

## **LEGAL ISSUES OF THE ROLE OF SUPERVISORY BOARD IN GOVERNANCE JOINT-STOCK COMPANIES**

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**Abstract:** This article discusses the governing bodies of joint-stock companies, in particular, supervisory board, its importance, the powers and functions of supervisory board, specifically its powers to provide organizational assistance to the general meeting of shareholders, and the powers directly related to the governance of the company, composition and formation of supervisory board, board's meetings. The basic theories and comparative legal analysis of the legislation of developed countries were carried out, the existing trends are identified, gaps and contradictions in the legislation are diagnosed and suggestions and proposals were made to address deficiencies in legislation.

**Keywords:** corporate governance, supervisory board, shareholders' meeting, shareholder, control, monitoring, an independent member, chairman, cumulative voting, decision.

One of the solutions to the monitoring problem between shareholders and directors (executive body) is the creation of a representative body - the supervisory board, which specifically performs such functions. Investors (shareholders) of a corporation elect their representatives to a body that protect their property (capital) and interests, and control the activities of directors. The supervisory board is one of the most effective corporate governance mechanisms.

The supervisory board, which is an important level in the system of corporate bodies, is based on the German model and is essentially similar to external directors in the American corporate governance system.

Apparently, the supervisory board has broad powers that provide overall leadership. The powers of the general meeting include issues of fundamental importance to the destiny of society. We can say that due to the lack of full confidence in the Supervisory board,

shareholders are protected from unlawful actions by its members. The powers of the general meeting to resolve certain issues may be transferred to the supervisory board only in cases stipulated by the charter of the company. For example, the introduction of amendments and additions to the charter of a company in connection with an increase in the charter capital of the company, the creation of executive body of the company and early termination of its powers, etc. It can be noted that in the distribution of governance these powers shift mainly towards the supervisory board.

The powers of the board of directors (supervisory board) are not defined in detail in the joint-stock legislation of foreign countries. For example, section 111 of the German Stock Corporation Act defines the following functions of the supervisory board: it shall supervise the management of the company, the supervisory board may inspect and examine the books and records of the company as well as the assets of the company, in particular cash, securities and merchandise [1].

However, in many joint stock companies, the supervisory board is not the actual governing body. Important decisions are made outside of it, leaving only formal approval of decisions to the share of members of the supervisory board. Despite the work that has begun to strengthen local corporate governance, it should be recognized that it often becomes more formal. Members of the Supervisory board report to the board of directors (executive body).

In our opinion, the nature of the activities of the supervisory board, the requirements for its members in practice, the structure of the board, and the priority of its functions largely depend on how the joint-stock company determines the role and functions of the board of directors [2].

In order to increase the effectiveness of the Supervisory board, first of all, it is necessary to comply with the current legislation and determine the role of the Supervisory board in the legislation, its significance for the company and the tasks assigned to the Supervisory board by the owners (shareholders).

As noted above, in accordance with Article 75 of the Law on Joint Stock Companies and the Protection Of Shareholder Rights ( hereinafter the Law ), in addition to the exact powers

of the supervisory board, it can be authorized to resolve many issues of the company functions. These powers cannot be delegated to the executive body by the supervisory board for consideration [3].

The transfer of such powers to the Supervisory board is common in the practice of Western countries. The work of specialists who can professionally resolve these issues in the Supervisory board has made this practice possible.

The powers of the Supervisory board can conditionally be divided into two groups. The first group includes the powers to provide organizational assistance to the general meeting of shareholders, the second group includes the powers directly related to the governance of the company. For example, the authority to determine the date of the general meeting of shareholders or to prepare the agenda may be delegated to the first group, the authority to enter into transactions or increase the authorized capital of the second group.

Some issues, including the reorganization of the company, are decided by the supervisory board only with the approval of the general meeting of shareholders.

With regard to the functions of the Supervisory board, its role as a supervisor should be emphasized. In particular, he organizes an internal audit service, hears his reports on a quarterly basis, freely uses any documents related to the activities of the executive body (for official purposes), and makes a decision on conducting an audit.

Among the issues that must be resolved by the Supervisory board, the main is to determine the priorities of society.

At the same time, the main and relatively undeveloped function of the company internal management is to determine the strategy of the corporation.

It is well known that a strategy is usually understood as a strong procedural concept, which includes specific actions that can lead to a clear practical advantage over a period of time [4].

The strategy should be constantly updated. In the future, it is necessary to plan and implement actions that will contribute to the implementation of the strategic idea of a more successful use of resources.

As for the formation of the supervisory board, its members are elected by the general meeting of shareholders for 1 year in the manner prescribed by this law and the company charter. Persons elected to the Supervisory board may be re-elected indefinitely [3. Art. 76]. Members and directors of a company management, persons working under an employment contract in a company, persons working under an employment contract in subsidiaries and affiliates, as well as members of the management bodies of these companies cannot be elected to the supervisory board of the company.

However, according to the laws of some European countries, company employees who are not members of any governing body can also participate in the supervisory board. For example, in Germany, if the number of employees increases by 500, the supervisory board will consist of one third of them. Even the chairman of the supervisory board of a joint stock company can be elected from among the employees of this company [5].

In accordance with Article 387 of the Code of Trade Companies, officials working in divisions directly subordinate to the executive body, such as the chief accountant, lawyer, department head or store manager, as well as members of the board of directors, graduates and employees of the company cannot be elected to the supervisory board.

Sweden also provides for employee participation in governance. If the number of employees exceeds 25, local branch offices that have entered into collective bargaining agreements with employers will be entitled to appoint two representatives to the board of directors (supervisory board). If a corporation has 1,000 or more employees, the number of such representatives increases to three [6].

The legislation of the Russian Federation provides that only employees of state enterprises have the right to participate in a similar way. For example, in a state-owned enterprise with more than a thousand employees and more than 2% of non-shareholders, the supervisory board should include representatives of such workers [7].

Based on this comparative legal analysis and taking into account the fact that our national economy is based on socially oriented market relations, we propose to include in our national legislation “Employee Stock Ownership Plans” (ESOP) , which paid off in international practice, as well as a mechanism for representing workers, work councils and trade unions.

The purpose of this participation is to protect the interests of the employees of the enterprise, which is part of the idea of "industrial democracy" in the literature.

Legislation allows the election of candidates only from among shareholders or inviting them from abroad. As a rule, the charter limits the composition of the supervisory board of other joint stock companies, members of the collegial executive body or representatives that specifically serve the interests of other enterprises.

However, according to the assessment to the Law of the Republic of Uzbekistan “On Joint-Stock Companies and the Protection of Shareholders' Rights” dated March 20, 2019, at least one independent member of the supervisory board of the company, whose shares are listed on the stock quotation list, must be included. That is, an independent member of the supervisory board should include a person who is not associated with the organization and (or) acts in other organizations [8].

In this case, a person who meets the following criteria is recognized as an independent member of the supervisory board:

- man, who has not worked in the company and (or) its subsidiaries for the last three years;
- a person not being a shareholder of the Company and (or) founder (shareholder, member) of its affiliate;
- a person , who is not in a relationship of civil law with a major customer, and (or) a major supplier of the company and (or) its branch. In this case, those customers and suppliers who have a valid contract for an amount equal to more than two thousand times the base estimated amount are recognized as the main customer and the main supplier;
- a person who does not have any agreement with the company and (or) its affiliates, with the exception of cases related to ensuring the performance of duties and functions of a member of the supervisory board ;
- society, governing and internal control bodies and (or) its branches over the past three years, the person or member of the husband (wife) of their member, parents (adoptive parents), children (adopted child), a person born, not a half brother (brother) and sister (sister);
- a person who is not an employee of a government body or state enterprise.

It should be noted that in companies with a predominant share of state and (or) business associations, the appointment of an independent member of the supervisory board and voting in an independent member of the supervisory board is the responsibility of the state and (or) representatives of the business association.

It is noteworthy that the scope of application of qualification requirements for members of the supervisory board, elected on the basis of the state's share in the supervisory board of state enterprises, has increased. In particular, from July 1, 2019, heads or deputy heads of state bodies (with the exception of the Agency for Management of State Assets of the Republic of Uzbekistan) can be elected to the supervisory board of State Enterprises by state share, if they have a certificate of corporate governance qualification [9].

In addition, the requirements for persons elected to the supervisory board of a company may be set forth in the charter of the company or in a decision approved by the general meeting of shareholders [3. Art. 76].

Unfortunately, according to the experience of developed countries, this institution has paid off, but national joint-stock companies do not want to have an “alien” independent member on the supervisory boards. According to the latest amendment to the law, joint-stock companies whose shares are listed on the national stock exchange (NSE) must have at least one independent member on their supervisory board. Because of this rule, they are leaving national stock exchange. In particular, in the first 6 months after the adoption of this law, 11 joint-stock companies withdrew from the NSE quotes, not understanding the essence of the law [10].

As stated by Article 76 of the Law “On Joint-Stock Companies and the Protection of Shareholders' Rights” stipulates that the number of members of the Supervisory board should be more than seven members for a company with more than five hundred shareholders and more than one thousand shareholders and for a company at least nine members [3].

Based on the proposal to divide joint-stock companies into public and non-public companies, we propose changing the following: for a company with more than five hundred shareholders, the number of members of the supervisory board of a company can be at least seven, and for a company with more than a thousand shareholders, the number of members

may be at least nine. In public companies, the number of members of the supervisory board must be at least 4.

A similar requirement is enshrined in article 66 of the Federal Law of the Russian Federation “On Joint-Stock Companies”, which provides that the number of members of the supervisory board of public joint stock companies must be at least 5 people [11].

The election of the members of the Supervisory board of the Company is carried out by cumulative voting. In a cumulative vote, the number of votes for each shareholder is multiplied by the number of persons who must be elected to the supervisory board of the company, and the shareholder has the right to completely vote for one candidate or distribute them among two or more candidates.

Candidates who receive the largest number of votes are considered elected to the supervisory board of the company.

In addition, the general meeting of shareholders does not elect the state representative, who is one of the members of the supervisory board.

The chairman of the supervisory board organizes its work, convenes and chairs the meeting of the supervisory board, organizes the minutes of the meeting, and chairs the general meeting of shareholders, unless otherwise provided by the charter of the company. In the absence of the chairman, one of the members of the board fulfills his duties [3. Art. 77].

In foreign practice, specifically, in accordance with Section 107 of the German Stock Corporation Act, the Supervisory board elects a chairman and at least one deputy chairman from among its members [1].

The role of an independent member of the Supervisory board, presented as a result of recent changes in our national legislation on corporate governance, is manifested in relatively impartiality and fairness in choosing a corporate strategy and ensuring the effective functioning of the Supervisory board and relatively full protection of shareholders' rights.

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