of the Supervisory Board\textsuperscript{1259}. Nevertheless, the Management Board must require consent of the Supervisory Board for certain transactions\textsuperscript{1260}, such as granting credits to members of the Management Board or \textit{Prokuristen}\textsuperscript{1261}, decisions or measures which fundamentally change the asset, financial or earnings situations of the enterprise\textsuperscript{1262} or any other kind of transaction as provided in the articles of association of the corporation\textsuperscript{1263}. Apart from the limitation on specific transactions, the Management Board has to coordinate the long-term policies of the corporation with the Supervisory Board\textsuperscript{1264}.

As in Germany, the Management Board in Uzbekistan is obliged to implement the resolutions of the Supervisory Board provided that such resolutions are within the competence of the Supervisory Board\textsuperscript{1265}.

### 5.1.2. Limitations viz-a-viz the shareholders

\textsuperscript{1258} Id.
\textsuperscript{1259} Dryander & Riehmer, supra note 781, at 39, Wirth, et al., supra note 87, at 100.
\textsuperscript{1260} Dryander & Riehmer, supra note 781, at 39.
\textsuperscript{1261} § 89 AktG; Dryander & Riehmer, supra note 781, at 39.
\textsuperscript{1262} Section 3.3 of the German Corporate Governance Code.
\textsuperscript{1263} § 111(4) AktG.
\textsuperscript{1264} Section 4.1.2 of the German Corporate Governance Code.
\textsuperscript{1265} Art. 86 of the Uzbek Law on Joint-Stock Companies.
In Germany, the Management Board is obligated to follow the resolutions of the shareholders accepted at the general meetings\textsuperscript{1266} only if such resolutions are within the competence of the general meeting and do not involve the issues pertaining the management of the corporation\textsuperscript{1267}, except as in cases where the Management Board specifically asks for shareholder approval\textsuperscript{1268}. In fact, the Management Board is obliged to ask for shareholder approval under \textit{Holzmüller} doctrine in certain cases, as discussed earlier\textsuperscript{1269}. As a result, the members of the Management Board are not liable for following such resolutions of the general meeting of shareholders\textsuperscript{1270}. In case of corporate groups, the Management Board of a subsidiary may be obliged under control agreement to follow the instructions provided by the controlling enterprise\textsuperscript{1271}.

In Uzbekistan, the Management Board is obliged to implement the resolutions of the general meeting only if such resolutions are within the competence of the general meeting\textsuperscript{1272}.

\textbf{5.2. Supervision}

Supervision of corporate management is one of the most hotly debated topics in the field of corporate governance, however, the scope and standards of supervision differ depending on the jurisdiction.

In Germany, the Supervisory Board is in charge of supervision of the Management Board, as specified by the AktG, German Corporate Governance Code, and the case law.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{1266} § 83(2) AktG.
\item \textsuperscript{1267} Wirth, et al., supra note 87, at 100.
\item \textsuperscript{1268} Id.
\item \textsuperscript{1269} See supra section 3.3.1.4
\item \textsuperscript{1270} § 93(4) AktG.
\item \textsuperscript{1271} § 93(2) AktG.
\item \textsuperscript{1272} Art. 86 of the Uzbek Law on Joint-Stock Companies.
\end{enumerate}
\end{footnotesize}
Article 111 of AktG provides that the “Supervisory Board shall supervise the management of the company”. The German Corporate Governance Code provides that the “Supervisory Board appoints, supervises and advises the members of the Management Board and is directly involved in decisions of fundamental importance to the enterprise”\textsuperscript{1273}. For instance, the Supervisory Board is responsible for issuing rules of procedure of the Management Board\textsuperscript{1274}, thereby ensuring effective functioning of the Management Board.

Even though the scope of such supervision is limited to the members of the Management Board alone, and supervision of any other employees of the corporation is in the hands of the Management Board\textsuperscript{1275}, the Supervisory Board nonetheless must ensure that the lower levels of management are properly supervised by the Management Board\textsuperscript{1276}.

Apart from supervision, the Supervisory Board in German corporations also plays an important advisory role\textsuperscript{1277}, in this capacity, the Supervisory Board may advise the Management Board in matters of its sole competence, and likewise, the Management Board may seek advice from the Supervisory Board in such matters.

5.3. Reporting

5.3.1. Reporting to the supervisory body

The management bodies/persons in all three countries have to report to the supervisory bodies, however, the scope and frequency of such reports differ in the three jurisdictions.

The German law differentiates between the reports to the Supervisory Board in

\textsuperscript{1273} Foreword to the German Corporate Governance Code.
\textsuperscript{1274} Wirth, et al., supra note 87, at 101.
\textsuperscript{1275} Dryander & Riehmer, supra note 781, at 115.
\textsuperscript{1276} Id.
\textsuperscript{1277} Id.
general, to the chairman of the Supervisory Board, and specific Supervisory Board members\textsuperscript{1278}, and such reports as a rule are submitted in writing (including electronic form)\textsuperscript{1279}. Apart from the statutory requirements, the German Corporate Governance Code provides that the Supervisory Board must specify the Management Board’s information and reporting duties in more detail\textsuperscript{1280}.

The Management Board is obliged to provide reports to the whole Supervisory Board with respect to following issues, each with a different timeframe and frequency:

- the intended business policy, financing, investment and other matters regarding the future of the corporation – not less than once a year, unless the circumstances dictate otherwise;
- the profitability of the company, in particular the return on equity – at the meeting of the Supervisory Board where the approval of financial statements is sought;
- the state of business, in particular revenues, and the condition of the company – at least quarterly;
- transactions that may have a material impact upon the profitability or liquidity of the company – in time for the Supervisory Board to comment on the transaction\textsuperscript{1281};
- annual financial statements and the annual report – promptly upon completion of such report\textsuperscript{1282}.

Apart from the regular reports to the whole Supervisory Board, the Management Board is also obliged to promptly report to the Chairman of the Management Board of any significant developments concerning the business of the corporation\textsuperscript{1283}. Although the Supervisory Board is normally not obligated to conduct inquiries itself\textsuperscript{1284}, any member of the Supervisory Board may also require a report from the Management Board on business affairs of the corporation, affiliated entities, and other circumstances having a material

\textsuperscript{1278} Wirth, et al., supra note 87, at 111.
\textsuperscript{1279} Section 3.4 of the German Corporate Governance Code.
\textsuperscript{1280} Id.
\textsuperscript{1281} § 90(1) AktG; Wirth, et al., supra note 87, at 111.
\textsuperscript{1282} § 170(1) AktG.
\textsuperscript{1283} § 90(1) AktG; Wirth, et al., supra note 87, at 111.
\textsuperscript{1284} Johannes Semler, The Practice of the German Aufsichtsrat, in Klaus J Hopt and others (eds), Comparative Corporate Governance: The State of the Art and Emerging Research (Oxford University Press. 1998), at 272.
5.3.2. Reporting to the shareholders

As discussed in the earlier chapters, the shareholders have the decision-making rights when it comes to fundamental transactions and decisions that substantially affect corporation’s future. In all three countries, the shareholders are also providing reports when their rights in the corporation are affected, including any changes in the share capital, company structure (including mergers and acquisitions), and sale of assets.

In Germany, the Supervisory Board is obliged to provide reports to the general meeting of shareholders “on the results of its review of the annual financial statements, the annual report and the proposed appropriation of profits, including potential dividends”1286.

The Management Board is only obliged to provide information to the general meeting of shareholders if such information is pertaining to the items on the agenda of the meeting1287. For certain fundamental decisions, such as control agreements, mergers, spin-offs, change of legal form, the Management Board is obliged to submit a written report to the general meeting explaining the measure in question1288.

In Uzbekistan, the Supervisory Board is obliged to communicate to the shareholders any financial results of the corporation, nominations to the corporate boards, changes to the articles of association, and other fundamental transaction1289.

5.4. Representation

1285 § 90(3) AktG; Wirth, et al., supra note 87, at 111.
1286 § 171(2) AktG; Dryander & Riehmer, supra note 781, at 123.
1287 § 131(1) AktG; Wirth, et al., supra note 87, at 111.
1288 Wirth, et al., supra note 87, at 111.
1289 See infra section 2.4.2.3.
The balance of powers within the corporation is heavily influenced by the level of authority given to each party, i.e., power to represent the corporation in various situations. The corporation itself cannot take any action, indeed, all actions in the name of the corporation are taken by its agents, who, in turn receive authority from either the law or corporate documents. Since enabling a party to take an action may change the balance of powers, the section discusses the legal power to represent the corporation in various aspects of corporation’s activities, including before the third parties, before the shareholders and before the management.

5.4.1. Representation before the third parties

In Germany, the Management Board is the legal representative of the corporation before all third parties, and such power to represent arises only after the registration of the names of Management Board members in the commercial register. The powers of representation of the Management Board may not be subject to any restrictions in dealing with third parties, with certain exceptions. For instance, if the corporation subject to co-determination and owns more than 25% of shares in another corporation also subject to co-determination, then any decision of the Management Board of the first corporation with respect to exercising the rights as a shareholder will be subject to approval by the Supervisory Board, without such approval any action of Management Board is null and

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1290 Cahn & Donald, supra note 823, at 312.
1291 § 78(1) AktG.
1292 § 81(1), 39(1) AktG; Wirth, et al., supra note 87, at 104.
1293 Even though inside the corporation, the Management Board is mandated to follow the restrictions set by the Supervisory Board and/or the general meeting of shareholders, § 82(2) AktG.
1294 Section 32 of Co-Determination Act [Gesetz über die Mitbestimmung der Arbeitnehmer] of 4 May 1976, published in Federal Law Gazette BGB1 I 1153. Such decisions include, appointment and removal of Supervisory Board members, approval of Supervisory and Management Board actions, decision on the stricture of the corporation, see Wirth, et al., supra note 87, at 104.
The AktG provides for joint representation – unless the articles of association provide otherwise, all members of the Management Board may only represent the corporation jointly\textsuperscript{1296}. The principle of joint representation is not applicable in three cases: first, if a communication is delivered to one member of the Management Board, it is deemed to have been received by the corporation; second, each member of the Management Board individually has a right and obligation to report insolvency of the corporation; and third, knowledge or negligent lack of knowledge by one member of the Management Board constitutes knowledge or negligent lack of knowledge by the corporation as a whole. In the cases above, action or inaction of one member of the Management Board is attributed to the whole Management Board.

In case the corporation for any reason does not have a Management Board, the Supervisory Board may temporarily assume the power of representing the corporation before the third parties\textsuperscript{1297}.

In the United States, both MBCA and DeIGCL provide that the corporation is managed under the direction of the Board of Directors, which confers the powers of representation before the third parties onto the Board of Directors. The Board of Directors’ power of representation is to be exercised collectively, while individual directors do not have the agency power to deal with third parties\textsuperscript{1298}.

\textsuperscript{1295} Wirth, et al., supra note 87, at 104.
\textsuperscript{1296} § 78(2) AktG. However, in practice, the corporation is usually represented by two members of the Management Board or one member of the Management Board and a Prokurist, Wirth, et al., supra note 87, at 103.
\textsuperscript{1297} § 78(1) AktG.
\textsuperscript{1298} O'kelley & Thompson, supra note 419, at 142.
Moreover, the Delaware courts have held that the president of the corporation (i.e., the CEO) has all the powers necessary for its ordinary operations\(^\text{1299}\).

Both MBCA and DelGCL provide that the Board of Directors, which holds all the power of representation before the third parties, may delegate the powers of the representation to officers via prescribing in the bylaws, specific resolution of the Board of Directors, or re-delegation of the previously delegated officer\(^\text{1300}\). Neither of the acts provides any specific powers that such officers may receive; hence the powers should be expressly stated in the prescribing documents\(^\text{1301}\).

In Uzbekistan, the power to represent the corporation before the third parties lies entirely in the hands of the Management Board\(^\text{1302}\), however, unlike in Germany, such rights do not have to be registered in commercial register. The representation powers of the Management Board derive from the law; hence they may not be limited by the articles of association or otherwise\(^\text{1303}\). However, in certain cases, such powers of the Management Board may be subject to confirmation by the courts or third parties. For instance, in case the corporation has reached a settlement, such settlement may be rejected if the person singing the settlement on behalf of the corporation did not have sufficient authority to sign such a document.

### 5.4.2. Representation before the management

The management of the corporation is the legal representative of the corporation

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\(^{1299}\) See Joseph Greenspon's Sons Iron & Steel Co. v. Pecos Valley Gas Co., 156 A 350 (1931); Italo-Petroleum Corp. of America v. Hannigan, 14 A 2d 401 (1940), cited at Cahn & Donald, supra note 823, at 316, note 21.

\(^{1300}\) DelGCL 141 (c), Model Business Corporation Act Annotated, supra note 16, at 8-322.

\(^{1301}\) Cahn & Donald, supra note 823, at 316.

\(^{1302}\) Art. 86 of Uzbek Law on Joint-Stock Companies.

\(^{1303}\) Limitations on the power to represent the corporation should not be confused with the decision-making powers – the corporation may require in the articles of association that the Management Board receives Supervisory Board’s approval before proceeding with certain actions. Art. 82 of Uzbek Law on Joint-Stock Companies.
before third parties, however, it cannot represent the corporation before itself, and hence another party should take the function of representing the corporation in dealings with the management — the supervising body represents the corporation in dealings with the management.

In Germany, it is the Supervisory Board that acts as the representative of the corporation in dealings with the Management Board\(^\text{1304}\). In particular, such dealings include: appointment and removing the members of the Management Board\(^\text{1305}\), singing the contracts with the Management Board members\(^\text{1306}\), determining their remuneration\(^\text{1307}\). Moreover, in any actions against the Management Board, both in and out of court, the corporation is represented by the Supervisory Board\(^\text{1308}\).

In the United States, the Board of Directors represents the corporation in dealing with the CEO and/or management in the United States. Such representation is evident in cases of appointing and removing the senior officers of the corporation, and fixing their remuneration\(^\text{1309}\).

In Uzbekistan, the contract between the corporation and the CEO is signed by the Chairman of the Supervisory Board or the person authorized by him\(^\text{1310}\). However, the law does not prescribe whether the Chairman of the Supervisory Board should sign the contracts with the members of the Management Board or this authority may be given to the

\(^{1304}\) Daniel Gubitz, Tobias Nikoleyczik, Ludger Schult, Manager Liability in Germany: Director Liability of Members of Management and Supervisory Boards of German Companies, (Beck C. H., 2012), at 8.

\(^{1305}\) § 84(1) AktG.

\(^{1306}\) Both contracts – the service agreement and the appointment agreement, see Dryander & Riehmer, supra note 781, at 21.

\(^{1307}\) Gubitz et al., supra note 1304, at 8.

\(^{1308}\) § 112 AktG.


\(^{1310}\) Art.86 of Uzbek Law on Joint-Stock Companies.
CEO himself. The Supervisory Board also determines the remuneration of the CEO and members of the Management Board\textsuperscript{1311}, moreover, regardless of appointment rights, the Supervisory Board may remove any and/or all members of the Management Board if the latter violate the articles of association, or their actions (inactions) lead to damages suffered by the corporation\textsuperscript{1312}.

5.4.3. Representation before the shareholders

Another important aspect of representation is the power to represent the corporation before the shareholders, which includes any communication with the shareholders, all issues related to calling and organizing the general meeting of shareholders, preparing the agenda, presiding over the general meeting.

In Germany, it is the Management Board that has the right to call the general meeting of shareholders\textsuperscript{1313}, moreover, the Management Board is in charge of preparing the agenda of the general meeting, and communicating its contents to the shareholders\textsuperscript{1314}. Nevertheless, the Supervisory Board may call the general meeting of shareholders only if the interests of the corporation so require and the Management Board has failed to call the general meeting in due time\textsuperscript{1315}. In case the corporation brings a claim in the court against shareholders, then the corporation is represented jointly by the Management Board and the Supervisory Board\textsuperscript{1316}.

In the United States, under both the DelGCL\textsuperscript{1317} and MBCA\textsuperscript{1318}, the Board of Directors

\textsuperscript{1311} Art.86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{1312} Art.86 of Uzbek Law on Joint-Stock Companies.
\textsuperscript{1313} § 121(2) AktG.
\textsuperscript{1314} § 125(1) AktG.
\textsuperscript{1315} § 111(3) AktG.
\textsuperscript{1316} Dryander & Riehmer, supra note 781, at 46.
\textsuperscript{1317} DelGCL 211.
represents the corporation. First, the annual meeting is called by the Board of Directors; second, the agenda is prepared and published by the Board of Directors; third, all communications to the shareholders are also delivered by the Board of Directors.

In Uzbekistan, the annual general meeting has to be convened by the Supervisory Board\textsuperscript{1319}, and all details regarding the annual general meeting are determined by the Supervisory Board\textsuperscript{1320}, though Management Board may propose issues to be added to the agenda, The Chairman of the Supervisory Board presides on the general meetings of the shareholders\textsuperscript{1321}.

5.5. Fiduciary duties of directors

The section discusses the fiduciary duties of directors in the three countries examined here, focusing on the duty of care, duty of loyalty and business judgment rule.

Before discussing the concept of fiduciary duties in the chosen jurisdictions, one has to keep in mind certain difference between the legal systems with respect to the legal nature of the relationships between the managers and the corporation itself. While the Anglo-American legal systems rely on the concepts of agency and contract, the German and Uzbek law treat the Management Board and Supervisory Board as one of the three organs of the corporation\textsuperscript{1322}. In this light, the emphasis in Germany and Uzbekistan is put rather on the independence of these organs than their serving functions\textsuperscript{1323}. This may not have a practical importance, however, for a theoretical discussion, the approaches to the duties and hence the liabilities of the management may differ.

\begin{itemize}
  \item \textsuperscript{1318} MBCA 7.02(a).
  \item \textsuperscript{1319} Art. 64 of Uzbek Law on Joint-Stock Companies.
  \item \textsuperscript{1320} Art. 70 of Uzbek Law on Joint-Stock Companies.
  \item \textsuperscript{1321} Art. 84 of Uzbek Law on Joint-Stock Companies.
  \item \textsuperscript{1322} Baums, supra note 139, at 8.
  \item \textsuperscript{1323} Id.
\end{itemize}
In addition, as it was discussed earlier in this thesis, the corporate organs owe duties to the corporation and not to the shareholders; hence any reference to the duties of the organs indicated the duties owed to the corporation. Moreover, the duties owed by the corporate organs do not consist of obligations solely to maximize the shareholder profit, rather, acting in the best interests of the corporation as a whole.

The term “fiduciary” is frequently used to describe the nature of the duties of the directors, and the origins of the term deserve some attention. The fiduciary concept had its origin in the law of trusts, where it described the duty owed by a person (trustee) holding the title (but not the ownership) to the property of another person (beneficiary) who does not have the legal title, but can claim the benefits of the property. The trustee had to prudently manage the trust; moreover, he was barred from dealing in the trust property even if such actions did not harm the interests of the beneficiary. It was only later when the courts started to apply the same concept in case of the directors of the corporation.

The directors of the corporation were described as trustees first in the *Lofland vs. Cahall* case, and the analogy was later confirmed by the *Guth vs. Loft*, where the Delaware Supreme Court stated that the:

“[C]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy ... has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the

1324 See supra section 1.1.
1325 See supra section 1.3.1.
1327 Id.
1328 *Lofland vs. Cahall*, 118A. 1, 3 (Del. 1922).
1329 *Guth vs. Loft*, 2. 5 A.2d 503 (Del. 1939).
interests of the corporation committed to his charge, but also to refrain
from doing anything that would work injury to the corporation, or to deprive
it of profit”¹³³⁰.

Ever since, the concept of fiduciary relations has been used in reference to the
directors of the corporation, however, certain differences exist between the trustee-
beneﬁciary relationship and the director-corporation relationship, most important of which
is risk-taking. While the trustee has to invest only in “prudent” investments and was
forbidden from taking any risks, the managers of the corporation are expected to incur risks
in order to obtain proﬁts¹³³¹. Hence, the rigid standards applied towards the trustees had to
be lowered, for instance, the directors were allowed to engage in conﬂict of interest
transactions if such transaction were approved by the majority of disinterested directors or,
in certain cases, by the majority of shareholders¹³³². There are two main ﬁduciary duties as
defined as duty of care and duty of loyalty, discussion of which is contained below.

5.5.1. Duty of care and business judgment rule

In the United States, MBCA provides that the directors shall act “in good faith” and
“in a manner the director reasonably believes to be in the best interests of the
corporation”¹³³³, which is generally characterized as the duty of care¹³³⁴. Furthermore, the
directors’ duty of care applies to both management function and supervisory function¹³³⁵.

The standards of conduct provide for how someone should act in a certain activity,
while the standard of review is the test which is applied by the courts in reviewing such

¹³³⁰ Guth vs. Loft 2. 5 A.2d 503 (Del. 1939).
¹³³² Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991), cited in Walsh, Joseph T., Fiduciary Foundation of Corporate
¹³³³ MBCA 8.30(a).
activity to determine whether to impose liability. The duty of care is a standard of conduct, which provides for how the directors should act, and is not a standard of review – the standard of judicial review is the business judgment rule.

Corporate directors owe fiduciary duties to the corporation, and these duties include duty of care and duty of loyalty and in case the directors are charged with violation of these duties, actions of the directors can be reviewed by the courts using the business judgment rule.

The rule presumes that all business decisions are:

- “made by disinterested and independent directors
- on informed basis
- with a good faith belief that the decision will sever the best interests of the corporation”

If an action is brought against the decision of the directors, the court will examine the decision only to the extent necessary to find out whether the plaintiff has provided enough evidence to overcome the business judgment rule presumption. If the presumption has not been overridden, the court is prohibited by the business judgment rule from going into the details and examining the merits of the decision. If the presumption is overridden, the burden is shifted to the directors to prove that they have acted with the requisite level of care. Therefore, the rule has two components – one protects the directors from personal liability, and the other protects the decision itself from court intervention in case

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1338 Eisenberg, supra note 1336, at 438.
1339 Block et al., supra note 1335, at 1.
1340 Id., at 5.
1341 Id., at 111.
when the decision satisfies the requirements of business judgment rule\textsuperscript{1342}.

In Germany, members of both the Management Board and the Supervisory Board have the duty of care and shall “employ the care of a diligent and conscientious manager”\textsuperscript{1343}. This standard requires that the Management Board members act in the same way as a dutiful, independent manager of a comparable corporation in similar circumstances\textsuperscript{1344}, while exercising a high degree of care\textsuperscript{1345}. The members of the Management Board have a wide-ranging discretion, and are allowed to take certain risks while making “business decisions” – decisions that require entrepreneurial judgment\textsuperscript{1346}. With respect to the members of the Supervisory Board, the duty of care presumes the same wide discretion as for the Management Board in the cases where the Supervisory Board in involved in business decisions, e.g., consenting to a transaction where the Supervisory Board’s approval is required. In all other cases, the Supervisory Board has no discretion in discharging the duties to properly supervise and advise the Management Board\textsuperscript{1347}.

The United States style concept of business judgment rule was introduced into the German legal practice by the German Supreme Court in 1997 in the Arag/Garmenbeck case\textsuperscript{1348}, where the court noted that the managers are not liable for any “entrepreneurial decisions” if such decision:

\begin{itemize}
  \item was made within the discretion of the manager;
  \item has been properly prepared for;
  \item was not founded on the conflict of interest;
\end{itemize}

\textsuperscript{1342} Id., at 4.
\textsuperscript{1343} § 93(1)(2) AktG – with respect to the Management Board members, § 116 AktG expressly refers to the § 93 AktG while defining the duties of the members of the Supervisory Board.
\textsuperscript{1344} Dryander & Riehmer, supra note 781, at 47.
\textsuperscript{1345} Id.
\textsuperscript{1346} Id.
\textsuperscript{1347} Wirth, et al., supra note 87, at 130.
\textsuperscript{1348} Arag/Garmenbeck Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997; § 93 (S) AktG.
• did not impose unreasonable risks on the corporation\textsuperscript{1349}.

Later, in 2005, the business judgment rule was codified into the AktG, which provides that:

“There is no breach of duty if in case of an entrepreneurial decision the respective member of the Management Board could reasonably assume to be acting on the basis of adequate information and for the benefit of the corporation”\textsuperscript{1350}.

Under this new rule, provided that all the requirements above had been satisfied, the manager was not liable for any business decision taken; by analogy, members of the Supervisory Board were freed of liability for appointing the member of the Management Board who failed to perform his duties accordingly\textsuperscript{1351}. Another important aspect of the rule is the principle of availability of the information, i.e., only information available at the moment of taking decision is decisive while determining whether the business judgment rule protection applies, any subsequently available information is not considered\textsuperscript{1352}.

Nonetheless, the business judgment rule protects only the business decisions, and the manager charged with violation of law, articles of association, bylaws of the corporation may not rely on the business judgment rule\textsuperscript{1353}.

Unlike the developed countries such as Germany and the United States, Uzbekistan lacks experience in dealing with the duties and obligations of directors. Even though duty of care and duty of loyalty are provided, Uzbek legal system does not have concepts of business judgment rule and fiduciary duties, duties and obligations of the members of the Management Board and the Supervisory Board are scattered throughout several acts.

Article 45 of the Civil Code of the Republic of Uzbekistan provides that the person(s)\textsuperscript{1349} Gubitz et al., supra note 1304, at 4.\textsuperscript{1350} § 93(1)(2) AktG.\textsuperscript{1351} Gubitz et al., supra note 1304, at 4.\textsuperscript{1352} Id.\textsuperscript{1353} § 116(1) AktG
who by virtue of law of corporate documents of a legal entity are acting in its name, must act in the interests of this legal entity in good faith and reasonably\(^{1354}\). As discussed earlier in the thesis, the Management Board has the right to represent the corporation before the third parties, while the Supervisory Board represents the corporation before the Management Board\(^{1355}\), therefore both organs have the duty of care in discharging their duties.

In fulfilling their functions, the members of the Management Board have wide discretion, however, they do not enjoy the protection of the business judgment rule, since the legislation of the Republic of Uzbekistan does not contain any rule protecting the members of Boards or their decisions from the court review in case they fulfill the criteria of disinterestedness and good faith. Therefore, any action can be potentially reviewed by the courts and may lead to criminal or civil liability of the members of the Boards\(^{1356}\); the members of the Boards who have voted against the decision in question are relieved from such liability\(^{1357}\).

With respect to civil liability, since the members of the Boards are ultimately responsible for the wellbeing of the corporation, they may be found liable for losses suffered by the corporation due to their actions or inaction\(^{1358}\). However, there is a higher burden of proof in proving the criminal liability of the members of the Boards compared to civil liability. According to the Resolution of the Plenum of the Supreme Court of the

\(^{1354}\) Article 45 of the Civil Code of the Republic of Uzbekistan.

\(^{1355}\) See supra section 5.4.

\(^{1356}\) Article 35 of the Law of the Republic of Uzbekistan “On contractual and legal basis of activity carried out by economic establishments” dated 29.08.1998, No. 670-I.

\(^{1357}\) Article 88 of the Uzbek Law on Joint-Stock Companies.

\(^{1358}\) President of the Republic of Uzbekistan, Decree On Strengthening the Liability of the Executives (Officials) for the Insolvency of the Entrepreneurial Entities and Fulfillment of Contractual Obligations of 4 March 1998, NoUP-1938.
Republic of Uzbekistan of November 25, 2002, №26, the mere fact that the corporation has suffered a material loss (or lost profit) in itself is not sufficient to criminal liability of any member of the Boards\textsuperscript{1359}. The Resolution of the Plenum of the Supreme Court of the Republic of Uzbekistan of April 17, 1998, №11, provides that the abuse of power by a director is a direct cause for the liability of the director for the losses caused by such abuse, as well as the lost profit, while such abuse must be intentional and cause a loss to the interests of the corporation or shareholders\textsuperscript{1360}.

\textbf{5.5.2. Duty of loyalty}

The other fiduciary duty – the \textit{duty of loyalty} – requires that the directors act in the interests of the corporation and prohibits self-dealing by the directors.

In the United States, the duty of loyalty runs to both shareholders and the corporation\textsuperscript{1361}, and mandates that the best interests of the shareholders and the corporation take “precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally”\textsuperscript{1362}.

While determining what constitutes the “best interests” of the corporation, the directors have a wide discretion in analyzing the short term and long term goals, and more importantly, in making judgments where the interests of various groups pertaining to the corporation may collide\textsuperscript{1363}. Since the best interests of each corporation at a certain point of time will differ, the analysis ultimately reverts to the manner how the directors are

\textsuperscript{1359} The Resolution of the Plenum of the Supreme Court of the Republic of Uzbekistan on Certain Issues Pertaining to the Judicial Practice of Criminal and Administrative Offences related to Entrepreneurial Activity of November 25, 2002, №26.

\textsuperscript{1360} The Resolution of the Plenum of the Supreme Court of the Republic of Uzbekistan on Certain Issues in Judicial Practice regarding Crimes in the Sphere of Economics of April 17, 1998, №11.

\textsuperscript{1361} Hollinger International vs. Black, 844 a.2d 1022 (Del. Ch. 2004).

\textsuperscript{1362} Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1992).

\textsuperscript{1363} Model Business Corporation Act Annotated, supra note 16, at 8-187.
discharging their duties, rather than the substance of the decisions. Therefore, the relationship between the duty of loyalty and business judgment rule is essentially the same as the one between the duty of care and business judgment rule\textsuperscript{1364}. The plaintiff alleging the breach of the duty of loyalty must establish the fact sufficient to overcome the business judgment rule presumption. If successful, then the burden of proof shifts to the defendant directors to show the “entire fairness” of the transaction\textsuperscript{1365}.

In Germany, the doctrine of duty of loyalty is called *Treu pflicht*\textsuperscript{1366}, which belongs to the general principles of German law\textsuperscript{1367} and is based on the principle of good faith\textsuperscript{1368}. Unlike in the United States, in Germany, the duty of loyalty runs to the corporation itself and not its shareholders\textsuperscript{1369}. At the same time, the Management Board must always act in the best interests of the corporation\textsuperscript{1370} in order to ensure the lasting success of the corporation.

The duty of loyalty includes “a duty to promote the purpose of the Company [AG], a prohibition to cause the Company [AG] loss or damage, and a further duty to use shareholders’ rights and powers in a responsible manner”\textsuperscript{1371}. The focus on the duty of loyalty in Germany has dramatically increased since the *Mannesmann* case\textsuperscript{1372}.

In *Mannesmann* case, the court found that six former directors of Mannesmann AG in breach of duty of loyalty by committing *Untreue* (breach of fiduciary duty). After the takeover offer was received from Vodafone, they approved the compensation and benefits

\textsuperscript{1364} Block et al., supra note 1335, at 1.
\textsuperscript{1366} Maentysaari, Comparative Corporate Governance, supra note 36, at 363.
\textsuperscript{1367} Id.
\textsuperscript{1368} § 242 Bürgerliches Gesetzbuch, 1896 (hereinafter referred to as BGB); see also Maentysaari, Comparative Corporate Governance, supra note 36, at 363.
\textsuperscript{1369} Baums, supra note 139, at 7.
\textsuperscript{1370} Wirth, et al., supra note 87, at 109.
\textsuperscript{1371} Maentysaari, Comparative Corporate Governance, supra note 36, at 363.
in the amount of 60 million Euros to 18 executives\textsuperscript{1373}. The court recognized that approving after-the-fact, the payment to a Management Board of a sum not provided in the service contract and that does not bring any future benefit to the corporation is a violation of the duty of loyalty by the Supervisory Board members. The court has applied the concept of Untreue (breach of trust or disloyalty)\textsuperscript{1374}, which is a much stricter concept of criminal liability. The court recognized that although only “aggravated” breaches fall under Untreue,

“for a failure to manage entrusted assets to constitute breach of the duty of loyalty it shall not also be necessary, including in the case of a management body’s business judgment, that the act shall be ‘aggravating’”\textsuperscript{1375}.

Thus, German law has strengthened the focus on the duty of loyalty in terms of misappropriation of corporate assets, however, the decision left some ambiguity, it remains to be seen which types of cases should fall under the scope of Untreue.

In Uzbekistan, the article 88 of the Uzbek Law on Joint-Stock Companies provides that members of the Supervisory Board and the Management Board have to act in the best interests of the corporation. Combined with the control by the Supervisory Board and the general meeting of shareholders of related party transactions, multiple Management Board memberships and obligations not to compete, this can be interpreted as a form of duty of loyalty despite the fact that it is not formally recognized as such.

As discussed earlier in the thesis\textsuperscript{1376}, the Management Board members and the Supervisory Board members have to disclose any information on the nature of any interest

\textsuperscript{1374} German Criminal Code [Strafgesetzbuch], 13 November 1998, [BGBl I, 945, 33220], § 266. The official English translation provided by the Federal Ministry of Justice is available at http://www.iuscomp.org/gla/statutes/StGB.htm (last visited May 1, 2014).
\textsuperscript{1376} See supra section 3.3.3.4.
that they might have in any transactions\textsuperscript{1377}. As a general rule, such related party transactions are approved by the majority of the disinterested members of the Supervisory Board\textsuperscript{1378}, in case the transaction (including the sale of shares) involves over 5% of the company assets or all members of the Supervisory Board are considered related parties, the decision is made by majority of disinterested shareholders\textsuperscript{1379}. This ensures that any person voting for a transaction is disinterested.

In terms of non-compete clause, the members of the Management Board do not have the right to act as founders of companies that may create problems for the corporation’s revenue gains (sale of goods, providing services), and must suspend any such membership they hold in such companies when they are appointed as members of the Management Board and inform the Supervisory Board\textsuperscript{1380}. Thereby, the members of the Management Board may not hold positions in companies that are directly competing with the corporation, which is a part of the duty of loyalty.

Directors, members of the Supervisory Board and the Management Board in all three countries examined here have the duty of care and duty of loyalty, even though these duties stem from different sources and are formulated differently. The major difference lies in the business judgment rule protection which has originated in the United States, and has been recently introduced in Germany, but has not yet been introduced in Uzbekistan.

Despite the fact that in Uzbekistan the members of the Management Board and the Supervisory Board are bound by the duty of care and duty of loyalty, must act in good faith

\textsuperscript{1377} Article 92 of the Uzbek Law on Joint Stock Companies.
\textsuperscript{1378} Article 93 of the Uzbek Law on Joint Stock Companies.
\textsuperscript{1379} Article 93 of the Uzbek Law on Joint Stock Companies.
and be disinterested while taking decisions, it still remains to be seen whether the system is ready to introduce such a strong tool of director protection as business judgment rule, given the lack of informational infrastructure to ensure the disinterested nature of the members of the Boards, comparatively weak court system.

5.6. Conclusions

This chapter has focused on the functions and duties of the directors, the members of the Management Board and Supervisory Board in the United States, Germany and Uzbekistan. The analysis of the functions shows that management is vested in the persons with executive responsibilities who are charged with day-to-day responsibilities. Such persons are as a rule independent and have the right to represent the corporation before third parties, however, each system provides with certain checks and balances, by imposing limitations on the power of the managerial persons/bodies vis-à-vis the supervising body and the shareholders, e.g., control of large transactions and related party transactions. Each country provides that the supervisory body is in charge of direct supervision of the management, and may request reports and information on any issue; furthermore, the supervisory bodies have the function of representing the corporation before the management, which further strengthens their position in fulfilling the supervisory function. In terms of representation before the shareholders, the systems in three countries differ – while the Supervisory Board and Board of Directors represent the corporation in Uzbekistan and the United States respectively, in Germany, this function is in the hands of the Management Board. The control of the agenda and procedural issues related to the general meeting of shareholders is a strong tool in the power balance of the corporation.

Regarding the duties of the directors, members of the Supervisory Board and the
Management Board, all three countries provide for the duty of care and duty of loyalty, however, the sources of these duties are different. While in the United States the duties of directors originate in the law of agency and trust, German and Uzbek laws consider the Management and Supervisory Boards as “organs” of the corporation, and ascribe autonomous positions and independent competencies of the Boards. Duties vary in the context of management and oversight in all three countries, management having wide latitude in making the business decisions and therefore widest duty of care and loyalty, while the latitude in the context of oversight is limited. The business judgment rule, which protects directors from personal liability and their decisions from court intervention, has strong roots in the United States legal system and has recently been implemented in Germany. In Uzbekistan, the members of the Management and Supervisory Boards do not enjoy such protection since the legal system does not provide for business judgment rule presumption. Nonetheless, it may be for the time being, a wise choice not to introduce such protection due to weak informational infrastructure and court system.
CONCLUSIONS

This thesis has analyzed the internal governance structures in public corporations in Uzbekistan, Germany and the United States, and the protection of shareholders’ rights insofar as they directly affect the internal governance structure. Using the functional method, the thesis has focused on the key aspects shaping the power landscape in public corporations, comparing their similarities and differences. The central focus of the thesis is on the balance of powers in the corporation between the shareholders, managerial persons/bodies and supervisory persons/bodies.

Given the lack of English-language literature on corporate law and the legal system in Uzbekistan in general, the thesis has started with a short overview of corporate governance system in Uzbekistan, overview of the previous studies conducted, and a short introduction into the history of the development of the corporate law in Uzbekistan. The focus on the public corporations is substantiated by the policy decision in Uzbekistan to create large scale public corporations, increasing the minimum registered capital requirement by 140 times – from 2807 USD to 400,000 USD, and the fact that more than half of the country’s GDP is created by public corporations.

The level of shareholders’ power in public corporations in the three countries differs significantly, Uzbekistan providing for the most powers, followed by Germany and the United States. The relative powers of the shareholders are viewed from the prism of ownership structure – Germany and Uzbekistan have high levels of majority shareholdings, and the United States is characterized with relatively dispersed, with a high ownership of incumbent directors through stock ownership.

With respect to the shareholders’ rights, the United States have been on the move
towards empowerment of shareholders, e.g., one share-one vote rule provided by the national exchanges, move from plurality to majority voting, attempt to include shareholder nominees in corporation’s proxies. On the other hand, the rule 14a-11 has been struck down by the courts, while the versions of majority voting that are implemented by the corporations have not been effective. Since the shareholders are unable to directly call the general meeting of shareholders and thereby control the agenda, the Board of Directors retains a strong influence in director elections. Nonetheless, effective recourse to the courts is an important tool for the shareholders; for instance, the court may remove a director upon application by a shareholder, compel the Board of Directors to conduct the general meeting.

In Germany, there is also evidence of move towards shareholder empowerment: KoNtraG mandated one share-one vote rule in all corporations, the legislator introduced US-style derivative suits in 2005. Combined with the fact that the shareholders are able to call the general meeting of shareholders, nominate and elect the members of the Supervisory Board and propose issues to be included into the agenda, the shareholders have a much stronger influence on the corporation’s affairs.

Despite providing for the highest degree of protection among the three countries, Uzbekistan is on the path to provide further protection to shareholders. Uzbekistan introduced cumulative voting with the view to provide more representation of minority shareholders in the Supervisory Boards, and introduced derivative suits. Together with the powers to call the general meeting of shareholders, nominate the members of the Supervisory Board and propose issues to be included into the agenda, the shareholders have a strong influence on the corporation in general. However, the procedural issues are a
lingering concern in multiple areas, for instance, the members of the Supervisory Board elected by minority shareholders do not enjoy the protection from removal by the majority shareholders, the derivative suits do not have a special procedure as in Germany and the United States – a derivative suit may be introduced in two courts simultaneously.

With respect to corporate governance systems, the analysis of the systems in the three countries examined has been carried out from two perspectives: first, the right to appoint and remove the directors, and second, functions and duties of corporate organs. Since the right to appoint and remove is in the key difference, more attention is paid to the first issue.

The thesis evidences that the triangular system in Uzbekistan may legitimately be separated as a system and compared to the one-tier and two-tier systems in the United States and Germany respectively. The ability of shareholders to elect and remove both Supervisory Board and Management Board significantly changes the balance of powers within the corporation and draws the system away from both one-tier and two-tier systems, making the shareholders the strongest player in the power balance within the triangular system.

The one-tier system, which may be characterized as a board-centered model, focuses on the necessity to have the corporation’s affairs managed by a single body given the dispersion of shareholder ownership as well as the rational shareholder apathy caused by such dispersion. The “monitoring model” has drawn the one-tier system closer to two-tier system; however, the fundamental differences still remain. In particular, the strong position of the Board of Directors, though seriously challenged by the activist shareholders, remains the focus of the system. Another important feature is the degree of reliance on
timely involvement of the courts, where they act as referees between the shareholders and
the Board of Directors, resolving the issues and deadlocks. The courts are also heavily
involved in *ex post* review of the director actions, though such review is limited until the
business judgment rule presumption is overturned by the plaintiffs alleging any breach of
duty by directors. Such protection further reinforces the position of the Board of Directors in
the power balance of the corporation in one-tier system.

The two-tier system has emerged from the necessity to compensate for the removal
of the state control from the corporations, and the Supervisory Board was also in charge of
protecting public interest. In the German two-tier system, the Supervisory Board is in the
focus, since the Supervisory Board appoints and removes the Management Board, as well as
oversees and monitors the Management Board’s actions. The influence of the general
meeting on the appointment and removal of the Management Board is limited, for instance,
the vote of no-confidence by the general meeting may be regarded as a cause for removal
of Management Board member by the Supervisory Board member, though the Supervisory
Board is not obligated to remove such member. The Supervisory Board also represents the
corporation in any dealings with the Management Board. German idiosyncrasies, such as
influence of banks and co-determination, also evidence the strength of the Supervisory
Board in German two-tier system. The Management Board, in its turn, is an independent
body of the corporation in charge of the management, with certain limitations vis-à-vis the
Supervisory Board and the general meeting of shareholders. Also, the Management Board is
in charge of representing the corporation before the shareholders, i.e., controls the
procedural issues surrounding the general meeting of shareholders. The position of both the
Supervisory Board and the Management Board have been strengthened by introduction of
the US-style business judgment rule, which puts the initial burden of proof to the plaintiff
alleging any breach of duty. On the other hand, the position of the Management Board has been shaken up by the Holzmüller doctrine, where the Management Board is required to receive prior shareholder approval in cases when substantial shareholder interests are at stake.

The triangular structure allows the shareholders to hold most of the power and shape the internal structure of the corporation, since a developing country like Uzbekistan may be characterized by relatively weak courts, lack of professional managers and low trust of the investors. Therefore, the general meeting of shareholders as the “supreme authority” of the corporation has the right to appoint, remove, and monitor both boards. Strong position of the shareholders is further reinforced by the procedural rights of the shareholders with respect the general meeting of shareholders, and the widest array of substantive rights compared to Germany and the United States. Mandating the Supervisory Board was intended to serve as a cushion to play the role of liaison between shareholders and management, as well as more efficient supervision of the management. Another important difference is the control over the procedures of the general meeting of shareholders – while in Germany these issues are in the competence of the Management Board, the Supervisory Board assumes these powers in Uzbekistan. The relative strength of the shareholders in the triangular system is also evidenced by the absence of business judgment rule protection for members of the Management Board and the Supervisory Board.

Each of the three corporate governance structures has its strengths, weaknesses, and peculiarities; however, the analysis shows that each model fits into the general picture in its own way. In fact, I believe that for Uzbekistan as a developing country, providing
maximum power to the shareholders might be exactly what the system needs in order to develop a higher trust among the shareholders and investors. Therefore, despite numerous issues outlined in this thesis that have to be addressed, the general picture seems to be a solid fit for the time being.
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