COMPARATIVE ANALYSIS OF GERMAN, UNITED STATES AND UKRAINIAN APPROACHES TO THE ROLE OF MANAGEMENT – ITS LEGAL POSITION VS. ITS FACTUAL POSITION IN THE COMPANY

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EXECUTIVE SUMMARY

This thesis examines the role of public company management in Germany, the United States and Ukraine. It comparatively analyzes legal regimes that the states establish for managers of public companies and positions managers factually hold in these companies.

At the beginning, this thesis provides theoretical background on management as a process and component of a corporate structure. An insight is given into how the perception of the management process was evolving in scholarly works of classical management theorists and representatives of the behavioral management movement. The position of management as an element of a corporate structure is also analyzed in the framework of major corporate governance theories, namely, the agency theory, stewardship theory, stakeholder theory and mediating hierarchy theory.

The legal position of management in German, United States and Ukrainian public companies is studied through the detailed examination of corporate laws and regulations of the three states. This part of the research comparatively analyzes selected aspects of management functioning as addressed by law, specifically, formation and dismissal of management, composition and committees of the board of directors, manager remuneration, duties and liability.

The factual position of management in public companies of Germany, the United States and Ukraine is determined by analyzing their business practices and case law, as well as statistical data available for them. This final part of the thesis runs the examination of selected practical aspects of managerial activities, in particular, composition and interaction within the management structure, manager remuneration, scope of manager duties and liability, responsiveness of management to shareholder interests, and its strengths and weaknesses as they affect overall effectiveness of management.

The undertaken research has demonstrated that for several reasons the factual standing of company management in the three states does not always align with the regime established by law. First of all, corporate laws of all states are imperfect and tend to have serious gaps that provide management with additional freedom of action, which is to the highest degree apparent in Ukraine. Also, even if companies comply with formal requirements regarding management, this still cannot ensure that its status corresponds to the legislative intent, which is the case in all the three countries. Finally, mechanisms of management control are not always sufficiently effective or even existent, which again is notably evident in Ukraine.

TO MY FAMILY

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LIST OF ABBREVIATIONS

AG	(German: *Aktiengesellschaft*) public limited company
BGH	(German: *Bundesgerichtshof*) Federal Court of Justice of Germany
BGHZ	(German: *Entscheidungen des Bundesgerichtshofes in Zivilsachen*) Decisions of the Federal Court of Justice in Civil Cases
C.D. Cal.	United States District Court for the Central District of California
CEO	Chief executive officer
CFO	Chief financial officer
CFR	Code of Federal Regulations
DGCL	Delaware General Corporation Law
Del.	Supreme Court of Delaware
Del. Ch.	Court of Chancery of Delaware
ESCRIN	(Ukrainian: *Електронна система комплексного розкриття інформації*) Electronic System for Comprehensive Disclosure of Information
EUR	Euro
GBP	Great Britain pound
GCGC	German Corporate Governance Code
MBCA	Model Business Corporation Act
NASDAQ	National Association of Securities Dealers Automated Quotation
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
Sh. D.C. K.	Shevchenkivs'ky District Court for the City of Kyiv
SOX	Sarbanes-Oxley Act
U.S.	United States of America

USD	United States dollar
v.	(Latin: *versus*) against
Vas. D.C. Zap.	Vasylivs'ky District Court for the Zaporizhzhya Region
vs.	(Latin: *versus*) against
WL	Westlaw

INTRODUCTION

In the second half of the 19th century, growing complexity of production caused the change in perception of enterprises and raised the need for their effective management. At that time, accumulated knowledge and experience on managing various types of organizations took shape of a unified science of management. Still, it mainly focused on the nature and principles of management as the process of most efficient use, governance and control of a socio-economic system.

The revolution in the plane of business management occurred in 1932, when the landmark study "The Modern Corporation and Private Property" by Adolf Berle and Gardiner Means was published. The book ascertained the separation of ownership and control in modern corporations, thus, predetermining the development of corporate governance.

Corporate governance may be defined in an infinite number of ways. Yet, all definitions may be divided into two categories. The first complex of definitions pays primary attention to behavioral aspect of corporations, namely, their actual behavior in what relates to such factors as performance, growth, financial structure, efficiency and position of various stakeholders.[1] For example, according to the Organisation for Economic Co-operation and Development (OECD):

> Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.[2]

The Financial Times suggests that corporate governance was defined in a more specific way:

[1] Stijn Claessens, *Corporate Governance and Development*, 21 WORLD BANK RES. OBSER. 91, 93 (2006).
[2] OECD Principles of Corporate Governance, Preamble (2004).

> How a company is managed, in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. The concept encompasses a variety of issues, including disclosure of information to shareholders and board members, remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures, etc.[3]

The second category of definitions focuses on the set of rules governing operation of a corporation provided by the legal system, judiciary, financial and labor markets.[4] For instance:

> The system of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties (external stakeholders, governments and local communities …) who can be affected by the corporation's conduct, in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.[5]

In case of any interpretation, the central place in the system of corporate governance is devoted to the role of company management. Management is the main determinant of the overall behavior of a corporation, the main tool for achieving its objectives, and the main means of maintaining the balance between all of its stakeholders. It is, therefore, crucially important to identify and contrast legal and factual positions of management in the corporate structure.

This thesis examines the role of management in German, United States and Ukrainian public companies at the present stage of their development. Its purpose is to comparatively analyze regimes that state legislators provide for company management, determine the factual position of management in a company, identify to what extent the factual standing of company management differs from the legislative intent, and point out differences in approaches of the three selected states.

[3] *Definition of Corporate Governance*, FINANCIAL TIMES LEXICON (last visited Oct. 31, 2013), *available at*: http://lexicon.ft.com/Term?term=corporate-governance.

[4] Claessens, *supra* note 1, at 93.

[5] JEAN JACQUES DU PLESSIS ET AL., PRINCIPLES OF CONTEMPORARY CORPORATE GOVERNANCE 10 (2nd ed., Cambridge University Press 2011).

The literature on the topic in what relates to Germany and the U.S. is quite extensive. Among authors whose books significantly contribute to understanding of the status of management in German companies are Jean Jacques du Plessis and Ingo Saenger, Daniel Gubitz, Tobias Nikoleyczik and Ludger Schult, and Jan Lieder. The comprehensive characteristic of management in German companies is given in Carsten Jungmann's article contrasting the one-tier and two-tier board systems on examples of Germany and the United Kingdom.

In the U.S., one of the most highly recognized scholars in the field of corporation law and corporate governance is Stephen M. Bainbridge. Among other authors whose research concerns certain very important aspects of the position of management in U.S. corporations are Corinne Ball, Marilyn Sonnie and Anna F. Triponel, Donald H. Chew Jr. and Stuart L. Gillan, Bernard Black, and Steven N. Kaplan.

The books by Andreas Cahn and David C. Donald, Henry Hansmann and Reinier H. Kraakman contain substantial comparative analysis of the legal regime of companies and their management *inter alia* in Germany and the U.S. Theodor Baums and Kenneth E. Scott, Brian R. Cheffins, and Franklin A. Gevurtz provide an in-depth comparative analysis of some practical aspects of the status of company management as applied in Germany and the U.S.

In Ukraine, there is in general relatively little scholarly and academic works in the field of corporate law. The overwhelming majority of them is published in the form of a textbook and provides a general overview of company laws, not even slightly addressing the issue of their practical implementation. Some little particles of data on company factual structure and performance can be found mostly in researches of business magazines. This situation should be viewed in the context of the general problem of underdevelopment of corporate governance in Ukraine that has long-standing historical, social and economic reasons.

In particular, these are Ukraine's Soviet past, inseparably associated with the absence of private property, and its consequences, palpable even after more than two decades of the state's independence, that are major determinants of all spheres of Ukrainian life, including the corporate sector of its economy. The majority of Ukrainian public joint stock companies emerged as a result of privatization launched shortly after the state seceded from the Soviet Union, and it was initially difficult to equate them to classic corporations. Along with the development of the stock market and its infrastructure, these entities are gradually acquiring essential corporate features and perform traditionally assigned functions of accumulation and competitive reallocation of capital.[6] If taken in relative terms, however, corporate governance in Ukraine is still in its infancy compared to more than a century of practical application in German and U.S. companies.

This thesis will fill the gap in scholarly developments in the field of comparative corporate governance. Its main contribution is a comprehensive analysis of the legal and factual position of management in Ukrainian companies that has never been done before. With regard to German and U.S. companies, the thesis examines not only either legal status of management or its practical standing, but both of them in conjunction with each other, and uses some previously made findings about separate aspects of company management for the extensive analysis with ultimately providing the new substantial multidimensional research on the subject. Finally, the importance of this thesis is sustained by the fact that the analysis of the role of management in a company is given in the form of a comparison of its legal and practical regimes in the three states.

The major statement of this thesis is that the factual position of management in a company does not always coincide with the regime established by law. German and U.S. laws provide a detailed coverage of the matter and companies of these states mostly comply

[6] Артем Ягмурджи, *Актуальні проблеми формування ефективної системи корпоративного управління* [Artem Yagmurdzhi, *Actually Problems of Forming Effective System of Corporate Management*], 1(15) ЕКОНОМІЧНИЙ ВІСНИК ДОНБАСУ 144, 145 (2009).

with formal legal requirements, but in practice the role of company management is not always the same as was intended by the legislator. Ukrainian laws provide only the basics for outlining the status of management in a company and still contain major gaps and inconsistencies, which sometimes makes it difficult to even identify the actual legislative intent. In practice, managers are provided with substantial freedom of actions and ability to derogate from legislative prescriptions without experiencing rigid control.

This thesis comprises three chapters. The first chapter provides a theoretical background on what constitutes management. It analyzes different views on management of an organization as a process provided by different movements within the general management science. Also, the first chapter comparatively analyzes the role of management as a structural element of a public company according to the major corporate government theories. The second chapter in a comparative perspective examines legal provisions of Germany, the United States and Ukraine that determine the legal position of management in a public company. The study touches upon how laws of the three states regulate matters of formation and dismissal of management, composition and committees of the board of directors, manager remuneration, duties and liability. The third chapter provides an insight into what position management factually occupies in German, United States and Ukrainian companies. It analyzes in details factual data on composition of the board of directors and its interaction with other elements of the management structure, manager remuneration, scope of manager duties and liability, responsiveness of management to shareholder interests, and general effectiveness in achieving set objectives.

CHAPTER 1. INTRODUCTORY REMARKS ON COMPANY MANAGEMENT

Before turning to the analysis of legal and factual regimes of management in the three selected counties, this chapter elaborates on what constitutes management as a process and what place major corporate governance theories assign to management as a structural unit in the corporate system.

1.1. THEORETICAL VIEWS ON MANAGEMENT

The notion of management was evolving along with changing social and business relations, developing scientific knowledge, improving production technologies, and emerging means of communication and information processing. As soon as management practices improved to the level of an independent professional activity designed to provide interconnection and unity of the entire production process, the science of management was shaped. This subchapter provides a brief overview of its major theories and movements in order to identify the essence of the senior management process and distinguish determinants of its effectiveness.

1.1.1. CLASSICAL MANAGEMENT THEORY

The classical theory of management was developed in the period between 1885 and 1940. It combines the oldest and the most basic doctrines substantiating the process of organization management from a scientific and rational side. Being highly influenced by the Industrialization, this theory mostly elaborates on the ways to most efficiently plan, organize and control activities of an organization.[7]

[7] Wolfgang Pindur et al., *The History of Management: A Global Perspective,* 1 J. MANAG. HIST. 59, 60 (1995).

1.1.1.1. Henri Fayol's General Theory of Business Administration

Henry Fayol is a founder of the general theory of business administration within the classical theory of management. He was the first among scholars of the field to focus on the examination of duties and efficiency of organization's senior management, rather than distinct processes at the executive level.[8] By starting to analyze functionality of administrative management, Fayol developed a more extensive approach to the study of the subject and laid down a foundation of the modern organization theory.[9]

Henri Fayol suggested that every industrial organization is engaged into numerous activities of different kinds, which can be divided into six groups: technical (related to different stages of production), commercial (involving relations of purchase, sale and exchange), financial (aimed at using capital in the most efficient way), security (ensuring appropriate level of protection to organization's material and human resources), accounting (keeping records of revenues and expenses, and analyzing statistical data), and managerial activities.[10] Fayol paid primary attention to the last group of activities that, in his opinion, were aimed at "drawing up the broad plan of operations of the business, with assembling personnel, co-ordinating and harmonizing effort and activity."[11]

According to Fayol's initial detailed definition, "to manage" includes "to forecast and to plan, to organise, to command, to co-ordinate and to control."[12] Specifically, planning requires preliminary analysis of future conditions and elaboration of a suitable plan of action, prescribing a sequence of steps that should be undertaken and a result that is eventually anticipated.[13]

[8] MORGEN WITZEL, FIFTY KEY FIGURES IN MANAGEMENT 96 (London: Routledge 2003).
[9] Pindur et al., *supra* note 7, at 62.
[10] HENRI FAYOL, GENERAL AND INDUSTRIAL MANAGEMENT 3 (Constance Storrs trans., London: Sir Isaac Pitman & Sons 1949); Mildred Golden Pryor & Sonia Taneja, *Henri Fayol, Practitioner and Theoretician – Revered and Reviled*, 16 J. MANAG. HIST. 489, 491 (2010).
[11] FAYOL, *supra* note 10, at 5.
[12] *Id.* at 6.
[13] *Id.* at 43.

Fayol devotes a huge part of his research to the essence of the organizing element of management, which he saw in most efficient provision of an organization with different kinds of resources, in particular, raw materials, funds, tools and manpower.[14] More precisely, Fayol states that proper personnel management is the core of this task, since the key to success of an undertaking is having right people performing right tasks and applying right skills.[15]

In what concern managers' command, Fayol distinguishes its mission, object and art. The first consists in setting operation of an undertaking, the second – in getting maximum output from employees, and the third is founded on personal attributes and understanding of fundamentals of management.[16]

The co-ordination element provides that management harmonizes all relevant activities so that to ensure their efficiency and success, proportionally balances tasks and efforts, and conforms ends and means.[17]

Finally, when exercising control, management verifies whether an organization operates in line with an approved plan, instructions and principles.[18] Information obtained as a result of control activities may not always be accessible through routine supervision, while it can serve as a valuable auxiliary tool for management, allowing it to fix any existent flaws, prevent their recurrence and, thus, avoid unforeseen crises.[19]

In addition to the above described elements of managerial activity, Henri Fayol made a list of fourteen general principles of management, which are division of labor (providing for maximum effectiveness from applied efforts), authority (requiring obedience and fulfillment of orders), discipline (expecting sufficient efforts from all chains of the system), unity of command (prescribing accountability of an employee to only one supervisor), unity of

[14] *Id.* at 53.
[15] *Id.* at 53-54.
[16] *Id.* at 97.
[17] *Id.* at 103.
[18] *Id.* at 107.
[19] *Id.* at 107, 109.

direction (leading an entire undertaking along a single line of action towards common goals), subordination (calling for submission of individual interests to the needs of an entity), remuneration (serving as a fair reward and means of motivation), centralization (prescribing integration of authority and control), scalar hierarchy (providing for clear understanding of one's place in the system), order (requiring that all organization's activities are regularized and every unit, either material or human, is placed at the right place), equity (anticipating fair relations between management and employees), stability of personnel tenure (providing employees with sufficient time to accustom to their workplace and encouraging them to work at full), initiative (facilitating employee concern about organization's advancement), and *esprit de corps* (maintaining morale and cohesion in the working environment).[20]

Not all of the developments of Henri Fayol remained equally demanded by future generations of theorists and practitioners. For instance, over the time, some of the fourteen general principles of management lost their relevance, for instance, scalar hierarchy, centralization and stability of personnel tenure.[21] Instead, Luther Gulick revised and supplemented Fayol's five elements of managerial activity so that they ultimately included planning, organising, staffing, directing, co-ordinating, reporting and budgeting, and formed the commonly known acronym POSDCORB.[22] Irrespective of the nature of organization's business, any manager in a varying degree has to undertake these activities in his line of duty.[23] In this way, even if not in their original form, some of Fayol's theses got a firm foothold and served as a basis for new theories and movements in management studies.

[20] Pryor & Taneja, *supra* note 10, at 491-492, 499.
[21] WITZEL, *supra* note 8, at 99.
[22] Pindur et al., *supra* note 7, at 63.
[23] WITZEL, *supra* note 8, at 98.

1.1.1.2. Lyndall Fownes Urwick's Comprehensive Theory of Management Administration

Lyndall Fownes Urwick was the one who effectively consolidated numerous attainments of his predecessors and contemporaries, and eventually became the main contributor to the development of modern management doctrine and practices.[24] He addressed a wide range of issues in the plane of management, but upheld the general view that essentially the same management techniques are to be applied to all kinds of organizations, whether business, governmental or academic.[25]

When enunciating his theory of management of an organization, Urwick highly relied on Fayol's functional approach to the role of an executive.[26] Similar to Fayol, Urwick supported an idea that chiefs should follow clear rules and principles when exercising their managerial functions. Urwick developed sort of a "code of a good practice" containing a list of ten principles of management interpreting basic processes in administering an organization and emphasizing those of them he considered to be crucial.[27] Specifically, these principles include objective (providing that the sense of existence of any undertaking is its overall purpose), specialization (requiring that activities of a single organizational group was if possible limited to performing one function), co-ordination (effectively ensuring unity of efforts), authority (calling for a well-defined line of authority between all units of an organization), responsibility (providing for absolute accountability of supervisors for acts of their subordinates), definition (requiring that all duties, tasks and authority relations were clearly defined and brought to employee attention), correspondence (providing for conformity between the extent of authority and responsibility), span of control (excluding the possibility for a supervisor to exercise control over more than five-six subordinates with

[24] *Id.* at 299.
[25] John Trinkaus, *Urwick on the Business Academy*, 35 BUS. HORIZONS 25, 25, 27 (1992).
[26] EDWARD BRECH ET AL., LYNDALL URWICK, MANAGEMENT PIONEER: A BIOGRAPHY 75 (New York: Oxford University Press 2010).
[27] GERALD A. COLE, MANAGEMENT THEORY AND PRACTICE 22 (6th ed., Cengage Learning EMEA 2004).

interlocked tasks), balance (calling for balanced correlation between all organizational units), and continuity (requiring that organization's functionality was maintained, *inter alia* through its re-organization).[28]

Trying to provide a definition of management, Lyndall Urwick developed an unconventional approach. In his line of theorizing, Urwick initially firmly followed the position of his predecessor Frederick Taylor, although noticeably expanding it. He preferred to study every issue within the management topic by scientific means, "through definition, analysis, measurement, experiment, and proof, as in the physical or 'exact sciences'".[29]

However, over the time, Urwick managed to synthesize his findings with a response to being criticized for too little regard to a human relations factor in the structure of management. As a result, his theory considers management not as a complex of practices, but as "a spirit of enquiry" that is personal and individualistic, and "giving rise to systematic and organized bodies of managerial knowledge."[30]

1.1.2. BEHAVIORAL MANAGEMENT MOVEMENT

The behavior management movement developed in 1920s and 1930s, as a response to the limited approach of classicists viewing management as a set of impersonal techniques to increase efficiency of an organization. On the way to satisfying organization's needs and achieving its goals, the movement assigns a major role to human psychology, leadership, group motivation and relationships, rather than plain mechanics of management.[31]

[28] *Id.* at 22-23; BRECH ET AL., *supra* note 26, at 190.
[29] Lee D. Parker & Philip Ritson, *Rage, Rage against the Dying of the Light: Lyndall Urwick's Scientific Management*, 17 J. MANAG. HIST. 379, 383 (2011).
[30] *Id.* at 390.
[31] COLE, *supra* note 27, at 30; Pindur et al., *supra* note 7, at 65.

1.1.2.1. Mary Parker Follett's Human Relations School of Management

Mary Parker Follett is a founder of the human relations direction of the management theory. She is best known for challenging effectiveness of the previously established model of management as built on command and control.[32] In her works, Follett addressed human relations as a determining factor for organization's success,[33] where power of management is exercised not "over" employees, but "with" them.[34] As an alternative to former views, Follett suggested a more philosophic and creative approach to management as "the art of getting things done through people."[35]

In what concerns control, Follett prefers it to be carried out towards flows of information and facts, rather than people. In addition, control cannot be effective when imposed by a single source, but should present a balance of controlling activities within different parts of an organization.[36]

Follett suggests that coordination can better provide for achievement of organization's purposes. She also identifies four principles of coordination, which are comprehensive account for all factors of a certain situation, direct control of all people involved in it, commencement in early stages, and continuous nature of coordination process.[37]

As one of the main points of her theory, Follett impugns the role of technical experts who belittle significance of not only ordinary workers, but top managers. This situation of unconditional reliance on expert skills and opinions makes managers dependent that is threatening.[38] Instead of following inflexible indurate schemes, one should independently obtain necessary knowledge, form his own opinion, make his own decisions and shape his

[32] WITZEL, *supra* note 8, at 102.
[33] COLE, *supra* note 27, at 35.
[34] Lee D. Parker & Philip Ritson, *Fads, Stereotypes and Management Gurus: Fayol and Follett Today*, 43 MANAGE. DECIS. 1335, 1342 (2005) [hereinafter Parker & Ritson, *Fayol and Follett*].
[35] W. DAVID REES & CHRISTINE PORTER, THE SKILLS OF MANAGEMENT 2 (5th ed., Cengage Learning EMEA 2001), *citing* PAULINE GRAHAM, DYNAMIC MANAGING: THE FOLLETT WAY (Professional Publishing 1988).
[36] WITZEL, *supra* note 8, at 104.
[37] Mary Parker Follett, *The Process of Control*, IN PAPERS ON THE SCIENCE OF ADMINISTRATION 159, 163-165 (Lyndall Gulick & Luther Urwick eds., New York: Institute of Public Administration 1937).
[38] MARY PARKER FOLLETT, CREATIVE EXPERIENCE 20-21 (Longmans, Green and Co. 1930).

own line of action. Follett claims that such a liberal and creative approach to using knowledge serves as a strong motivation force, and not just for individuals, but also for individuals organized in units.[39] This is her great attainment in the field of organization behavior that not even that much challenged, but rather supplemented previously developed concepts of business management.

Finally, Follett contributed to the development of conflict management, suggesting that conflict may not always be destructive and improvident.[40] In a conflict situation, instead of struggling for domination or compromise, Follett suggests opposing sides to integrate their positions and satisfy needs of both of them. This option not only brings the "win-win" outcome to the very conflicting individuals or groups, but facilitates achievement of organization's purpose in general.[41]

1.1.2.2. Herbert Alexander Simon's Theory of Administrative Behavior

Herbert Alexander Simon is a founder of the behavioral approach to management. Contrary to the adherents of classical administrative management, attempting to rationalize and mechanize organization management, Simon highlighted human factor as its core element: "Since organisations are systems of behaviour designed to enable humans and their machines to accomplish goals, organisational form must be a joint function of human characteristics and the nature of the task environment."[42] The matters of particular interest for Simon were processes of strategic thinking, causal reasoning, decision making, problem solving and organizational relations.[43] At the same time, unlike Follett focusing primary on psychological and interpersonal aspects of administration, Simon was mainly concerned with

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[39] WITZEL, *supra* note 8, at 104.
[40] Pindur et al., *supra* note 7, at 65.
[41] *Id.*; Parker & Ritson, *Fayol and Follett*, *supra* note 34, at 1342.
[42] COLE, *supra* note 27, at 8, *citing* HERBERT A. SIMON, ADMINISTRATIVE BEHAVIOUR (3rd ed., Collier Macmillan 1976).
[43] Behrooz Kalantari, *Herbert A. Simon on Making Decisions: Enduring Insights and Bounded Rationality*, 16 J. MANAG. HIST. 509, 510 (2010); WITZEL, *supra* note 8, at 278.

seeing into the nature and structure of thinking processes and reasoning human behavior in a scientific way.[44] Consequently, he managed to present the most balanced way to combine behavioral and rational approaches in the plane of the management science.

In his scientific works, Herbert Simon actively criticizes the notion of principles of management for being scientifically groundless, inapplicable and contradictory that allows considering them as nothing more than "proverbs". For instance, he argues that the principles of unity of command and delegation of authority are mutually exclusive.[45]

Simon sees excessive rationality as the main flaw of the administrative theory advocating the principles approach. It assumes availability of exhaustive information about a situation that calls for certain decision, and the theory offers a universal solution fully satisfying all interested parties. In reality, however, this is impossible for two reasons. First, complete and fully reliable information is never accessible for organization managers.[46] Second, these are people, not organizations, who make decisions, and they never act absolutely rationally.[47] They should and do apply "satisficing" in order to reach results "good enough" for a particular situation, rather than theoretically suggested optimum solution.[48] This pattern called "bounded rationality" is one of Herbert Simon's major developments.

Simon proceeds further in his examination and characterizes the very organization as a boundary to rationality. The entire complex of information within an organization may be divided into two categories: facts supported by material data and values developed under the influence of intraorganizational culture and attitudes. When making their decisions, managers not only handle shortage and inadequacy of information, but also adjust these decisions to the values of an organization. In this way, organizations limit absolute rationality, and this is

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[44] Kalantari, *supra* note 43, at 510.
[45] *Id.* at 510-511.
[46] WITZEL, *supra* note 8, at 280.
[47] Kalantari, *supra* note 43, at 512.
[48] Pindur et al., *supra* note 7, at 66; WITZEL, *supra* note 8, at 280.

their very important feature ensuring that thinking and decision making activities are referred towards their goals.[49]

A single study that combines accomplishments of classic business administration theory with a more human-oriented approach is Simon's main contribution. It supported the innovation brought by the human relations movement to the management science, and secured that in the second half of the 20th century, the attitude towards knowledge within an organization shifted from disregard to acknowledgment of its importance.[50]

In the opinion of the author of this research, Herbert Simon's approach to understanding management of an organization is the most adequate out of all general theories of management analyzed in this section. It does not limit its scope with focusing on either human factor within the management process or its scientific and rational characteristics, but provides for comprehensiveness and balance between these two, thus, bringing the management science closer to managerial activities as they are in reality.

1.2. Role of Management in Major Corporate Governance Theories

In their landmark study, Berle and Means ascertain that compared to the former corporate system, an innumerable set of owners that "invests in a modern corporation so far surrenders his wealth to those in control of the corporation that he has exchanged the position of independent owner for one in which he may become merely recipient of the wages of capital."[51] Therefore, the two main characteristics of modern corporations are the aggregation of wealth of countless persons under a single corporate mechanism, and the separation of owners from managers making decisions and exercising control over an entire entity.[52]

[49] WITZEL, *supra* note 8, at 280-281.
[50] Pindur et al., *supra* note 7, at 66; WITZEL, *supra* note 8, at 281.
[51] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 3 (New York: The Macmillan Company 1933).
[52] *Id.* at 3, 6.

The situation creates favorable conditions for managers to go for their own interests, diverging from those of owners of corporate property.[53] This *inter alia* raised the question of "regulation" of managers' activities and the need for governance as "rules of the game for managers."[54] Various corporate governance theories address these issues each in its own fashion. This subchapter provides an insight into exactly what is the role of management of a corporation according to major corporate governance theories.

1.2.1. AGENCY THEORY

The agency theory of corporate governance views relationship between owners of a corporation and those actually controlling it as shaped in a form of an agency contract. According to this contract, shareholders are principals who authorize other persons, that is, managers, to act as their agents and to take on their behalf certain category of decisions in what relates to running a corporation.[55] It is worth mentioning here that the agency theory considers "management" to be compiled of not only the board directors, but also senior corporate officers. Despite the differences in the procedures of their formation and accounting, these both constituents of management act collectively on behalf of shareholders, owe them the same duties and subject to their control.[56]

Two opposite views on a corporation determine its purpose and, thus, the main objective of its management. Traditionally a corporation is considered to be private property

[53] *Id.* at 6.

[54] GÉRARD J. CHARREAUX, CORPORATE GOVERNANCE THEORIES: FROM MICRO THEORIES TO NATIONAL SYSTEMS THEORIES 1 (Université de Bourgogne, Working Paper of FARGO No. 1041202, December 2004), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=486522.

[55] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

[56] Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers are Fiduciaries*, 46 WM. & MARY L. REV. 1597, 1606-1607 (2005).

of its shareholders, and the main and ultimate goal of management is to maximize their wealth by means of increasing profitability of a corporation.[57]

Yet, along with evolution of the concept of a public corporation, there developed another view on a corporation as a social establishment that does not serve exclusively for shareholder benefit.[58] Law now recognizes a corporation as being perpetual, having its legal personality separate from those who initially invested in it and bearing liability limited only to the amount of its assets. Such privileges are legislatively given to corporations, since they are believed to be called to facilitate general welfare, rather than strictly maximize shareholder profits. That is, a corporation is viewed as an entity separate from its initial founders, and the task of its management is to act in its best interests, at the same time balancing interests of all parties related to it.[59]

Agency relationship is fiduciary in its nature,[60] suggesting that managers act in the best interests of shareholders, rather than their own. This relationship does not admit that interests of any other stakeholders may prevail over those of principals,[61] while presuming that by their nature managers tend to act opportunistically and serve their own interests.[62] To ensure control over their agents and prevent them from self-serving conduct principals incur certain expenditures, which are viewed as "agency costs".[63]

[57] *See* Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 832 (1999); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264-265 (1992).

[58] Leo L. Clarke et al., *The Practical Soul of Business Ethics: The Corporate Manager's Dilemma and the Social Teaching of the Catholic Church*, 29 SEATTLE U. L. REV. 139, 151-152 (2005); KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES 153-154 (Chicago: University of Chicago Press 2006).

[59] Allen, *supra* note 57, at 265.

[60] RESTATEMENT (SECOND) OF AGENCY § 1.

[61] Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273 (1982).

[62] James H. Davis et al., *Toward a Stewardship Theory of Management*, 22 ACAD. MANAGE. REV. 20, 23 (1997).

[63] Jensen & Meckling, *supra* note 55, at 308.

However, the primacy of shareholder interests cannot be properly concerted with the nature of a corporation as a separate legal entity,[64] as well as with the need to balance interests of other constituencies, for instance, creditors, equity owners, employees, consumers and communities.[65] In case when interests of an entity and its shareholders coincide, no problem usually arises. However, if those differ, managers face the dilemma between whether to choose and defend interests of a corporation or shareholders.[66] This is the incongruity within the agency theory.

As a result, scholars argue that principal-agent relationship should be reexamined so that to eliminate the need for managers to choose whether to maximize profits of a corporation or its shareholders. Still, even if the need for such a choice arises, managers should remain committed primarily to the advancement of a corporation.[67] Such a unipolar preference can hardly be compatible with traditional view on owner-manager relationship of the agency theory. Consequently, manifold views on what is the role of management in a corporation were developed within other corporate governance theories. Nevertheless, in the U.S., relations between company shareholders and its managers are still characterized as based predominantly on the principal-agent model.[68]

1.2.2. STEWARDSHIP THEORY

The stewardship theory provides an alternative to the agency theory in what concerns initial pursuits of managers. Specifically, it contests an assumption that managers are "opportunistic" and tend to maximize their personal wealth instead of caring of shareholders'

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[64] Allen, *supra* note 57, at 267.

[65] Leo L. Clarke, *supra* note 58, at 151-152.

[66] Z. Jill Barclift, *Fuzzy Logic and Corporate Governance Theories*, 6 PIERCE L. REV. 177, 186 (2007).

[67] Johnson & Millon, *supra* note 56, at 1644.

[68] Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AMER. J. COMP. L. 31, 31-32 (2005).

interests.[69] The theory sees managers as having pro-organizational, rather than individualistic and self-serving attitude towards the fulfillment of their duties in a corporation, and even in case when interests of an entity and its managers conflict, the latter will most likely act for the benefit of a corporation.[70]

The two theories analyze different relationship models between constituencies of an organization, as well as put forward different means of ensuring adequate performance on the part of managers. In particular, the agency theory argues that principals should apply coercive and financially stimulating incentives to make agents work properly.[71] In contrast, the stewardship theory suggests that principal-agent relationship was substituted with trust-based interaction between outside principals (shareholders), inside principals (board directors) and stewards (executive officers).[72] Stewards are motivated by a pattern where the better off an entity is, the more satisfied all of its stakeholders are, including owners and managers themselves.[73]

With such a clear focus on welfare of a corporation, the stewardship theory reduces the need for officers to choose whose interests to defend above all. However, the dilemma does not disappear completely. Although it is implied that the primary goal of managers' decisions is maximization of organization profits, officers know that directors watch their performance and they seek to ensure that directors will favorably evaluate it.[74]

The stewardship theory has its weak places, giving rise for its criticism. An essential condition for principal-steward relationship is managers' pro-organizational rather than individualistically oriented behavior, which is an assumption to the very same extent as an

[69] Davis et al., *supra* note 62, at 23; Lex Donaldson & James H. Davis, *Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns*, 16 AUST. J. MANAG. 49, 51 (1991).
[70] Davis et al., *supra* note 62, at 24.
[71] *Id.* at 31.
[72] *Id.* at 24-25.
[73] *Id.* at 25-26; Arad Reisberg, *The Notion of Stewardship from a Company Law Perspective: Re-Defined and Re-Assessed in Light of the Recent Financial Crisis?*, 18 J. FIN. CRIME 126, 128-129 (2011).
[74] Barclift, *supra* note 66, at 189.

assumption about managers' inherent opportunism of the agency theory, lacking certainty and irrefutability.[75] Also, the theory does not provide clear answers on the questions how to balance between building principal-stewardship relationship based on trust and the need to monitor potential errors and/or disinformation on the part of managers;[76] as well as how to control managers' performance at least to a minimal degree, but still preserve the trust element in the relationship.[77] Due to the fact that the theory is relatively young, no sufficient empirical evidence about how these situations are addressed in practice has been collected so far.

1.2.3. STAKEHOLDER THEORY

The stakeholder theory also challenges one of the postulates of the agency theory, namely, the primacy of shareholders' interests. It provides that in the same way as the shift in the shareholder-manager-employee relationship model once led to changed perception of private property and management, the emergence of other groups of parties somehow interested in corporate performance, requires reassessment of the corporation's traditional role exclusively as a means of profit maximization.[78] In the changed circumstances, a corporation should take due account of interests of all groups and individuals having "a stake" in a corporation.[79] This theory suggest a relationship model that in the best way describes corporate relations as they are approached in Germany, where managers are accountable to a company, rather than its shareholders, and have to balance interests of all of its stakeholders.[80]

[75] Jens Grundei, *Are Managers Agents or Stewards of Their Principals? Logic, Critique, and Reconciliation of Two Conflicting Theories of Corporate Governance*, 58 ZEITSCHRIFT FÜR BETRIEBSWIRTSCHAFT 141, 148 (2008).
[76] *Id.* at 149.
[77] *Id.* at 154-155.
[78] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 24 (Cambridge University Press 2010).
[79] *Id.* at 25.
[80] Peter Kolla, *The Mannesmann Trial and the Role of the Courts*, 5 GERM. L. J. 829, 831-832 (2004).

The rationale behind is that these interests should not be set against each other, as well as viewed as a sacrifice in a form of corporation's profits, but can be integrated so that to contribute to its profitability in the long term.[81] This sets a challenging task before management to make decisions and distribute corporate resources in a way so that to benefit legitimate stakeholders.[82]

However, the proposed approach to management entails numerous difficulties, without providing anything like acceptable solutions. First of all, there are no consistent criteria for determining "legitimate" stakeholders. Some scholars distinguish those based on whether there exist a contractual relationship between a corporation and its stakeholders (for instance, owners, employees, creditors, suppliers, consumers, etc.).[83] Others tend to identify stakeholders as all groups and separate persons influencing, or coming under the influence of, the degree to which the corporate purpose is accomplished (for example, competitors, media, local community organizations, society in general).[84] Being uncertain about whose interests they should address, managers are unable to determine what these interests actually are.

Additionally, when a number of target groups of managers' activities increases, this raises an issue of their accountability. If managers remain accountable exclusively to shareholders, the ability of other stakeholders to influence performance of corporate purpose is belittled, while if managers become accountable to every group of stakeholders, their efforts are dispersed and the efficiency of such accountability, thus, diminish.[85]

[81] Charles Blattberg, *Welfare: Towards the Patriotic Corporation*, IN FROM PLURALIST TO PATRIOTIC POLITICS: PUTTING PRACTICE FIRST 4, 8 (New York: Oxford University Press 2004), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2250348.

[82] Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MANAGE. REV. 65, 85 (1995).

[83] *Id.*; Thomas Clarke, *The Stakeholder Corporation: A Business Philosophy for the Information Age*, 31 LONG RANGE PLANN. 182, 187 (1998).

[84] FREEMAN, *supra* note 78, at 25.

[85] Thomas Clarke, *supra* note 83, at 186-187.

Finally, the need to balance between various interest groups may facilitate engagement into opportunistic and self-serving practices on the part of managers.[86] Even the scholars advancing the theory do acknowledge that there is still the need for legislators to provide rules and sanctions framing relationships of stakeholders.[87]

1.2.4. MEDIATING HIERARCHY THEORY

According to the authors of the mediating hierarchy theory, an agent-principal model examined by the agency theory provides a limited perspective on the nature of corporate relations. It is based on the presumption that these two roles are clearly attributed to particular people, while in practice, corporate relations are mostly ambiguous with a usual practice for its individual participant to perform multiple roles.[88]

Instead, the mediating hierarchy theory suggests considering a corporation as a team of people tied by a complex agreement to put efforts for their common benefit.[89] Within this model, no constituency is a principal exclusively enjoying the right of control.[90] It is exercised by hierarchs at each organizational level in order to prevent rent-seeking and shirking. In fact, the board of directors performs this task as well, standing at the top of the hierarch structure. Yet, rather than an agent of shareholders, the board acts as a trustee in relation to a company balancing conflicting interests of its constituencies so that to ensure efficiency of the entire team.[91]

Similar to the stewardship theory, the theory of mediating hierarchy does not consider directors as self-dealing, opportunistic and pursuing their own gain at the expense of a

[86] Donaldson & Preston, *supra* note 82, at 86-87.
[87] *Id.* at 87.
[88] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA L. REV. 247, 259 (1999).
[89] *Id.* at 278.
[90] *Id.* at 277.
[91] *Id.* at 280-281.

corporation and its stakeholders. This attitude positively correlates with the U.S. practice to seek increasing independence of corporate boards of directors.[92]

The rearranged model of corporate relations, seeing directors as company trustees, provides also for chief officers of a corporation to serve as stewards of the trust. In this way, the mediating hierarchy theory diminishes the manager's dilemma directing officer efforts on maximization of company's wealth.[93]

At the same time, practical applicability and consistency of the theory is criticized on several grounds. First, the theory extends the economic concept of team production on the whole corporation that generalizes its arguments and decreases its utility.[94] Second, it does not explain in what way it is possible for the board to maintain the balance of interests, when there is one dominating element among all corporate constituencies, for instance, a controlling shareholder.[95] Third, developers of the mediating hierarchy theory state that the team hires directors for them to *inter alia* exercise proper control within an organization,[96] while these is the board of directors who "hires factors of production, not the other way around,"[97] in their opinion, able to properly perform assigned tasks.

[92] CORPORATE GOVERNANCE AND BUSINESS ETHICS 57-58 (Alexander Brink ed., Springer 2011).
[93] Barclift, *supra* note 66, at 193.
[94] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 594 (2002-2003) [hereinafter Bainbridge, *Director Primacy*].
[95] *Id.* at 596-597.
[96] Blair & Stout, *supra* note 88, at 280.
[97] Bainbridge, *Director Primacy*, *supra* note 94, at 598.

CHAPTER 2. COMPARATIVE ANALYSIS OF THE LEGAL POSITION OF COMPANY MANAGEMENT IN GERMANY, THE UNITED STATES AND UKRAINE: SELECTED ASPECTS

The core of corporate relations between ownership and control lies in a clear division of powers between shareholders and the board of directors to the side of the latter who is considered to be a more efficient decision-maker.[98] This is the case in both single-tier and two-tier systems, where the board is authorized to monitor and control top managers, to determine the policy direction of a company, and to establish a set of contacts necessary for obtaining resources or other needs of the business.[99]

However, different countries undertake different approaches regarding how exactly to organize corporate governance. The two main organizational frameworks for governing a company provide for the operation of either a two-tier or single-tier managing system. The first system is legislatively mandatory in many states of Continental Europe, specifically, in Germany. In this case, law requires that management and supervision were legibly distributed between separate bodies of a company.[100] The second system is usually adopted by the Anglo-Saxon countries, including the United States. It prescribes performance of both managerial and supervisory functions for the single board of directors.[101] In Ukraine, the separation between supervision and management is mandatory, if the number of company

[98] Paul L. Davies, *The Board of Directors: Composition, Structure, Duties and Powers*, COMPANY LAW REFORM IN OECD COUNTRIES: A COMPARATIVE OUTLOOK OF CURRENT TRENDS 4-5 (OECD, Stockholm, Sweden, 7-8 December 2000), *available at*: http://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf.

[99] STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 64 (New York: Oxford University Press 2008) [hereinafter BAINBRIDGE, NEW CORPORATE GOVERNANCE].

[100] GREGORY FRANCESCO MAASSEN, AN INTERNATIONAL COMPARISON OF CORPORATE GOVERNANCE MODELS: A STUDY ON THE FORMAL INDEPENDENCE AND CONVERGENCE OF ONE-TIER AND TWO-TIER CORPORATE BOARDS OF DIRECTORS IN THE UNITED STATES OF AMERICA, THE UNITED KINGDOM AND THE NETHERLANDS 15 (3rd ed., Spencer Stuart 2002).

[101] *Id.*

shareholders equals or exceeds a clearly specified minimum.[102] However, the structural model of corporate governance in Ukraine is still at an early stage of its development. In fact, it formally combines separate components of all the traditional models,[103] which makes it difficult to clearly distinguish between duties and authorities of different management bodies and often hinders their effective operation.

This chapter analyzes different aspects of the position of management in a company as determined by laws and regulations of the three states and how these legal regimes relate to each other in a comparative light.

2.1. Election/Appointment and Dismissal of Managers

2.1.1. Germany

In Germany, the management board (*Vorstand*) of a public limited company is responsible for managing its activities.[104] The board may consist of one or more natural persons[105] who are appointed by the supervisory board for a renewable term of up to five years.[106] If there is more than one person in the management board, the supervisory board may designate one of them to be a chairman of the board.[107]

As a general rule, members of the supervisory board may not serve in the management board, but the former may appoint one of its members to perform the missing position in the latter for the period not exceeding one year, during which this person if refrained from serving in the supervisory board.[108]

[102] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 51.2 (2008).
[103] Yagmurdzhi, *supra* note 6, at 146.
[104] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 76(1) (1965).
[105] German Stock Corporation Act §§ 76(2), 76(3).
[106] German Stock Corporation Act § 84(1).
[107] German Stock Corporation Act § 84(2).
[108] German Stock Corporation Act § 105(2).

The supervisory board may revoke the appointment of a member or a chairman of the management board only “for a good cause”, which includes a gross of duty, inability to properly manage a company, a lack of confidence vote by the general meeting.[109]

In its turn, the supervisory board (*Aufsichtsrat*) of a German company is formed by the general meeting of shareholders and company’s employees. As well as in case of the management board, only natural persons are appointed as members of the supervisory board[110] for a period up to about five years.[111]

Shareholders, who elected members of the supervisory board at the general meeting without being bound to a nomination, may dismiss them by a three quarter majority of votes.[112] If a member of the supervisory board was appointed according to the articles of association, he may be dismissed by a person that made such appointment, or by the majority vote of the general meeting, if requirements of the articles regarding this appointment right are no longer applicable.[113]

2.1.2. THE UNITED STATES

In contrast, no two-tier system of management with compulsory representation of employees is anticipated under U.S. legislation. For instance, under the General Corporation Law of the state of Delaware[114] that is a corporate capital of the United States, except if otherwise is provided by law of the certificate of incorporation, “The business and affairs of every corporation … shall be managed by or under the direction of a board of directors.”[115]

[109] German Stock Corporation Act § 84(3).
[110] German Stock Corporation Act § 101(1).
[111] German Stock Corporation Act § 102(1).
[112] German Stock Corporation Act § 103(1).
[113] German Stock Corporation Act § 103(2).
[114] The Delaware General Corporation Law is incorporated in the Delaware Code Title 8, Chapter 1 [hereinafter DGCL].
[115] DGCL § 141(a).

Similarly as in Germany, the board of directors of a Delaware corporation may consist of one of more natural persons, and their exact number is established either by the bylaws or the certificate of incorporation.[116] However, unlike Germany, where shareholders participate in the election of directors indirectly, that is, through their representatives in the supervisory board, directors in the U.S. are elected directly at the annual meeting of shareholders, unless they decide to elect directors by written consent.[117] Also, as opposed to German boards of directors, these are holders of the majority of shares in a company who may remove any director or the whole board regardless of whether there is a cause for such an action.[118]

The wording of DGCL, stating that corporate affairs are to be managed "by or under the direction of a board of directors,"[119] makes it possible for directors to be in charge of general strategic decision making and monitoring, while delegating routine management of a company to specifically qualified subordinates.[120] Essentially the same option is affirmed by the Model Business Corporation Act of the American Bar Association,[121] providing that "All corporate powers shall be exercised by or under the authority of the board of directors of the corporation."[122] Based on these provisions, board directors may and do hire corporate officers to perform operational management, especially in large corporations.[123]

2.1.3. UKRAINE

In Ukraine, the law provides that it is obligatory for a public company to establish the supervisory board, if ten or more persons owe its common shares. In companies, where there

116 DGCL § 141(b).
117 DGCL § 211(b).
118 DGCL § 141(k).
119 DGCL § 141(a).
120 STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 231 (New York: Foundation Press 2002) [hereinafter BAINBRIDGE, LAW AND ECONOMICS].
121 The Model Business Corporation Act is adopted by the majority of the American states as a basis for their state corporate laws [hereinafter MBCA].
122 MBCA § 8.01(b).
123 ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW: TEXT AND CASES ON THE LAWS GOVERNING CORPORATIONS IN GERMANY, THE UK AND THE USA 305 (Cambridge University Press 2010).

are nine or less owners of common shares and the supervisory board is absent, its functions are performed by the general meeting.[124]

The supervisory board (*Nahlyadova rada*) of a company is responsible for protecting rights of shareholders, and exercising control and regulation over the executive body of a company within its authority as provided by the law and company's charter.[125] In contrast to Germany and the U.S., both natural and legal persons may serve in the board. To be elected as a member of the supervising director, a natural person must be of full civil capacity, while a legal person must owe shares of a company. A legal person may have an unlimited number of its representative in the supervisory board.[126] The provision allowing legal persons to be elected as members of the supervisory board is controversial, as it is said to provide a convenient cover for actual decision makers, at the same time isolating them from any liability.[127]

The first supervisory board is formed by the founders' meeting.[128] Subsequently, candidacies for supervising directors, their number in the board and conditions of their service are approved by the general meeting.[129] It is mandatory for public companies that members of their supervisory boards were elected through cumulative voting.[130] This voting procedure provides that the total number of votes of a shareholder is multiplied by the number of members of the board, and a shareholder may choose either to give all calculated votes for one candidate or distribute them in support of several candidates. This voting

[124] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 51.2 (2008).
[125] Law of Ukraine "On Joint Stock Companies," Art. 51.1.
[126] Law of Ukraine "On Joint Stock Companies," Art. 53.1.
[127] Анатолій Єфименко, *Корпоративне управління за Законом "Про акціонерні товариства": здобутки та помилки* [Anatoliy Yefymenko, *Corporate Governance Pursuant to Law "On Joint Stock Companies": Achievements and Mistakes*], 12 ЮРИДИЧНИЙ ЖУРНАЛ (2009), *available at:* http://www.justinian.com.ua/article.php?id=3370, [hereinafter Yefymenko, *Corporate Governance*].
[128] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 10.2(6) (2008).
[129] Law of Ukraine "On Joint Stock Companies," Art. 33.2(9), 53.7.
[130] Law of Ukraine "On Joint Stock Companies," Art. 53.3.

scheme is recognized to be very complicated,[131] but at the same time, it ensures that minority shareholder representatives participate in voting.[132] A chairman of the supervisory board may be elected from among its members by the simple majority of their votes.[133]

The term of service of supervising directors is prescribed by their contracts with a company. The general meeting may decide on early termination of powers supervisory board members, and in case of a public company this concerns the board *en banc*. Additionally, authority of every single director may be terminated at his own request or in case of his physical or legal inability to perform duties.[134]

The executive body (*Vykonavchyi Organ*) of a company manages its routine activities, being authorized to make decisions on all matters that are not prescribed to be performed exclusively by the general meeting and supervisory board.[135] The executive body may be established in the form of a collective body (e.g., a board, directorate) or a sole authority (e.g., a director, director general).[136] Members of the executive body are individuals with full civil capacity, who do not hold the position in the supervisory board or audit committee of the same company.[137]

Legal provisions addressing appointment and removal of members of the executive body, as well as its status in relation to other company bodies, establish quite a confusing model of power distribution between the general meeting and supervisory board. Specifically, according to the Law "On Joint Stock Companies", it is the supervisory board that is authorized to elect and terminate powers of a chairman and members of the executive body.[138] Also, these rights may belong to the general meeting as per the company's charter, in

[131] ГОСПОДАРСЬКЕ ПРАВО УКРАЇНИ 189-190 (Світлана Несинова ed., Київ: Центр учбової літератури 2012), [Svitlana Nesynova ed., COMMERCIAL LAW OF UKRAINE].
[132] Yefymenko, *Corporate Governance*, *supra* note 127.
[133] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 54.1 (2008).
[134] Law of Ukraine "On Joint Stock Companies," Art. 57.
[135] Law of Ukraine "On Joint Stock Companies," Art. 58.1.
[136] Law of Ukraine "On Joint Stock Companies," Art. 58.3.
[137] Law of Ukraine "On Joint Stock Companies," Art. 58.4.
[138] Law of Ukraine "On Joint Stock Companies," Art. 52.2(8).

which case the board is competent to dismiss a chairman and members of the executive body from duties and appoint a person temporarily performing duties of a chairman.[139] In its turn, the Civil Code explicitly authorizes the general meeting to form the executive body and to determine the scope of its powers and composition.[140] Finally, as provided by both the Civil Code and Law, the management board is accountable to both the general meeting of shareholders and supervisory board, and ensures fulfillment of their decisions.[141]

In order to hereinafter avoid confusion with terminology, it must be noted that the Law uses the term "officers" for natural persons serving as a chairman and members of the supervisory board, executive body and audit commission, a corporate secretary, chairman and members of any other body formed pursuant to the company's charter.[142]

2.2. Composition of the Board(s) of Directors

2.2.1. Germany

As noted above, members of the management board in Germany are appointed by the supervisory board according to provisions of the German Stock Corporation Act.

As for members of the supervisory board, their exact number depends on the company's constitution, while the proportion of shareholder/employee representatives – on the codetermination law that applies to the company.[143] Specifically, pursuant to the Codetermination Act of 1976, which is the most widely applicable law on codetermination in Germany, representatives of employees and those of shareholders each occupy half of the seats in the supervisory board.[144] However, these are shareholders who appoint the chairman,

[139] Law of Ukraine "On Joint Stock Companies," Art. 52.2(10), 61.2.
[140] Civil Code of Ukraine No. 435-IV, Art. 99.1 (2003).
[141] Civil Code of Ukraine, Art. 161.1; Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 58.2 (2008).
[142] Law of Ukraine "On Joint Stock Companies," Art. 2.1(15).
[143] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, §§ 95, 96 (1965).
[144] German Act on Co-determination by Employees (BGBl. I, p. 1153), Sec. 7(1) (1976).

while employees are entitled to appoint the vice-chairman.[145] Due to the fact that the chairman of the supervisory board shall have a casting vote in case of a voting deadlock,[146] it is possible to consider the balance of power in the supervisory board to be slightly more shifted in favor of shareholders.[147]

German law provides no tough requirements on independence of the supervisory board. Recommendatory provisions of the German Corporate Governance Code (GCGC) assign the board itself to "include what it considers an adequate number of independent members."[148] Independence of a supervisory board member provides for the absence of his "personal or business relations with the company, its executive bodies, a controlling shareholder or an enterprise associated with the latter which may cause a substantial and not merely temporary conflict of interests."[149] In addition, the Code insists that not more than two former management board members served as supervising directors and supervisory board members did not provide directorial, advisory or similar services to company's important competitors.[150]

2.2.2. THE UNITED STATES

In the United States, companies are pushed to ensure that the number and influence of non-executive directors, especially, independent ones, in their boards of directors were enhanced.[151]

Particularly, major stock exchanges establish detailed requirements on director independence in their rules. Both the NASDAQ and NYSE demand that their listed

[145] German Act on Co-determination by Employees, Sec. 27(1).
[146] German Act on Co-determination by Employees, Sec. 29(2).
[147] Otto Sandrock & Jean Jacques du Plessis, *The German System of Supervisory Codetermination by Employees*, IN GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 149, 158 (Jean Jacques du Plessis et al. eds., Springer 2012).
[148] GCGC Sec. 5.4.2 (2013).
[149] GCGC Sec. 5.4.2.
[150] GCGC Sec. 5.4.2.
[151] Davies, *supra* note 98, at 8.

companies had the majority of their boards comprised of independent directors.[152] The NASDAQ Stock Market Rules specify that an independent director is "a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."[153] Similarly, the NYSE Manual stipulates that a director cannot be considered independent unless the board establishes that he has no material relationship with a company, "either directly or as a partner, shareholder or officer of an organization that has a relationship with the company."[154]

Also, for instance, based on the privately elaborated guidelines of the California Public Employees' Retirement System, the principles of board independence and leadership provide *inter alia* that the substantial majority of the boards is to be composed of independent directors; that if a chair of the board serves at the same time as a company's chief executive officer (CEO), the board either formally or informally appoints an independent director for leading and coordinating other independent directors; and that any director cannot also act as a consultant and/or service provider towards a company.[155]

As opposed to the other two countries, it is a usual practice in the United States, when the chairman of the board of directors also serves as the company's CEO.[156] The two-tier systems of Germany and Ukraine does not provide for such duality, although they do not mandatorily forbid it in their corporate laws. This does not automatically depend on whether a governing body of a company has one or two tiers either. The legislator of the United Kingdom tries to avoid too strong concentration of power in a single source and, thus, insists

[152] NASDAQ Stock Market Rules, rule 4350(c)(1); NYSE Listed Company Manual § 303A.01.
[153] NASDAQ Stock Market Rules, rule 4200(a)(15).
[154] NYSE Listed Company Manual § 303A.02(a)(i).
[155] U.S. CORPORATE GOVERNANCE 107-108 (Donald H. Chew & Stuart L. Gillan eds., Columbia University Press 2009).
[156] THOMAS CLARKE, INTERNATIONAL CORPORATE GOVERNANCE: A COMPARATIVE APPROACH 70 (Routledge 2007).

that a company excluded the opportunity for the chairman of the board to serve as its chief executive.[157] Although the United Kingdom is outside the scope of this research, it is a good example of a single-tier board system that stands for the separation of monitoring and executive functions of the CEO. In Germany and Ukraine, the duality is impossible, simply because executive officers are not allowed to seat in the supervisory board and, thus, are physically separated from its leadership.[158]

2.2.3. UKRAINE

In Ukraine, the main Law "On Joint Stock Companies" does not provide any requirements on independence of members of the supervisory board. In fact, it introduces provisions not fully compatible with the best corporate governance practices on independence.[159] In particular, the Law allows for a legal person sitting in the supervisory board to have an unlimited number of proxies in the board. Also, the way a proxy acts in the board is to be determined by his shareholder.[160]

Some detailed prescriptions on independence of the supervisory board are contained in the Principles of Corporate Governance approved by the State Commission for Securities and Stock Market of Ukraine based on the model principles elaborated by the OECD. However, the Principles may not be considered as an effective regulatory tool, since they are of recommendatory nature, and companies do not predominantly adhere to them.[161]

[157] UK Corporate Governance Code, Sec. A.2.1 (2012).
[158] MAASSEN, *supra* note 100, at 15.
[159] Yefymenko, *Corporate Governance*, *supra* note 127.
[160] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 53.1 (2008).
[161] *Ukraine – Report on the Observance of Standards and Codes (ROSC): Corporate Governance Country Assessment*, WORLD BANK 3 (Oct. 2006), *available at*: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/11/20/000334955_20081120054615/Rendered/PDF/465440ESW0P0961BLIC10UA0rosc1cg1ukr.pdf.

The Principles recommend that no less than 25% of members of the supervisory board were independent directors.[162] The Principles characterize an independent director as the one who is independent of company executives, its related entities, and major contractors, and is not involved in any other relations with a company that may affect independence of his judgment.

Categories of persons who do not meet the criterion of independence include: current and former (in the period within the past three years) executives of a company or its subsidiaries, persons related to a company or its contractors, persons that receive from a company any income other than remuneration for serving in its board and profits arising from owing its shares, owners of more than 5% of company's shares, and representatives of the state.[163]

2.3. COMMITTEES OF THE BOARD OF DIRECTORS

2.3.1. GERMANY

German law does not mandatorily require that specialized committees were formed within the system of management. The Stock Corporation Act provides an option for the supervisory board to compose one or more committees from its members.[164] It specifically mentions the possibility to establish an audit committee so that to supervise accounting process and monitor effectiveness of the systems of internal control, risk management and internal revision, both independently and in addition to the external audit.[165] The recommendation to set up an audit committee is also contained in the GCGC.[166] Additionally, the Code mentions that the supervisory board may assign shareholder representatives to form

[162] Principles of Corporate Governance, as attached to the Resolution of the State Commission for Securities and Stock Market of Ukraine No. 571 "On approval of the Principles of Corporate Governance," Sec. 3.1.5 (December 11, 2003).
[163] *Id.* Sec. 3.1.5.
[164] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 107(3) (1965).
[165] German Stock Corporation Act § 107(3).
[166] GCGC Sec. 5.3.2 (2013).

a nomination committee that shall be charged with selecting candidates to the supervisory board to be approved by the general meeting.[167]

Although committees of the supervisory board are still less popular in Germany as opposed to the United States, the number of audit, nomination and compensation committees in boards of German companies is gradually increasing.[168] If established, all committees are expected to prepare board's deliberations and resolutions and to supervise performance of resolutions issued before.[169] Committees are obliged to regularly report to the board on their activities.[170] It is impermissible that specific issues entrusted exclusively to the supervisory board were decided by any committee instead of the board.[171]

2.3.2. THE UNITED STATES

It is possible throughout the country for the board to set up committees with a view to perform some of its functions. Still, laws of some states require that an option to establish committees was clearly prescribed by the company's articles of association or bylaws.[172] For instance, in Delaware, the board may establish one or more committees, each of them composed of one or more directors.[173] Authority of a committee shall be specified in the resolution of the board or bylaws of a company, and may relate to any part of management of a company, except for matters that need to be approved by shareholders and those in any way modifying company's bylaws.[174]

[167] GCGC Sec. 5.3.3.
[168] KLAUS J. HOPT & PATRICK C. LEYENS, BOARD MODELS IN EUROPE – RECENT DEVELOPMENTS OF INTERNAL CORPORATE GOVERNANCE STRUCTURES IN GERMANY, THE UNITED KINGDOM, FRANCE, AND ITALY 5 (European Corporate Governance Institute, Law Working Paper No. 18/2004, January 2004), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=487944.
[169] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 107(3) (1965).
[170] German Stock Corporation Act § 107(3); GCGC Sec. 5.3.1 (2013).
[171] German Stock Corporation Act § 107(3).
[172] BAINBRIDGE, LAW AND ECONOMICS, *supra* note 120, at 230.
[173] DGCL § 141(c)(2).
[174] DGCL § 141(c)(2).

The federal Sarbanes-Oxley Act (SOX) provides a list of requirements concerning formation, composition and independence of audit committees that should be met by companies listed with national securities exchanges.[175] Each stock exchange is entitled to supplement the list, as well as to require establishment of other committees.

In particular, except for an obligation to form an audit committee,[176] the New York Stock Exchange makes it mandatory for boards of listed companies to have a nominating/corporate governance committee,[177] and a compensation committee.[178] In its turn, the NASDAQ Stock Market requires that audit committees of boards of listed companies were composed of minimum of three independent directors.[179] Additionally, members of the committee shall neither receive any fee except for their service in the board, nor be an affiliated person of a corporation.[180]

2.3.3. UKRAINE

Similarly to the United States and Germany, Ukrainian law gives an option to the supervisory board to establish permanent or temporary committees from among its members for the purpose of studying and preparing issues within the competence of the board. The Law specifically mentions committees on audit and information policy.[181] It is the authority of the supervisory board to determine the procedure and scope of committee activities.[182] The law only requires that chairmen of audit committees were members of the supervisory board chosen on proposal of shareholders that do not control activities of a company.[183]

[175] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 165 Stat. 245, Sec. 301 (2002).
[176] NYSE Listed Company Manual § 303A.06.
[177] *Id.* § 303A.04(a).
[178] *Id.* § 303A.05(a).
[179] NASDAQ Stock Market Rules, rule 4350(d).
[180] *Id.*
[181] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 56.1 (2008).
[182] Law of Ukraine "On Joint Stock Companies," Art. 56.2.
[183] Law of Ukraine "On Joint Stock Companies," Art. 56.1.

The Principles of Corporate Governance provide more detailed recommendations for supervisory board committees. In particular, except for committees addressed in the law, the Principles suggest setting up nomination and remuneration committees, and mention committees on strategic planning, finance and investment, and corporate governance as examples of permanent committees.[184]

The Principles point the expediency for the majority of audit, nomination and remuneration committees to be composed of independent directors. An audit committee should be responsible for control over financial and economic activity of a company, accounting and risk management. It is suggested that an audit committee of the board cooperated with a general audit commission of a company, and offices of internal and external audit. A nomination and remuneration committee should be in charge for attracting qualified professionals to company's management and establishing efficient incentives for their qualitative work.[185]

Both the law and Principles stress that committees only prepare recommendations for the supervisory board to approve respective measures.[186] It is the board itself who is responsible for decisions taken based on committee recommendations.[187]

2.4. MANAGER REMUNERATION

The schemes that companies use to compensate managers for their services are influenced among other things by general views on means of motivation and importance of leadership accepted in their environments. Specifically, in the United States, a CEO is considered to be a major contributor to company's success, implying that his efficiency may be stimulated by high wages. This approach receives much criticism for executive

[184] Principles of Corporate Governance, *supra* note 162, Sec. 3.1.9.
[185] *Id.*
[186] *Id.*; Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 56.3 (2008).
[187] Principles of Corporate Governance, *supra* note 162, Sec. 3.1.9.

compensation becoming unreasonably excessive, but legislators are trying to at least follow the process.[188]

In Germany, the board is a collegial body, whose members get paid in the amount that maintains certain proportion to remuneration of other employees.[189] German legal norms attempt to secure this attitude.

In Ukraine, there is no clearly established approach towards executive remuneration either in law or in corporate tradition. Legally, company's behavior concerning this issue is not strictly regulated, and very often, since not having well-defined objectives and incentive programs, companies decide on manager compensation depending on actual situation.[190]

Anyway, the issue of executive compensation is a double-edged sword. On the one hand, generous payments may serve as a powerful incentive for managers to increase corporate wealth. On the other hand, since managers are often in a position to influence the mechanism of compensation conferment, compensation may become a moral hazard, inducing managers to break their fiduciary duties.[191]

2.4.1. GERMANY

In Germany, the main element of the management structure designed to prevent self-dealing on the part of managers is the supervisory board.[192] According to the law, the supervisory board acts as a representative of a company against the management board,[193] including in what relates to compensation of members of the latter.

[188] CAHN & DONALD, *supra* note 123, at 416-417.
[189] *Id.* at 417.
[190] Костянтин Смирнов, *Гроші в ТОПку* [Kostyantyn Smyrnov, *Money to the TOP*], 11 КОНТРАКТИ (Mar. 2008), *available at*: http://archive.kontrakty.ua/gc/2008/11/22-groshi-v-topku.html.
[191] CAHN & DONALD, *supra* note 123, at 416.
[192] *Id.* at 427.
[193] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 112 (1965).

The remuneration scheme for supervising directors shall be approved by shareholders or prescribed in articles of association.[194] In cases of both supervisory and management boards, the amount of remuneration shall be established in reasonable proportion to directors' duties and conditions of a company.[195] Additionally, in the absence of any specific reasons, compensation packages of managing directors must not exceed the standard amount, but provide long-term incentives for sustainable development of a company.[196] Although there is an option for the supervisory board to set up a compensation committee, it shall not be entitled to ultimately decide management compensation issues instead of the board.[197]

German law substantially addresses the issue of disclosure of management compensation concerning both listed and unlisted corporations. The latter are obliged to disclose the total amount of remuneration paid to members of their both supervisory and management boards.[198] Similarly to provisions standing in the U.S., German law requires that all elements of remuneration were disclosed, comprising cash salary, profit participation, options or other securities compensation, reimbursement of any kind of insurance payments and other service related expenses, commission, compensation in any form other than disbursement, and reimbursement provided in a current year, but not included in annual accounts.[199] Yet, in contrast to the U.S., German legislation contains no requirement to indicate company's rationale for using specific remuneration scheme.[200]

With regard to listed companies, starting from the fiscal year 2006, compensation of managing directors must be disclosed individually, designating each director's name and being divided into success independent, success related and having long-term incentive effect

[194] German Stock Corporation Act § 113(1).
[195] German Stock Corporation Act §§ 87(1), 113(1).
[196] German Stock Corporation Act § 87(1).
[197] German Stock Corporation Act § 107(3).
[198] CAHN & DONALD, *supra* note 123, at 429.
[199] German Commercial Code (RGBl. p. 219) BGBl. III/FNA 4100-1, Sec. 285(9) (1897), as amended by the Executive Board Compensation Disclosure Act of 2005.
[200] CAHN & DONALD, *supra* note 123, at 429.

categories.[201] Introduced after a lasting debate, this requirement aims to exclude the possibility for the board to report merely a general sum of director payments made within a year and, thus, to keep shareholders in ignorance of whether and to what degree the amount executive compensation corresponds to company's progress.[202]

2.4.2. THE UNITED STATES

In the United States, it is predominantly the board of directors that is competent to establish compensation schemes for its members. In particular, this is how the issue is addressed in DGCL.[203] No obligation to receive approval of shareholders for executive remuneration plans is contained in DGCL, MBCA, or acts of the Securities and Exchange Commission.[204]

However, following the example of German companies having a supervisory element in their management system, U.S. securities exchanges first suggested that compensation related questions were supervised by non-executive directors of the board and then required that audit committees of the boards were mandatorily composed of independent directors competent in finance.[205]

Finally, at the moment, stock exchanges may prescribe that listed companies are obliged to have specifically designed compensation committees within their boards that meet specific requirements. As an example, compensation committees of companies listed with the NYSE must include only independent directors,[206] and have a charter specifying purpose,

[201] German Commercial Code (RGBl. p. 219) BGBl. III/FNA 4100-1, Sec. 285(9) (1897), as amended by the Executive Board Compensation Disclosure Act of 2005.

[202] Jean Jacques du Plessis & Ingo Saenger, *The General Meeting and the Management Board as Company Organs*, IN GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 55, 69-70 (Jean Jacques du Plessis et al. eds., Springer 2012).

[203] DGCL § 141(h).

[204] CAHN & DONALD, *supra* note 123, at 428.

[205] *Id.* at 427.

[206] NYSE Listed Company Manual § 303A.05(a).

rights, duties, and evaluation of annual performance of the committee.[207] It is the direct responsibility of the compensation committee to assess performance of the CEO considering goals and objectives of a company, and, either independently or cooperating with other independent directors, to establish CEO compensation package.[208]

Neither MBCA nor corporation law of Delaware provides specific rules on disclosure of information about executive compensation. However, in reports that companies submit to the SEC, they must provide detailed statements of remuneration paid to directors and executives, namely, "principal executive officer," "principal financial officer" and other three executive directors receiving the highest remuneration.[209] Additionally, companies should specify and elaborate on their internal policies and techniques applied to calculate executive remuneration,[210] including an assessment of risk these factors may have for a company.[211] In their reports, companies must indicate the name of an officer and disclose all categories of executive remuneration, in particular, salary, bonuses, stock and options grants, non-equity incentive remuneration plans, pension value changes and nonqualified deferred remuneration earnings.[212] Virtually the same requirement for detailed disclosure applies also to remuneration of directors.[213]

Policies of U.S. companies on executive remuneration subjected to the intense critique on the ground of managers being excessively overpaid to the detriment of shareholders. As a result, the federal Dodd-Frank Act effective since 2010 *inter alia* introduces the requirement that shareholders of a company voted in order to approve remuneration plans for its executive officers, known as the say-on-pay rule. Voting on executive remuneration shall occur at least once every three years, with the decision on exactly how often it should be held to be voted at

[207] *Id.* § 303A.05(b).
[208] *Id.* § 303A.05(b)(i)(A).
[209] 17 C.F.R. § 229.402(a) (2012).
[210] 17 C.F.R. § 229.402(b)(2).
[211] 17 C.F.R. § 229.402(s).
[212] 17 C.F.R. § 229.402(c).
[213] 17 C.F.R. § 229.402(k).

least once every six years.[214] Still, the Act does not provide that shareholder approval or disapproval of executive remuneration plans was binding for a company or its board of directors,[215] thus, not significantly improving the way this matter is handled.

2.4.3. UKRAINE

Ukrainian law is quite concise in what relates to the issue of manager remuneration, and generally, this issue is much less regulated if compared to the above analyzed legal regimes of Germany and the U.S.

The right to establish the amount of remuneration of supervisory board members belongs exclusively to the general meeting.[216] Procedure of payment to supervising directors is determined by the company's charter, its regulation on the supervisory board, and contracts concluded between a company and members of the board.[217] In its turn, it is the authority of the supervisory board to approve conditions of company contracts with members of the executive body, including the amount of their compensation.[218]

The Principles of Corporate Governance provide slightly more detailed insight about how members of the supervisory board should be remunerated. They prescribe that the task of determining compensation of board members should be assigned to a nomination and remuneration committee. It is important that director compensation was fair and provided efficient incentives for them to ensure company's success. Therefore, the Principles suggest that in total director remuneration was composed of a fixed part and a variable part, where the latter directly depended on performance of directors and a company in general. Information

[214] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, Sec. 951 (2010).
[215] Dodd-Frank Wall Street Reform and Consumer Protection Act, Sec. 951.
[216] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 33.2(17) (2008).
[217] Law of Ukraine "On Joint Stock Companies," Art. 51.3.
[218] Law of Ukraine "On Joint Stock Companies," Art. 52.2(9).

on individual and aggregate compensation paid to directors, as well as the number of shares they owe, should be disclosed in the annual report of a company.[219]

A nomination and remuneration committee should also develop proposals on compensation packages for members of the executive body, although the final decision on their approval is to be taken by the supervisory board. Remuneration prescribed to executives should serve as a fair compensation for their efforts and powerful incentive to qualitatively perform their duties, and, thus, it should be consistent with company's performance. The remuneration disclosure requirement for executives is the same as the one suggested for members of the supervisory board.[220]

2.5. Decision Making by the Board of Directors

2.5.1. Germany

The corporate governance model of Germany is based on the state's social market economy prescribing to maintain the balance in decision-making between capital (shareholders) and labor (employees).[221] "Employee co-determination is important in the decision-making process and makes a significant impact as a long-term relational incentive in the company."[222]

Although this is the management board, and namely all its members jointly, who are authorized to manage and represent the company,[223] it has to subject many of its decision to the authorization and supervision of the supervisory board. For instance, it is an obligation of the management board to report to the supervisory board on such issues as intended business and other kinds of corporate policy (e.g., financial, investment and personnel), company's profitability, company's business progress, transactions that may be particularly important in

[219] Principles of Corporate Governance, *supra* note 162, Sec. 3.1.13.
[220] *Id.* Sec. 3.2.6.
[221] CLARKE, *supra* note 156, at 402.
[222] *Id.* at 403.
[223] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, §§ 77(1), 78(1), 78(2) (1965).

what relates to company's profitability and liquidity.[224] Also, without prior approval by the supervisory board, it is impermissible for the very members of the management board to enter into any business transactions in the same field of activity, where their company operates, or to become a member of another company's management board, a managing director or personally liable partner of another business entity.[225]

Either the company's constitution or the supervisory board rules should provide a list of transactions fundamentally important to a company (e.g., relating to the change in the company's assets or of its financial conditions), for which consent of the supervisory board is mandatory to be obtained.[226] However, the supervisory board should refrain from imposing burdensome requirements for obtaining its consent on the management board, and if this happened to be the case, the management board may still pass a decision provided that not less than three fourths of the votes cast by shareholders at the general meeting.[227]

2.5.2. THE UNITED STATES

The U.S. model of corporate governance provides that "The business and affairs of … corporation … shall be managed by or under the direction of a board of directors" elected by shareholders, unless otherwise provided by law or the certificate of incorporation.[228] Except for the fiduciary duties of directors, the legislator does not particularly specify, in contrast to Germany, how the board of directors performs its functions, and, thus, given that it complies with all the established rules, it has a wide discretion in choosing whether to act actively or passively and what steps exactly to undertake.[229]

[224] German Stock Corporation Act § 90(1).
[225] German Stock Corporation Act § 88(1).
[226] German Stock Corporation Act § 111(4); MADS ANDENAS & FRANK WOOLDRIDGE, EUROPEAN COMPARATIVE COMPANY LAW 312-313 (Cambridge University Press 2009).
[227] German Stock Corporation Act § 111(4).
[228] DGCL § 141(a).
[229] Baums & Scott, *supra* note 68, at 53-54.

It is definitely the board of directors in the U.S. who retains authority and determines decision-making within the company without participation of shareholders or influence of exogenous events.[230] It may be stated that the first two stages of the decision-making process, namely, initiation and ratification of a decision, as well as monitoring of its performance, are carried out by the board of directors,[231] while implementation of the approved decisions is classically entrusted to executives.

Despite the heated debate on whether or not shareholders should be authorized to substantially decide on corporate issues, the attempts of the activists for extending shareholder powers has eventually failed and now control rights of shareholders remained extremely weak and limited to the possibility to decide on electing the board members, approving the company's charter and bylaws, selling a substantial part of company's assets and voluntarily dissolving it. When it comes to, for instance, mergers and acquisitions, even being authorized to vote on these issues according to Delaware law, shareholders need the board's approval.[232]

The board of directors is responsible for appointing and removing executive officers and, in general, possesses "ample authority to act as an overseer of management … it chooses."[233] In what relates to monitoring, the system is in its essence the same as in Germany providing for supervising directors' performance, although structured differently and not intended to involve employee representatives. In contrast to the presence of the two separate boards, supervisory functions in American corporations are fulfilled by independent directors of the single board, which ensures better coordination within its boundaries.[234]

[230] BAINBRIDGE, NEW CORPORATE GOVERNANCE, *supra* note 99, at XII.
[231] MAASSEN, *supra* note 100, at 31.
[232] Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 616 (2006).
[233] Baums & Scott, *supra* note 68, at 53.
[234] CLARKE, *supra* note 156, at 174.

2.5.3. UKRAINE

From the outset of its independence, Ukraine established the two-tier board system of corporate governance, excluding the possibility for members of the executive body to simultaneously sit in the supervisory board. This practice is well-established and strictly followed.[235]

The main difference between the two-tier management systems of Germany and Ukraine is that corporate law of the latter does not provide for mandatory employee representation in the supervisory board of a company. Nevertheless, the law envisages a limited opportunity for company employees to get involved in the board's activities. At the invitation of the supervisory board, representatives of a trade union or any other body authorized to by employees may participate in the board's meetings and have a deliberate vote.[236]

Supervisory board is a body that protects the rights of company shareholders, and, within the assigned authority, controls and regulates activities of the executive body.[237] In addition, the new Law develops a long list of matters that belong to the exclusive competence of the supervisory board, thus, making it unprecedentedly influential. Specifically, the supervisory board is traditionally authorized to undertake comprehensive organization of shareholder meetings, to appoint, dismiss and set conditions of employment contracts of a chairman and members of the executive body, and to elect and dismiss a chairman and members of other company bodies. The supervisory board is also exclusively entitled to decide on placement, sale and buy-out of shares and other securities, approval of the property market value, election of a company registration commission and auditor, appointment of its appraiser, and election or replacement of its registrar, matters related to dividend payment, company participation in industrial and financial groups, matters related to company merger,

[235] Yefymenko, *Corporate Governance*, *supra* note 127.
[236] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 55.1 (2008).
[237] Law of Ukraine "On Joint Stock Companies," Art. 51.1.

takeover, division, split-off and transformation, and probability of declaring company's insolvency.[238]

No other body may take decisions on these matters, except for the general meeting in clearly determined cases.[239] At the same time, the company charter and shareholder meeting may additionally assign the other issues to be decided by the supervisory board.[240]

2.6. MANAGER DUTIES

2.6.1. GERMANY

The common law concept of fiduciary duties distinguishing between the duty of care and the duty of loyalty is not accepted by German law in its original form, but since both legal systems seek to ensure the appropriate level of manager care and loyalty, some similarities are evident.[241]

The German Stock Corporation Act requires that directors of the management board applied "diligence of a prudent businessman" when running a company.[242] At least in its wording, this standard of business prudence seems to be much more rigorous, than the requirement of the U.S. MBCA to act "with the care that a person in a like position would reasonably believe appropriate under similar circumstances".[243]

However, since no objective measure of business prudence is developed in German law, it is left for a court to assess in every given case whether actions of a director met the standard. Also, this requirement directs courts to address the attitude leading a director to certain decisions, rather than concrete actions that he should have done.[244]

[238] Law of Ukraine "On Joint Stock Companies," Art. 52.2.
[239] Law of Ukraine "On Joint Stock Companies," Art. 52.3.
[240] Law of Ukraine "On Joint Stock Companies," Art. 52.1.
[241] Theodor Baums, Personal Liabilities of Company Directors in German Law, Speech at the Stratford-upon-Avon Conference of the British-German Jurists' Association 6 (Apr. 21, 1996), *available at*: http://www.jura.uni-frankfurt.de/43029388/paper35.pdf.
[242] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 93(1) (1965).
[243] MBCA § 8.30(b).
[244] Baums, *supra* note 241, at 9.

It has historically developed that shareholder structures of German public companies are considerably more concentrated compared to those of the U.S. As a result, German corporate laws elaborate much more on the issue of conflicts between majority and minority shareholders, rather than shareholders and managers, for this purpose even establishing a separate area of law of corporations (*Konzernrecht*). Its rules assign that majority shareholders owe the duty of loyalty to minority shareholders, for instance, in case of affiliated companies dealing with each other, when all control relations have to be indicated in an annual report rendered by independent auditors.[245]

With regard to managers, the duty of loyalty (*Treuepflicht*) requires them to avoid creating conflict of interest, and, if this is impractical, to involve disinterested people for making decisions.[246] In case of manager self-dealing, it is the prerogative of the supervisory board to represent a company against its managing directors.[247] Yet, there exists no obligation for directors to disclose their personal and potentially conflicting interests before the supervisory board.[248]

2.6.2. THE UNITED STATES

The concept of fiduciary duties is a valuable corporate governance attainment of the common law states, providing that, since company directors are better informed about and have a possibility to influence corporate affairs, they "stand in a fiduciary relationship to the corporation, which requires that they act prudently and in the best interest of the corporation, rather than in their own interest", and, particularly, "owe the corporation complete loyalty, honesty and good faith."[249]

[245] Baums & Scott, *supra* note 68, at 40.
[246] CAHN & DONALD, *supra* note 123, at 340.
[247] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 112 (1965).
[248] Baums, *supra* note 241, at 8.
[249] Corinne Ball et al., *Advice for Corporate Directors*, IN MERGERS AND ACQUISITIONS: TRENDS AND DEVELOPMENTS 137, 141 (Practising Law Institute, Jan. 11-12, 2010).

As noted above, the wording of the duty of care standard in the U.S. is more flexible, if compared to Germany. It requires directors to serve in the board as "ordinary prudent and diligent men" taking into account "the usages of business."[250] Directors are also expected to apply ordinary skill and knowledge, and to make decisions rationally, being adequately informed and after substantial deliberation.[251] All of these requirements remind the standard for determining ordinarily negligent conduct. However, except for a few states, the majority of U.S. jurisdictions establish that at least gross negligence on the part of a director has to take place so that the duty of care review could be undertaken.[252]

The duty of loyalty obliges a director to ensure that there is no conflict between his self-interests and duty to a company. Accordingly, the breach of duty occurs when a director uses his office "to promote, advance or effectuate a transaction" between a company and himself or a party related to him, and "that transaction is not substantively fair" to a company.[253]

A part of the director duty of loyalty is the requirement for him to act in good faith when serving in the board. However, the failure to act in good faith is not on its own sufficient to give rise to a separate action for the duty of loyalty breach.[254]

Also, unlike Germany, the U.S. concept of fiduciary duties of care and loyalty of a director provides for his obligation to disclose, or to candor, information about any existent conflicts of interests involving matters within director competence, on which he suggests to act. The information must be disclosed to other members of the board of directors, as well as to shareholders in case if a decision requires their approval.[255]

[250] *Briggs v. Spaulding*, 141 U.S. 132, 152 (1891).
[251] Ball et al., *supra* note 249, at 143; Baums & Scott, *supra* note 68, at 42-43.
[252] BAINBRIDGE, LAW AND ECONOMICS, *supra* note 120, at 286-287.
[253] *Solash v. Telex Corp.*, 1988 WL 3587, at *7 (Del. Ch. 1988).
[254] Ball et al., *supra* note 249, at 153.
[255] *Id.* at 188.

2.6.3. UKRAINE

In contrast to legislation of the other two countries, Ukrainian laws do not enshrine the concept of fiduciary duties. Its very much simplified analogy is present in the Civil Code of Ukraine, requiring that a person who is entitled to act on behalf of a legal entity by its constituent documents or law, is obliged to do so in the best interests of this entity, fairly and reasonably, and not to exceed his powers.[256] The Law "On Joint Stock Companies" replicates the requirement for officers of public companies to act in their best interests.[257] However, there is neither legislative definition nor unanimous scholarly opinion on the substance of fairness and reasonableness, which makes it impossible to clearly identify how exactly managers should act.[258]

The Principles of Corporate Governance elaborate in more details on the duties of company officers, suggesting the regime highly resembling the one accepted in the U.S. Specifically, officers must act reasonably, in good faith and the best interests of a company. This requires them to perform their duties applying due care and diligence that is typically expected of a person who takes informed decisions in a similar situation. Officers must not abuse their powers or behave in a way so that to damage business reputation of their own or a company.[259]

Also, officers are required to disclose information about their conflicts of interests related any company decision or transaction.[260]Finally, it is impermissible for officers to use

[256] Civil Code of Ukraine No. 435-IV, Art. 92.3 (2003).
[257] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 63.1 (2008).
[258] Ірина Гришина, *Проблемні питання відповідальності виконавчого органу акціонерного товариства у внутрішніх корпоративних правовідносинах* [Iryna Gryshyna, *Problem Questions of Responsibility of Executive Body of Joint-Stock Company in the Internal Corporate Legal Relationships*], 4(46) ПРАВО І БЕЗПЕКА 259, 260 (2012).
[259] Principles of Corporate Governance, *supra* note 162, Sec. 3.3.1.
[260] *Id.* Sec. 3.3.2.

business opportunities of a company for their own benefit,[261] as well as to found or serve in an organization competing directly or indirectly with it.[262]

These recommendations are insufficient so that to ensure meeting even minimum standards of conduct in good faith and company's best interests. The concept of fiduciary relationship should not be further neglected and directors liability should be introduced not only in case of his incompliance with formal rules, namely, when a director decides on matters beyond his authority, but also in case when these decisions essentially contradict to the best interests of a company.[263]

2.7. MANAGER LIABILITY

2.7.1. GERMANY

In Germany, there exist internal manager liability (*Innenhaftung*) for his misconduct towards a company, and external manager liability (*Außenhaftung*) for misconduct towards third parties. Exactly what kind of liability arises depends on whether a manager breached his duty to a company or third parties.[264]

Directors of the management board are jointly and severely liable to a company for a breach of their duties that causes damages.[265] In this case, a company bears the burden of proof for the fact of incurring damages and their amount, acts of a manager, and causal connection between the second and the first.[266]

Favorably for directors, German law recognizes the main standpoint behind the business judgment rule, requiring that a company provided protection to appraised business

[261] *Id.* Sec. 3.3.3.
[262] *Id.* Sec. 3.3.4.
[263] Анатолій Єфименко, *Реформа українського корпоративного права як необхідна складова євроінтеграційного процесу* [Anatoliy Yefymenko, *Reform of Ukrainian Corporate Law as a Necessary Component of European Integration Process*], 35/36 ВІСНИК КНУ ІМ. Т.ШЕВЧЕНКА, МІЖНАРОДНІ ВІДНОСИНИ 108, 114 (2007) [hereinafter Yefymenko, *Reform*].
[264] DANIEL GUBITZ ET AL., MANAGER LIABILITY IN GERMANY: DIRECTOR LIABILITY OF MEMBERS OF MANAGEMENT AND SUPERVISORY BOARDS OF GERMAN COMPANIES 5 (München: C.H.Beck 2012).
[265] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 93(2) (1965).
[266] GUBITZ ET AL., *supra* note 264, at 4.

decisions of managers so that to facilitate innovation, creativity and risk taking for its subsequent benefit.[267] Directors do not bear liability for unsuccessful decisions, if they had reasonable grounds to assume that their choice was based on adequate information and for the company's benefit.[268] It is though the manager's burden to prove that he acted diligently and conscientiously and applied sufficient care under given circumstances.[269]

It is significant that the modified form of the business judgment rule was approved in Germany in a judicial way – by the Supreme Court for Civil Matters in its famous *ARAG* case.[270] In 1997, it recognized that business judgment is an inherent feature and necessity for members of the management board, without relying on which carrying out commercial activities cannot be possible. At the same time, the Court explicitly denied that supervising activities of the company supervisory board provide for undertaking entrepreneurial risk that would allow extending application of the business judgment rule on its directors as well.[271]

In a dispute, between a member of the management board and a company, the latter is represented by its supervisory board both in and out of court.[272] In what relates to liability of supervising directors, it is established according to the same principles applied to members of the management board. Additionally, German law specifically denotes the duty of confidentiality of supervising directors, and prescribes them to bear liability for damages resulting from inadequate remuneration.[273]

Turning to external relations, German laws provide no specific provisions on manager liability towards third parties. Managers can be held liable to external stakeholders (for

[267] Baums, *supra* note 241, at 9.
[268] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 93(1) (1965).
[269] German Stock Corporation Act § 93(2).
[270] II ZR 175/95, 135 BGHZ 244 [*ARAG v. Garmenbeck*] (April 21, 1997).
[271] CAHN & DONALD, *supra* note 123, at 372-373.
[272] German Stock Corporation Act § 112.
[273] German Stock Corporation Act § 116.

instance, shareholders, creditors, employees, etc.), usually when their liability is attributed to that of a company.[274]

Also, liability towards third parties arises in case of a director breaking tort law. In this instance, tort may take the form of an intentional wrongful injury, violation of an explicit legal provision that entails damages, and either intentional or negligent offence against certain clearly determined rights or protected interests.[275] Since German law establishes that directors owe their duties to a company, usually its shareholders may sue directors under the same terms, that is, when tort occurs. Yet, there is a small possibility for shareholders to sue directors for breach of their contractual obligations before the former, if neither tort is present, nor it is feasible to recover losses through payment to a company.[276]

2.7.2. THE UNITED STATES

The issue of director liability in the U.S. is closely tied to the concept of the business judgment rule. It is a common law rule establishing "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[277] Thus, so that a director was considered to be performing his duty when making a business judgment in good faith, three requirements must be met: the absence of director's personal interest in the subject of a judgment, his sufficient awareness about all aspects of a judgment allowing him to view it as appropriate in a given situation, and his reasonable belief that a judgment is for the best interests of a company.[278]

[274] GUBITZ ET AL., *supra* note 264, at 6.
[275] Baums, *supra* note 241, at 14.
[276] *Id.* at 15.
[277] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).
[278] AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c) (American Law Institute Publishers 1994).

In court, the burden to disprove the presumption of the business judgment rule is placed on a plaintiff. If any of its elements is refuted, a director has to demonstrate that his decision was fair in relation to a company. This presumption favoring directors from the very outset is the main difference between the U.S. approach to the business judgment rule and the one applied in Germany, though the rationale is essentially the same. As a result, the level of management protection is much higher in the United States.[279]

For a long time, many analysts claimed that since state laws provided no protection of the business judgment rule, it was unreasonable and risky of any person to serve as a director.[280] As a response, many states implemented an option of limitation of director liability into their statutes.

For instance, the General Corporation Law of Delaware makes it possible that a certificate of incorporation included "A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."[281] However, such provision cannot exempt a director from liability for violation of his duty of loyalty to a company or its shareholders; acts not in good faith; unlawful payment of dividends, purchase or redemption of shares; or conclusion of a transaction personally benefiting a director to an inappropriate extent.[282] An identical legal regime for limitation of director liability is provided in MBCA, except for that it also precludes the effect of such limitation in case when a director intentionally broke criminal law.[283]

[279] CAHN & DONALD, *supra* note 123, at 372.
[280] BAINBRIDGE, LAW AND ECONOMICS, *supra* note 120, at 299.
[281] DGCL § 102(b)(7).
[282] DGCL § 102(b)(7).
[283] MBCA § 2.02(b)(4).

2.7.3. UKRAINE

Duties and responsibilities of members of the supervisory board and executive body are established in their civil or employment contracts with a company.[284] Therefore, their liability arises based on the general rules of labor law.

In particular, managers of organizations bear material liability limited to the amount of damages resulting from their actions, but not exceeding their average monthly salary, in case if damages were caused by excessive cash payments, incorrect accounting and storage of material, financial and cultural values, failure to take necessary measures to prevent downtime, poor quality production, theft, destruction and deterioration of material, financial and cultural values.[285] Managers of organizations bear full material liability only if agreed in writing to undertake such for failure to ensure the integrity of property and other assets put under their supervision.[286]

Officers of Ukrainian companies are liable to them for damages caused by their acts or omissions.[287] In case if liability arises for several officers, they bear it jointly and severally.[288] In the Resolution of its Plenum, the Supreme Court of Ukraine elaborates that the amount of damages, caused by several employees, is determined for each of them based on the degree of his culpability, type and limits of liability. Joint and several liability applies only if a court finds that damages were inflicted intentionally and jointly by several employees.[289]

[284] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 51.3, 58.5 (2008).
[285] Labor Code of Ukraine No. 322-VIII, Art. 133(2) (1971).
[286] Labor Code of Ukraine, Art. 135[1].
[287] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 63.2 (2008).
[288] Law of Ukraine "On Joint Stock Companies," Art. 63.3.
[289] Resolution of the Plenum of the Supreme Court of Ukraine No. 14 "On judicial practice in cases of compensation of damages caused to enterprises, establishments and organizations by their employees," para. 16 (December 29, 1992).

Although risk bearing is the central problem of management, the concept of the business judgment rule is absent in Ukrainian law.[290] In a very much concise manner, the Principles of Corporate Governance suggest that in the course of any disputable case, a company should take into account the rule of ordinary business risk in making critical decisions.[291]

[290] Володимир Кравчук, *Відповідальність посадових осіб органів управління юридичних осіб* [Volodymyr Kravchuk, *Liability of Officers of Management Bodies of Legal Persons*], 3 ЮРИДИЧНИЙ РАДНИК 39, 40 (2006).

[291] Principles of Corporate Governance, *supra* note 162, Sec. 3.3.6.

CHAPTER 3. COMPARATIVE ANALYSIS OF THE FACTUAL POSITION OF COMPANY MANAGEMENT IN GERMANY, THE UNITED STATES AND UKRAINE: SELECTED ASPECTS

In general terms, the factual position of managers in companies of the three countries reflects their more general perception on company's purpose and how managers contribute to its achievement.

German society is equality-oriented and tends to avoid sharp contradistinction between its members. This is reflected in the corporate governance model seeking to maintain the balance of interests of all company stakeholders, without giving unjustified preference to any category. The same attitude determines the role that is allocated for company management. It is well-defined in Germany that managers act for the benefit of a company, consider interests of all of its stakeholders, and are treated based on the regular employee-employer scheme, rather than a separate privileged element in the company structure.

The United States adhere to the classic principle-agent theory of corporate governance, where regard is mainly given to shareholder interests. In this model managers are seen as the main tool of maximization of shareholder wealth, for which reason they enjoy generous incentives and great freedom in making decisions.

As a result of peculiar historical processes, Ukrainian model of corporate governance provides for interaction of company owners, one of whom is engaged in management of a company and, thus, stands in a much more favorable position. This "managerial" corporate governance model entails isolation of business from involving outside elements, including investors.[292]

[292] Yagmurdzhi, *supra* note 6, at 145.

This chapter analyzes selected aspects of how three legal regimes of company management is practically implemented, what factual strengths and weaknesses three different approaches to the role of management provide and how they relate to each other in a comparative perspective.

3.1. COMPOSITION AND INTERACTION WITHIN THE MANAGEMENT STRUCTURE

3.1.1. GERMANY

The core of the German two-tier board system is a well-defined separation of governing and supervising functions that is called to prevent conflicts of interests between the boards.[293] Schematically, shareholders and employees appoint members of the supervisory board, who are reelected in case of efficient monitoring of the management board, while members of the latter are appointed by the supervisory board and preserve their positions if a company operates successfully. However, in reality, the two-tier structure involving co-determination of employees entails several important problems hindering efficient operation of management.

First of all, the direct disadvantageous consequence of co-determination in German companies is the excessive size of their supervisory boards. Different statistics report that the average number of supervising directors in the boards is over 13,[294] in some years almost reaching 19,[295] or even 21 members[296]. The majority of researchers agree that these numbers are too large that negatively influences the board's performance, since its decision making process becomes more time-consuming, its members do not always have a change to present

[293] Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems – Evidence from the UK and Germany –*, 4 EUR. COMPANY & FIN. L. REV. 426, 450 (2006).
[294] Jan Lieder, *The German Supervisory Board on its Way to Professionalism*, 11 GERM. L. J. 115, 151 (2010).
[295] Jungmann, *supra* note 293, at 446.
[296] Sandrock & Plessis, *supra* note 147, at 168.

their comments and suggestions,[297] liability of the board is distributed among all directors and, thus, its extent lowers with regard to every particular member, and the risk of the conflict of interest situations arises[298]. The legislative limitation on the supervisory board's size seem to be an uneasy thing to implement, since workers unions has so far managed to effectively resist amending the position of co-determination in the board.[299]

The current legal regime of the supervisory board, analyzed in details in the previous chapter of this research, is said to substantially contribute to the board's professionalism and efficiency in protecting shareholder interests. Specifically, requirements on independence of supervising directors and committee members and the board's involvement in the process of making decisions on matters of general strategic and fundamental importance in theory ensure that the supervising board is an influential mechanism for monitoring the management board.[300]

However, the procedure of formation of the supervisory board by the general meeting of German companies is criticized for being purely nominal, since supervising directors are often elected, only if their candidacies are suitable for the management board. In many cases, only people, who are able to exercise "adequate" control as viewed by current managers, are approved to compose the supervisory board. In practice, appointed supervising directors are not that independent in performing their duties,[301] and this does not contribute to the best presentation of interests of a company, its shareholders and employees.

With this regard, one of the most ingloriously famous German cases is the *Mannesmann* incident that took place in 2000. After the take over of the Mannesmann AG, a committee within its former supervisory board assigned enormously huge bonuses for the total amount of more than EUR 100 million to some of the company's former senior

[297] Jungmann, *supra* note 293, at 456.
[298] Lieder, *supra* note 294, at 151.
[299] *Id.* at 152.
[300] *Id.* at 125, 131.
[301] Jungmann, *supra* note 293, at 450.

executives. Neither by-laws of the company nor assignees' contracts prescribed the possibility for managers to receive such bonuses. Still, the entire committee with only one abstention approved the resolution that was obviously detrimental for company's shareholders.[302]

Also, in contrast to legislatively prescribed co-determination of employees, investors of German companies factually enjoy a special standing in their supervisory boards as well. Specifically, representatives of private German banks occupy approximately 12% of supervising director offices assigned to be appointed by shareholders. This is only one of the ways for banks to exercise their influence on a company. In addition, they are usually large shareholders of German public companies, actively using their proxy votes in order to maintain their interests in supervisory boards.[303] As a result, independence of the board in deciding company matters should be questioned, especially if it comes to making strategic decisions that are potentially beneficial to a company, but expose bank investments to risk.[304]

In their turn, employee representatives cannot be considered as truly independent members of the supervisory board either. They are formally selected to serve in the board in the interests of other workers, which in conflicting situations are often put before the company's interests. For example, in 2002, Frank Bsirske, a chairman of the Trade Union for the Service Sector, serving as a vice chairman of the supervisory board of Lufthansa AG, initiated an employee strike to the detriment of the company.[305] Alternatively, the supervisory board of Volkswagen, comprising employee representatives who are all Germans, cannot be considered independent when refusing to move company production to Brazil that is, despite promising to be advantageous to a company, is obviously inconvenient for its workers.[306]

[302] Sandrock & Plessis, *supra* note 147, at 175-176.
[303] Jungmann, *supra* note 293, at 457-458.
[304] ROBERT IAN TRICKER, CORPORATE GOVERNANCE: PRINCIPLES, POLICIES AND PRACTICES 468 (2nd ed., Oxford University Press 2012).
[305] Lieder, *supra* note 294, at 149-150.
[306] TRICKER, *supra* note 304, at 468.

At the same time, since appointment of certain persons to the management board depends on the approval by the supervisory board, the former tend to avoid unpopular decisions (particularly, significant downsizing) so that to earn the goodwill of employee representatives and stay in office, even if this is harmful to the company.[307] The possibility of bribes on the part of managers, but on the account of a company, cannot be excluded as well. For instance, in 2005, it was reported that one of members of the management board of Volkswagen arranged meetings for employee representatives in the company's supervisory board in luxurious sites around the world and provided them with diverse private entertainment, all this at the expense of the company.[308]

Finally, although researchers acknowledge that presence of independent directors in the board may somehow improve its performance, they do not reveal significant positive correlation between the number of independent supervising directors and company's progress.[309] This finding seems to be tenable, since independent directors are usually not well versed in the specifics of an industry and company's activities. It is, therefore, a matter of self-organization of the board in every particular case to provide that it consists of an optimum ratio of stakeholder representatives and outsiders with essential knowledge, skills and experience.[310]

3.1.2. UNITED STATES

The one-tier corporate governance system accepted in the U.S. provides for the board of directors as an indiscrete managing establishment allowing to avoid problems of the

[307] Sandrock & Plessis, *supra* note 147, at 173.
[308] *Id.* at 177-178.
[309] ANDREAS BERMIG & BERND FRICK, BOARD SIZE, BOARD COMPOSITION, AND FIRM PERFORMANCE: EMPIRICAL EVIDENCE FROM GERMANY 22 ("Corporate Governance, Codetermination and Firm Performance: Share Price Reactions to Changes in the Composition of Supervisory Boards in German Companies" Research Project Results, May, 2010), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1623103; Lieder, *supra* note 294, at 134.
[310] Lieder, *supra* note 294, at 134.

board's excessive size, hampered interaction between supervising and managing bodies, and need to compromise interests of different stakeholders that are clearly present in Germany. With that, since law does not structurally separate controlling and managerial functions of the governing body, the board is required to ensure this separation internally by monitoring its own decisions.[311] Effective realization of this task is the main concern of the U.S. unitary board system that often becomes quite problematic.

On the modern stage, the turning point in the development of corporate governance in the U.S. was the adoption of SOX in 2002 that addressed and actually changed major determinants of corporate boards.[312] It is empirically proved that the general size and number of inside directors in boards of U.S. companies distinctly decreases after enactment of the Act and introduction of additional requirements of board independence into major stock exchange rules.

Particularly, in 2003, the average total size of the board of directors of a large company is 10 members, which is 6.5 members in a small company. From 2001 to 2003, the average ratio of executive directors in boards of large companies decreases from 28% to 24%, and in small companies – from 38% to 35%. In the same period, the average percentage of executive-dominated boards decreases from 11% to 7% in large companies, and from 29% to 21% in small companies.[313]

As for the CEO concurrently serving as the chairman of the board of directors, this practice has long been actively used in the U.S. and this was not affected by SOX and subsequent stock exchange rules. Specifically, in 2001, large companies had one person holding both positions on average in 67%, and small companies – in 54% of cases, while in 2003, these numbers changed to 71% and 50% respectively.[314] One of the most recent

[311] Jungmann, *supra* note 293, at 460.
[312] James S. Linck et al., *The Determinants of Board Structure*, 87 J. FIN. ECON. 308, 309 (2008).
[313] *Id.* at 318.
[314] *Id.*

researches demonstrates that 49% of S&P 1500 companies have their CEOs serving as chairmen of boards of directors. The rest of companies separate these roles, assigning a non-executive (37%), executive (12%), or lead/presiding director for the position of the board chairman.[315]

In the same way as in Germany, researches do not reveal substantial positive relationship between the board's independence and company's performance.[316] Some of them actually suggest that company's performance becomes even worse when the board is outsider-dominated than that where executive directors hold a majority.[317] With this regard, except for robust statistics, scholars refer to the biggest modern corporate scandal of Enron, where the fourteen-member board with eleven outside directors appeared to be unable to prevent the company's collapse.[318]

Again, one of the possible reasons for such results is that usually the board of directors is composed of a group of people with different knowledge, skills and experience,[319] while proper professional background is no less important asset than impartiality in making decisions.

Moreover, the requirement for independence provides for the formal absence of personal financial benefit from any kind of company's performance. However, director "dependence" may be revealed in some other kind of relations, for instance, with those who actually appoint and dismiss a director. These relations, if present, may significantly affect director impartiality when judging and making decisions.[320] Therefore, instead of blindly

[315] Annalisa Barrett, *Board Leadership among S&P 1500 Companies*, EQUILAR (Dec. 26, 2012), *available at*: http://www.equilar.com/corporate-governance/2013-reports/board-leadership-among-s-p-1500-companies.

[316] Sanjai Bhagat & Bernard Black, *The Non-Correlation between Board Independence and Long Term Firm Performance*, 27 J. CORP. L. 231, 263-265 (2001); Jeffrey L. Coles et al., *Boards: Does One Size Fit All?* 87 J. FIN. ECON. 329, 351 (2008).

[317] Bhagat & Black, *supra* note 316, at 248.

[318] *Id.* at 233.

[319] *Id.* at 263-264.

[320] *Id.* at 266; Baums & Scott, *supra* note 68, at 59.

hiring outsiders, it may be more reasonable to ensure the balance of expediently incentivized competent executives and truly independent directors in the board.[321]

3.1.3. UKRAINE

When turning to the analysis of management of Ukrainian companies, it should be noted first that relevant information is not easily accessible. Totally domestic companies provide data on the structure, composition, activities and remuneration of members of their supervisory boards and committees up to only 40%. For comparison, non-residents – foreign public companies that list their shares on foreign stock exchanges, but also keep major parts of their assets in Ukraine, – are open by 71%.[322]

In 2011, the Commission for Securities and Stock Market held that public companies must "in a descriptive form" disclose information on their management bodies, officers and founders to the Electronic System for Comprehensive Disclosure of Information (ESCRIN).[323] Yet, because of the vague wording and so far little term of operation, the System provides no sufficient information for making reliable statistics.

It is indicated in the research of the Ukrainian Business Resource that supervisory boards of Ukrainian companies, both residents and non-residents, comprise on average six directors.[324] The proportion of non-executives in the total number of supervising directors is 69%, and independent directors – 26%. The Resource does not specify who is considered to be a non-executive director, and, since the law clearly excludes any possibility for a person to simultaneously serve in the supervisory board and executive body, this characteristic is

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321 Bhagat & Black, *supra* note 316, at 265.

322 *Открытость украинских компаний. Исследование. Часть 2* [*Openness of Ukrainian Companies. Research. Part 2*], УКРАИНСКИЙ БИЗНЕС РЕСУРС (Jun. 12, 2012), *available at*: http://ubr.ua/business-practice/own-business/otkrytost-ukrainskih-kompanii-issledovanie-chast-2-141813.

323 Resolution of the State Commission for Securities and Stock Market of Ukraine No. 981 "On approval of the Regulation on information disclosure by listed share and corporate bond issuers and the Procedure for filling out the disclosure forms and the changes to them made by listed share and corporate bond issuers," Addendum 3, Sec. 3 (June 22, 2011).

324 *Openness of Ukrainian Companies. Research. Part 2*, *supra* note 322.

unclear. It is, however, stated that the supervisory board may include a majority shareholder or middle managers that raises a question about whether the board performs merely a decorative function in the management structure.[325] Still, apparently these stakeholders are those to comprise 31% of executive directors in the supervisory board.

In the vast majority of cases, purely domestic companies report not having independent directors in their supervisory boards. In fact, companies operating only at the national stock market are not motivated to introduce outside directors in the board, since neither laws nor rules of national stock exchanges require them to do so. Most frequently, Ukrainian companies revise their policy on the supervisory board composition when it comes to getting listed on a foreign stock exchange.[326] This was the case of the mining company Ferrexpo listed with the London Stock Exchange in 2007, and the egg product holding Ovostar Union listed with the Warsaw Stock Exchange in 2011.[327]

Among all stakeholders, minority shareholders are mostly interested that the supervisory board included some number of independent directors for effective control of executives. To ensure their trust, Ukrainian companies usually hire foreigners with experience in multinational companies and big names to serve in their supervisory boards, although rare exceptions happen.

Yuriy Zastavny is an independent director in the development holding TKS and holding of emotions !FEST. The first company is listed with the Frankfurt Stock Exchange, and the decision to involve an outside director in the supervisory board was made at the request of its minority shareholders. In the case of !FEST that owns a chain of creative

[325] *Id.*
[326] *Id.*
[327] Анна Ковальчук, *Неисполнительные директора в украинском бизнесе: Milkiland и еще четыре примера* [Anna Koval'chuk, *Non-executive Directors in Ukrainian Business: Milkiland and Four Other Examples*], FORBES UKRAINE (Jun 24, 2013), *available at*: http://forbes.ua/business/1352223-neispolnitelnye-direktora-v-ukrainskom-biznese-milkiland-i-eshche-chetyre-primera.

restaurants, its owners initiated involvement of an independent director in the board, as a part of company's development strategy.[328]

Current conditions of Ukrainian market anticipate that relations with state authorities or individual people in power to a very large extent determine the future of business. In this situation, personal ties of a formally independent director in government circles may become a valuable asset to a company. For instance, Ihor Mityukov was invited as an independent director to the mining company Ferrexpo as soon as the company's shares were listed with the London Stock Exchange. Except for impressive professional achievements, Mityukov is known for his close ties in the government. Under governance of different political forces, he used to serve as a minister of finance and counselor to the president and prime-minister.[329] It would be reasonable to assume that the majority shareholder of the company Kostyantyn Zhevago took due regard of Mityukov's diversified experience.

Very often, major owners of Ukrainian companies are reluctant to delegate management of their companies to strange people. This may be understandable, since private businesses in Ukraine are relatively young, and the majority of company owners are their initial founders, who find it difficult to withdraw from management even if there are good candidates for the position of a CEO.[330] According to Ukrainian Forbes, almost 30 founders of domestic companies in the top 200 list of the magazine manage them on their own or assign top management positions to their close people.[331]

If owners ultimately do decide to hire a professional chief executive, they usually have to choose between domestic and foreign candidates. In 2007-2008, companies tended to

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[328] *Id.*

[329] *Id.*

[330] Алена Гриневская, *Поделиться полномочиями. Будет ли наемный CEO эффективней собственника бизнеса?* [Alyona Grinevskaya, *To Share Powers. Is Hired CEO Going to Be More Efficient than Business Owner?*]. 5 ИНВЕСТГАЗЕТА (Feb. 18, 2013), *available at*: http://www.investgazeta.net/praktika/podelitsja-polnomochijami.-budet-li-naemnyj-effektivnej-sobstvennika-biznesa-163744/.

[331] Юрий Аксенов и Владимир Вербяный, *Самые эффективные боссы Украины* [Yuriy Aksyonov & Vladimir Verbyany, *The Most Efficient Bosses of Ukraine*], FORBES UKRAINE (Mar. 28, 2013), *available at*: http://forbes.ua/business/1348457-samye-effektivnye-bossy-ukrainy.

hire foreign "polished" CEOs with an experience of working for big brands, while after the crisis, owners much more meticulously examine actual previous achievements of a candidate and consider his ability to work under conditions of uncertainty and risk of Ukrainian economy. In this case, the advantage does not always appear to be on the side of an acknowledged foreigner.[332]

3.2. MANAGER REMUNERATION

As it was briefly noted in the section devoted to legal regulation of manager remuneration, a scheme that a company chooses so that to establish its managers' remuneration often largely depends on the general attitude to management accepted in this company's environment. Traditional views on management also determine what inside and outside factors and to what extent are taken into account when deciding on how much and in what form managers will be paid.

3.2.1. GERMANY

The feature that clearly distinguishes German corporation in their approach to manager remuneration is that non-executive – supervising – directors are paid there much less than executive directors – members of the management board. Specifically, according to the 2011 study, average total remuneration of a supervising director in major German companies is more than twenty times lower than that of an executive director: EUR 56,000

[332] Владимир Вербяный, *Какого руководителя ищут для своих компаний украинские собственники* [Vladimir Verbyany, *What Manager Are Ukrainian Owners Looking for Their Companies*], 3 FORBES UKRAINE (Mar. 2013), *available at*: http://forbes.ua/magazine/forbes/1348306-kakogo-rukovoditelya-ishchut-dlya-svoih-kompanij-ukrainskie-sobstvenniki.

compared to EUR 1,008,000 respectively.[333] The gap is even increasing when it comes to medium and small size entities.[334]

Although scholars still dispute about the actual effectiveness of the non-executive element(s) in the management structure,[335] it cannot be denied that the supervisory board is the core of the whole two-tier corporate system. Supervising directors are loaded with complicated and challenging tasks, and the level of time consumption and responsibility of their job is gradually increasing. Without discussing reasonableness of amounts of executive remuneration in German companies, its huge imbalance with remuneration of members of supervisory boards is said to be incongruous.[336]

The study of annual reports of a few hundred of German listed companies for the period between 2005 and 2009 reveals that total remuneration of a managing director varies between EUR 21,000 and EUR 13,000,000 resulting in an average of EUR 1,500,000. The sharp difference between the lowest and highest chief executive remuneration takes place, because companies vary from each other in size, age and industry, but remuneration amounting to EUR 21,000 is an exception.[337] An average fixed part of managing director remuneration (salary, cars and insurance package) constitutes averagely 43% out of the total or EUR 687,000. Managing directors receive almost the same amount, on average 42% of total compensation, in the form of annual cash bonuses. In contrast to the U.S., long-term remuneration (shares, stock options, pension and other long-term compensation plans) is

[333] CHRISTIAN LAZAR ET AL., REMUNERATION OF NON-EXECUTIVE DIRECTORS IN GERMAN LISTED FIRMS: AN EMPIRICAL NOTE 8 (HHL Research Paper Series in Corporate Governance No. 12, May 2013), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272993.

[334] *Id.* at 6, 15.

[335] Peter D. Hahn and Meziane Lasfer, *The Compensation of Non-Executive Directors: Rationale, Form, and Findings*, 15 J. MANAG. GOV. 589, 593, 596 (2011).

[336] LAZAR ET AL., *supra* note 333, at 8.

[337] MORITZ HEIMES & STEFFEN SEEMANN, COMPENSATION AND INCENTIVES IN GERMAN CORPORATIONS 8 (University of Konstanz, Department of Economics Working Paper Series 2011-20, May 2011), *available at*: http://www.uni-konstanz.de/FuF/wiwi/workingpaperseries/WP_20-11-Heimes-Seemann.pdf, [hereinafter HEIMES & SEEMANN, COMPENSATION AND INCENTIVES].

allocated much smaller amount, averagely 15%, in overall remuneration packages of chief executives.[338]

In 2005-2009, remuneration of all executives in selected German listed companies, not exclusively managing directors, averagely amounts to EUR 1,000,000. The ratio for the fixed part, annual cash bonuses and long-term elements of the remuneration package constitutes 53%, 35% and 12% respectively.[339] In is noteworthy that many executives received either no or negligibly low long-term remuneration during the estimated period.[340]

In Germany, the discussion on excessive compensation is less heated than it is in the U.S., appealing mostly to the notions of fairness and justice, and public dissatisfaction.[341] This may be predetermined by the state's traditionally different approach to the matter. German society has an equally-oriented mentality that urges companies to equitably distribute rewards and avoid defiantly big gaps in remuneration of managers compared to average employees.[342]

In fact, the co-determination element is designed to ensure that employee interests are taken into account in the course of the management process.[343] The effectiveness of this structure is still under question,[344] but the pace of executive remuneration increase in Germany is actually much slower than in the U.S. In 1980s executives in both countries

338 *Id.* at 8-9.

339 MORITZ HEIMES & STEFFEN SEEMANN, WHICH PAY FOR WHAT PERFORMANCE? EVIDENCE FROM EXECUTIVE COMPENSATION IN GERMANY AND THE UNITED STATES 13 (University of Konstanz, Department of Economics Working Paper Series 2012-29, November 15, 2012), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2084705, [hereinafter HEIMES & SEEMANN, PAY FOR PERFORMANCE].

340 *Id.*; HEIMES & SEEMANN, COMPENSATION AND INCENTIVES, *supra* note 337, at 9.

341 Peter H. Koepf, *Greedy Fat Cats, Needy Workers*, GERMAN TIMES (Jan. 2008), *available at*: http://www.german-times.com/index.php?option=com_content&task=view&id=3196&Itemid=81.

342 Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 AMER. J. COMP. L. 497, 514-515 (2001).

343 *Id.* at 514.

344 *Id.* at 529.

received approximately the same amounts of remuneration, while currently U.S. managers earn several times as much as their German counterparts.[345]

Finally, the two-tier corporate system, excluding the possibility for managing directors to serve in the supervisory board, and higher degree of ownership concentration makes executive remuneration in German companies less pay-performance sensitive, than in the U.S.[346]

Nevertheless, some scholars state that Germany is getting closer to the U.S. in what relates to executive remuneration.[347] Even now, similarly to the U.S., the variable part of remuneration of German executives is frequently determined among others or even solely on accounting-based rather than stock market performance.[348] Further, German companies tend to become more responsive to their shareholder interests that may turn into remuneration schemes being even more performance oriented.[349]

The increase of the variable performance-dependent remuneration components has also proven to be facilitated by the cross-listing of German companies on the U.S. stock exchanges as well as hiring U.S. managers in German boards.[350] German companies enter the global field competing for the most talented managers, and similar competition is developing in its domestic market of managerial services.[351] Competition becomes even more rigid in the crisis times, being spurred by a struggle of companies to limit their losses and increase

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[345] *Id.* at 507-508; *additionally see* numbers mentioned above.

[346] HEIMES & SEEMANN, PAY FOR PERFORMANCE, *supra* note 339, at 17.

[347] *See generally* Cheffins, *supra* note 342; Niels Hermes & Annemarie Schulenburg, Executive Compensation and Anglo-American Influence: European Evidence, Presentation at the 9th European Academy of Management (EURAM) Annual Conference (Liverpool, May 2009), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1980353.

[348] HEIMES & SEEMANN, PAY FOR PERFORMANCE, *supra* note 339, at 15.

[349] Cheffins, *supra* note 342, at 509-510.

[350] Hermes & Schulenburg, *supra* note 347, at 14.

[351] FRANCESCA FABBRI & DALIA MARIN, WHAT EXPLAINS THE RISE IN CEO PAY IN GERMANY? A PANEL DATA ANALYSIS FOR 1977-2009 18 (Institute for the Study of Labor 2012, IZA Discussion Paper No. 6420, March 2012), *available at*: http://ftp.iza.org/dp6420.pdf.

efficiency.[352] The demand for managers obviously stimulates the increase of their remuneration.[353]

Still, the issue remains open and it will eventually be clear to what extent the U.S. approach can be accepted in Germany and whether it will be modified under the influence of German economic and cultural peculiarities.[354]

3.2.2. THE UNITED STATES

Remuneration of CEOs of U.S. corporations is increasing year by year, except for some reductions following a series of corporate scandals in the early 2000s and the world economic crisis.

The majority of statistics examines CEO remuneration information of U.S. biggest companies, where amounts of remuneration are enormously huge.[355] If to consider diversity of the U.S. market, in 2006, an average CEOs earned total USD 5,500,000, where 26% was attributed to salary, 27% – to bonuses, 39% – to stock and options, and 10% – to other categories of a remuneration package.[356]

During the years 2005-2009, non-CEO executives in U.S. listed corporations receive on average USD 2,200,000 of total remuneration. Components of executive remuneration packages are related in a markedly different percentage ratio, if compared to Germany. The fixed part and annual cash bonuses amount to only 33% and 24% of a total package

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[352] *Id.* at 23.

[353] *Id.* at 18.

[354] Cheffins, *supra* note 342, at 538.

[355] *See Historical CEO Compensation*, FORBES (Apr. 28, 2010), *available at*: http://www.forbes.com/2010/04/26/executive-pay-ceo-leadership-compensation-best-boss-10-bosses_chart.html, analyzing data of 800 (1989-1999) and 500 (2000-2010) biggest U.S. companies; Lawrence Mishel & Natalie Sabadish, *CEO Pay in 2012 Was Extraordinarily High Relative to Typical Workers and Other High Earners*, ECONOMIC POLICY INSTITUTE, Issue Brief #367 (Jun. 26, 2013), *available at*: http://www.epi.org/publication/ceo-pay-2012-extraordinarily-high/, examining top 350 firms by sales volume; Elliot Blair Smith & Phil Kuntz, *CEO Pay 1,795-to-1 Multiple of Wages Skirts U.S. Law*, BLOOMBERG (Apr. 30, 2013), *available at*: http://www.bloomberg.com/news/2013-04-30/ceo-pay-1-795-to-1-multiple-of-workers-skirts-law-as-sec-delays.html, referring to S&P 500 companies.

[356] Nuno Fernandes et al., *Are US CEOs Paid More? New International Evidence*, REV. FINANC. STUD. 52 (forthcoming) (2012), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159119.

respectively, while long-term payments take averagely 43% of total remuneration that characterizes the U.S. approach as much more long-term focused.[357]

In the United States, the issue of executive remuneration is surrounded by the heated debate on whether or not managers are excessively overpaid. Numerous sources condemn the corporate governance system for shortcomings facilitating managers being paid unjustifiably high wages. In particular, executives are able to influence decisions making in what relates to their remuneration. The board of directors in U.S. corporations is responsible for determining executive remuneration, while a number of senior executives may be its members. In this situation, whether remuneration amounts are reasonable, depends on the level of executive self-discipline or the extent of actual independence of a compensation committee if such exists in the board.[358]

Next, even if being formally self-determined in deciding on executive remuneration, boards are blamed for poor monitoring, since they assign huge executive remuneration irrespective of actual company's performance.[359] Instead, directors are guided by the market price for executive services, self-interest in maintaining this price at the highest level (for instance, in case when they serve as executives in other companies), and concerns about their personal image in the board.[360]

Finally, highly dispersed ownership and management structure, allowing for a CEO to serve as a chairman of the board, conduce high pay-performance sensitivity in U.S. corporations.[361] However, performance often includes not only performance on the stock

[357] HEIMES & SEEMANN, PAY FOR PERFORMANCE, *supra* note 339, at 13.

[358] Cheffins, *supra* note 342, at 528.

[359] STEVEN N. KAPLAN, EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE IN THE U.S.: PERCEPTIONS, FACTS AND CHALLENGES 21-23 (Chicago Booth Research Paper No. 12-42, September, 2012), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2134208.

[360] Edward E. Lawler, *Outrageous Executive Compensation: Corporate Boards, Not the Market, Are to Blame*, FORBES (Oct. 9, 2012), *available at*: http://www.forbes.com/sites/edwardlawler/2012/10/09/outrageous-executive-compensation-corporate-boards-not-the-market-are-to-blame/.

[361] HEIMES & SEEMANN, PAY FOR PERFORMANCE, *supra* note 339, at 17.

market, but accounting performance, which is highly predetermined by a company's size and industry and, thus, cannot be regarded as a tribute to executives.[362]

Interestingly, Dodd-Frank provisions introducing the shareholder say-on-pay votes applicable starting from the fiscal year 2011 were applied by companies, but did not appear to change much in the matter of executive remuneration. Supporters of the initiative believed that providing shareholders with some degree of authority to decide on amounts of executive remuneration would make them go down. Still, as long as these amounts are determined based on the pay-for-performance principle and market prices for executive services, actual effectiveness of shareholder involvement in the process is highly questionable.[363] Moreover, the statistics of voting for the first year of Dodd-Frank application evidence that in the vast majority of cases shareholders uphold existing executive remuneration policies. Specifically, shareholders of 98% of companies do approve suggested remuneration plans, with 73% – by the majority of more than 90% of votes, and less than 8% – by the majority below 70% of votes.[364]

3.2.3. UKRAINE

As noted in the previous chapter, Ukrainian law provides companies with almost free hand for determining compensation of their management and, even more interestingly, it does not oblige companies to substantiate its amounts. Without being obliged to do so, companies prefer not to disclose information on individual compensation of their managers, not even mentioning rationale behind.

An annual report mandatorily indicates only the total amount of compensation received by company's key management figures over the previous year. The category of key management covers directors of all enterprises in a corporate group, top executives and heads

[362] KAPLAN, *supra* note 359, at 22-23.
[363] *Id*. at 25.
[364] *Id*.

of departments. Most companies indicate the exact number of managers in their reports. Therefore, analysts have the only option of calculating an average income of a manager.[365]

Such approach allows to distinguish top Ukrainian companies-employers and industries where managers are most generously compensated.[366] These are industrial holdings, oil and gas companies and commercial banks. Annual salary of an industrial holding CEO varies from USD 250,000 to USD 1,500,000 and USD 100,000-900,000 for its chief financial officer (CFO). Top executive total annual income (comprising salary and bonuses) in the industry lies in the range of USD 375,000-3,500,000 for CEO, and USD 150,000-1,800,000 for CFO. Commercial banks annually pay chairmen of their supervisory boards fixed salaries varying from USD 120,000 to USD 1,000,000, and total packages amounting from USD 350,000 to USD 2,000,000. Salary and total annual income ranges for CFOs of commercial banks constitute USD 100,000-360,000 and USD 120,000-700,000 respectively.[367]

As stated by Ukrainian Forbes, the only domestic CEO who is ready to reveal his individual earnings is the principal owner and general manager of Ferrexpo Kostyantyn Zhevago. Last year, Zhevago received USD 240,000 salary and USD 50,000 bonus payments, and compensation of his CFO was three times as much.[368]

At the same time, conditions for operation of large public companies are now in Ukraine quite specific. It is no secret that major business and government in Ukraine are highly intertwined and strongly influence one another. Specifically, companies face here high political risks and this factor often touches upon their personnel policy. On the one hand,

[365] Юрий Аксенов и Нина Мищенко, *Где больше платят* [Yuriy Aksyonov & Nina Mishchenko, *Where They Pay More*], 7 FORBES UKRAINE (Jun. 2013), *available at*: http://forbes.ua/magazine/forbes/1354516-gde-bolshe-platyat.

[366] *Id.*; Владимир Вербяный et al., *Рейтинг зарплат – 2013* [Vladimir Verbyany et al., *Salary Rating – 2013*], 9 FORBES UKRAINE (Sep. 2013), *available at*: http://forbes.ua/magazine/forbes/1357404-rejting-zarplat-2013.

[367] Verbyany et al., *supra* note 366.

[368] *Id.*

modern Ukrainian prosperous business belongs to people, who have access to resources, secure their business through government structures and can be sure that their property will not be taken from them. These people do not necessarily need to hire the most talented managers, since they are less important for company's well-being than arrangements with authorities.[369]

However, management efficiency is evaluated by changes in the cost of company assets that largely vary from industry to industry. There are industries where there is no competition or where government regulation creates conditions for successful operation of only one or few entities (e.g., natural monopolies like energy companies, gas and oil transportation companies). Managers of these companies usually receive huge salaries and bonuses,[370] although their qualification is not necessarily a decisive criterion for their appointment.[371]

On the other hand, in some cases, personal efforts and achievements of a manager in Ukraine can much more influence prosperity of a company and, thus, the amount of his compensation if compared to that of his colleagues in a foreign company.[372] Therefore, except for purely professional manager skills, personal influence and ties of a manager, and his ability to perform assigned tasks exactly in current conditions of the corporate sector are the factors among others determining the amount of his compensation, but certainly not appearing in annual financial reports.

For instance, top management of the financial industrial group VETEK (an abbreviation for the Russian name Eastern European Fuel and Energy Company) that belongs

[369] Владимир Вербяный, *Подвиг здесь неуместен* [Vladimir Verbyany, *Feat Is Inappropriate Here*], 9 FORBES UKRAINE (Sep. 2012), *available at*: http://forbes.ua/magazine/forbes/1336434-podvig-zdes-neumesten.
[370] Verbyany et al., *supra* note 366.
[371] Smyrnov, *supra* note 190.
[372] *Id.*

to the newly-born Ukrainian oligarch with a disputable reputation[373] is required to unconditionally fulfill his tasks, for what managers are substantially overcompensated if compared to their previous earnings as well as average amounts of top manager compensation in the market.[374] Before the business started to become more public, its PR officer was responsible for scrupulous monitoring of press coverage and arrangement of public relations based on a principle "the less information, the better", which may also be interpreted as "to pay everyone so that they remained silent".[375] Considering that until recently it was almost impossible to find any comprehensive information on this business,[376] one may conclude that the officer's compensation was justified.

Generally, management services in Ukraine are very expensive, being compensated with approximately the same total amounts as paid to managers in Germany and in some cases, even as in the U.S.[377] However, compared to these countries, Ukrainian companies very often have no clearly defined objectives and motivation programs and still pay their managers much higher basic salaries for their loyalty.[378]

Considering that well qualified managers are highly demanded at the job market and total amounts of their compensation are increasing even after several waves of the economic

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[373] Сергій Щербина, *Мільйонери нізвідки. Легалізація групи Курченка* [Serhiy Shcherbyna, *Millionaires from Nowhere. Legalization of Kurchenko's Group*], УКРАЇНСЬКА ПРАВДА (Mar. 12, 2013), *available at*: http://www.pravda.com.ua/articles/2013/03/12/6985342/.

[374] Владимир Вербяный и Севгиль Мусаева, *Бывший консультант ВЕТЭК: Курченко сознательно не переманивал людей из СКМ* [Vladimir Verbyany & Sevgil Musaeva, *Former Consultant for VETEK: Kurchenko Did Not Deliberately Intercept People from SCM*], FORBES UKRAINE (Sep. 25, 2013), *available at*: http://forbes.ua/business/1358509-byvshij-konsultant-vetek-kurchenko-soznatelno-ne-peremanival-lyudej-iz-skm.

[375] Владимир Вербяный и Севгиль Мусаева, *Хедхантер Абдушелишвили: В ВЕТЭК – институт приказа* [Vladimir Verbyany & Sevgil Musaeva, *Headhunter Abdushelishvili: In VETEK – Institute of Order*], FORBES UKRAINE (Sep. 24, 2013), *available at*: http://forbes.ua/business/1358491-hedhanter-abdushelishvili-v-vetek-institut-prikaza.

[376] Севгиль Мусаева, *Курченко – о покупке медиахолдинга UMH Group* [Sevgil Musaeva, Kurchenko – About Purchase of Media Holding UMH Group], FORBES UKRAINE (Jun 21, 2013), *available at*: http://forbes.ua/business/1354323-kurchenko-o-pokupke-mediaholdinga-umh-group.

[377] Smyrnov, *supra* note 190; *Інвесткомпанії. Перемогла молодість* [*Investment Companies. Youth Has Won*], 11 КОНТРАКТИ (Mar. 2008), *available at*: http://archive.kontrakty.ua/gc/2008/11/25-investkompaniyi-peremogla-molodist.html.

[378] Smyrnov, *supra* note 190.

crisis,[379] people capable of handling management in modern conditions and with a set of available tools have a chance to be generously compensated for their efforts without being subjected to tight restrictions and control.

3.3. MANAGER DUTIES AND LIABILITY

3.3.1. GERMANY

In Germany, members of both the supervisory and management boards owe their fiduciary duties to a company, and this is company's primary prerogative to enforce these duties.[380] When it comes to the duty of care, this provides that acting "for the benefit of a company"[381] in no way aligns with or concedes to interests of individual shareholders, their collective, or other stakeholders.

With this regard, in 1992, the Supreme Court for Civil Matters ruled that the only two things shareholders of a company may expect from its managers is "that the company keeps within its objectives" and that shareholder "capital investment will not be endangered by actions which 'simply no honest businessman would undertake'".[382]

In one of its relatively recent cases,[383] the German Supreme Court denied that supervising directors preferred shareholder interests over those of the company and, thus, breached their duty to supervise, when granted unsecured upstream loan to the company's majority shareholder whose subsequent insolvency led to the insolvency of the company. The Court refused to recognize the loan agreement as an adverse transaction, since it was concluded on appropriate terms and no information of the shareholder's inability to pay was available. Nevertheless, the Court elaborates on the duty of control and supervision of supervising and managing directors, requiring that they thoroughly verify recoverability of

[379] Verbyany et al., *supra* note 366.
[380] Baums, *supra* note 241, at 6-7.
[381] German Stock Corporation Act (BGBl. I, p. 1089) FNA 4121-1, § 93(1) (1965).
[382] Baums, *supra* note 241, at 8.
[383] II ZR 102/07 [*OLG Jena, LG Er-furt*] (BGH, December 01, 2008).

the loan and creditworthiness of the shareholder both before the deal is concluded and in the course of its performance. In addition, it is the director responsibility to introduce measures providing information on compliance with terms of the deal and early warning in case the risk of non-repayment increases. If sued, directors bear the burden to prove that such measures existed and were efficient.[384]

The loudest modern German corporate trial in the *Mannesmann* case directly touches upon the issue of the director duty of care. Mannesmann AG was taken over by the British telecommunication giant Vodafone Plc for the negotiated price of EUR 178 billion, which is considered to be the biggest deal ever concluded.[385] The executive committee of the Mannesmann's supervisory board composed of four members, two of which were elected by company's shareholders and two – by its employees, assigned GBP 10 million bonus to the CFO for "extraordinary accomplishments both before and after negotiating the takeover", and the same amount to be distributed among Mannesmann's other senior executives.[386] The award was approved by three members of the committee and one member abstaining. After the bonus sum was divulged and paid, members of the executive committee faced a criminal suit for the breach of trust (*Untreue*). The case passed a chain of trials, reached the Supreme Court and was ultimately settled for the amount of EUR 5.8 million on the part of the accused.[387]

Still, the case appeared to be landmark, since it emphasized several important peculiarities of the German approach to the matter of director duties and liability. First, although German law recognizes the business judgment standard for manager decisions, the Court held that committee directors of Mannesmann breached their duty of care to the

[384] ROBERT KOBELT, IMPLICATIONS OF MOMIG ON CORPORATE BANKING 5, 6 (Raupach & Wollert-Elmendorff, Forum Juris Newsletter 01/2009, 2009), *available at*: http://www.raupach.de/docroot/medialib/mandanten/juris/en/0016_01-04-2009_forum_juris.pdf.

[385] Kolla, *supra* note 80, at 829.

[386] Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 461 (2007) [hereinafter Gevurtz, *Disney*].

[387] *Id.* at 461-462.

company, when awarding the bonus that provided a company with no benefit. In this way, the Court applied more skepticism and less deference to the director decision, than would be done under the business judgment standard traditionally accepted in the U.S.[388]

Second, by accepting the possibility of criminally prosecuting Mannesmann's directors, the Court impliedly confirmed that German companies adhere to the stakeholder model of corporate governance, where shareholder interests should not be put above interests of other stakeholders. Specifically, the Court rejected the argument of the defense that the amount of the assigned bonus was justified, taking into account the rise of the company share price as a result of the takeover.[389] If considered from the U.S. point of view, application of criminal sanctions to director failure to act in the best broader interests of the company may look disproportionate, while in Germany it seemed not to cause substantial objection.[390] The same can be said of the duty of loyalty breach. If such occurs and satisfies the threshold of a criminal offence, criminal sanctions are applied and, as elaborated below, even shareholder consent is irrelevant in this process.[391]

Third, the fact that Vodafone, which was Mannesmann's major (98.66%) shareholder at the time the bonus was assigned, approved the award was not sufficient for the Court to ascertain that the director breach was nullified. Seeing that this action was not even filed by shareholders, this approach looks much stricter than that in the U.S., where major duty of care claims are run in the derivate suits (for instance, the *Disney* case discussed below) and it is legally allowed that director liability was eliminated in case of shareholder waiver to claim the duty of care breach.[392]

[388] *Id.* at 463-464, 466, 468.
[389] Kolla, *supra* note 80, at 834.
[390] Gevurtz, *Disney*, *supra* note 386, at 490-491.
[391] Klaus J. Hopt, *Conflict of Interest, Secrecy and Insider Information of Directors, A Comparative Analysis*, 10 EUR. COMPANY & FIN. L. REV. 167, 191 (2013).
[392] Gevurtz, *Disney*, *supra* note 386, at 484-485.

It should be mentioned here that the practice of derivative suits is generally alien to German courts. Managers owe and, thus, breach their fiduciary duties towards a company, not its shareholders. In case of oversight of supervising directors, it is the management board's responsibility to sue them that can hardly happen in practice, considering that managing directors can be incriminated for mismanagement along with their colleagues.[393]

As mentioned in the second chapter of this thesis, German corporate law devotes much more attention to the fiduciary duty of loyalty of majority shareholders owed to minority shareholders, rather than that of managers owed to a company or shareholders in general. Such fiduciary relationship is confirmed in the *Linotype* case decided by the Supreme Court for Civil Matters.[394] In this case, the majority shareholder of the company solely approved the decision on its liquidation, since he planned to unite some of the company's enterprises with his own business. It is significant that the decision was previously agreed with the company management board. The Court ruled that the majority shareholder breached his duty of loyalty towards minority shareholders, when single-handedly decided on company's liquidation without letting minority shareholders be involved in the transaction and receive a part of company assets.[395]

3.3.2. THE UNITED STATES

If compared to the German practice of enforcing manager fiduciary duties, the U.S. approach is much more flexible, provides directors and executives with wider extent of discretion in their interaction with a company, and assumes only *ex post* challenging of

[393] Brian R. Cheffins & Bernard Black, *Outside Director Liability across Countries*, 84 TEX. L. REV. 1385, 1424-1425 (2006).

[394] II ZR 75/87, 103 BGHZ 184 [*Linotype*] (February 01, 1988).

[395] KATHARINA PISTOR & CHENGGANG XU, FIDUCIARY DUTY IN TRANSITIONAL CIVIL LAW JURISDICTIONS LESSONS FROM THE INCOMPLETE LAW THEORY 30 (European Corporate Governance Institute, Law Working Paper No. 01/2002, October 2002), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480.

manager decisions for failure to apply due loyalty and care, with the latter being reviewed exclusively after the presumption of the business judgment rule is overcome.[396]

The standard for reviewing director business judgments was examined by the Delaware Court of Chancery in the famous *Disney* case.[397] The shareholders of the Walt Disney Company sued its board of directors, assuming that the latter acted with gross negligence in violation of their duty of care, when approved the agreement with Michael Ovitz employing him as the company's president and entitling him to remuneration and severance payment in the amounts significantly exceeding the average. After a one-year work for the Disney, Ovitz left the company and received the severance package of USD 140 million.[398] The Court did not find directors in breach of their duty of care. It specified, and this is the major difference of this case compared to the *Mannesmann* judgment, that the presumption of the business judgment rule stands unless "fraud, bad faith, or self-dealing" is proved or a decision is irrational in the business sense,[399] regardless of whether directly advantageous for a company. Approving the employment agreement with Ovitz, the company's directors were "at most ordinarily negligent", which is "insufficient to constitute a violation of the fiduciary duty of care" pursuant the business judgment rule that was exercised by the directors.[400]

The duty of care requires directors to be "reasonably informed," so that to act rationally when making their decisions.[401] In the *Van Gorkom* case,[402] the Supreme Court of Delaware addresses the issue of adequate awareness of circumstances of the forthcoming transaction. Specifically, after two hours of deliberations, the board of directors of TransUnion approved its merger by the other company without being adequately informed

[396] CAHN & DONALD, *supra* note 123, at 345, 372.
[397] *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 747 (Del. Ch. 2005).
[398] Ball et al., *supra* note 249, at 154.
[399] *Walt Disney Co.*, 907 A.2d at 747.
[400] *Id.* at 760.
[401] Ball et al., *supra* note 249, at 143.
[402] *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

about the method used by the TransUnion's CEO when determining the company's purchase price per share and its intrinsic value. For this, the Court found the directors grossly negligent, which does not allow considering their business judgment as made on an informed basis.[403] In addition, directors failed to fully inform the company's shareholders about the conditions of the deal. As a result, the Court held that directors of TransUnion were in breach of their fiduciary duty of care to the company's shareholders.[404]

Turning to the duty of loyalty, in *Stone v. Ritter*, the Supreme Court of Delaware ruled that "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty."[405] Specifically, in contrast to the German Supreme Court,[406] establishing that effective control and monitoring is a part of the director duty of care, the Delaware Court held that directors do not comply with their duty of loyalty, when failing to introduce an adequate information and control system or, if such is introduced, to consciously track its activities, thus, remaining uninformed of risks they need to address.[407]

It must be noted that, although the above analyzed cases deal with duties of board directors, "officers of … corporations, like directors, owe fiduciary duties of care and loyalty, and … the fiduciary duties of officers are the same as those of directors."[408] However, when it comes to authorizing limitation and elimination of liability pursuant to Section 102(b)(7) DGCL, these provisions cover exclusively directors or persons performing duties assigned to the board of directors.[409] If a person holds the position of both a director and officer, "actions taken solely in the defendant's capacity as an officer are outside the purview of Section

[403] *Id.* at 874.
[404] *Id.* at 893.
[405] *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).
[406] II ZR 102/07 [*OLG Jena, LG Er-furt*].
[407] *Stone*, 911 A.2d at 370.
[408] *Gantler v. Stephens*, 965 A.2d 695, 708-709 (Del. 2009).
[409] DGCL § 102(b)(7).

102(b)(7)."[410] In the situation when defendant's actions cannot be separated as referred to performance of either director or officer duties, "any duty of care claim stated against that individual is exculpated."[411] Also, provisions on liability limitation address only pecuniary liability of directors, not excluding the possibility to still apply equitable remedies.[412] Finally, in court, protection from liability pursuant to the discussed legal provision is "an affirmative defense" implying that "Defendants seeking exculpation under such a provision will normally bear the burden of establishing each of its elements."[413]

3.3.3. UKRAINE

One of the biggest flaws of Ukrainian company law is that officer-company relations are governed by labor law provisions. This approach makes it difficult for shareholders to dismiss unfair and incompetent management. An absurd practice of application of labor law is an opportunity for a manager, who was dismissed by shareholders, to be reinstated in his office by court.[414] Specifically, a gross violation of work duties that is a ground for dismissal of an organization manager is neither clearly determined in law,[415] nor interpreted by the Supreme Court of Ukraine. If a manager is dismissed on this ground, it is for a court in each particular case to review whether there was a gross violation on his part.[416]

As an example, in 2011, the District Court for the city of Kyiv upheld dismissal of the state municipal enterprise manager.[417] The Court ruled that the manager's failure to get acquainted with a new job description, which is an integral part of the contract determining

[410] *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270, 1288 (Del. 1994), *citing* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORP. & BUSINESS ORG. § 4.19, at 4-335 (Supp. 1992).

[411] *Brown v. Brewer*, No. 06-3731, 2010 WL 2472182, at *4 (C.D. Cal. June 17, 2010); California adopted MBCA in 1977.

[412] BAINBRIDGE, LAW AND ECONOMICS, *supra* note 120, at 300.

[413] *Emerald Partners v. Berlin*, 726 A.2d 1215, 1223-1224 (Del. 1999).

[414] Yefymenko, *Corporate Governance*, *supra* note 127.

[415] Labor Code of Ukraine No. 322-VIII, Art. 41(1) (1971).

[416] Resolution of the Plenum of the Supreme Court of Ukraine No. 9 "On judicial practice in labor disputes," para. 27 (November 6, 1992).

[417] Since labor relations of managers of both state enterprises and public joint stock companies are governed by the same norms of labor law, it is relevant to cite this case here.

the scope of manager authority, amounted to a single gross violation of work duties as per Art.41(1) of the Ukrainian Labor Code.[418]

The contrasting approach was demonstrated in the other 2011 case. The District Court for the Zaporizhzhya Region satisfied a claim for reinstatement of the commercial bank manager in his office. The Court held that numerous violations of law (including violation of rules on cash transactions, complete disregard for bank orders and regulations, abuse of official duties, misappropriation of depositor funds, and failure to provide the bank with cash register documents on property entrusted to it that caused considerable material damage to the bank) constituted a continuing rather than a single gross violation of work duties on the part of the manager, and, thus, the ground for dismissal was absent.[419]

Also, as mentioned in the second chapter, Ukrainian law does not provide for fiduciary duties for managers of a company. By reason of the lasting historical period of state ownership, current supervisory and executive directors of Ukrainian companies generally lack true understanding of the requirement to act in the best interests of a company, contained in the Civil Code and Law "On Joint Stock Companies". The practice of holding management liable for caused damages, except for criminal liability for theft or fraud, is not developed either. Finally, the defective attachment of management to labor law that does not provide any demand for employees to apply due care, diligence and loyalty towards their employer virtually excludes the possibility to introduce the concept of fiduciary duties into corporate relations, thus, indirectly facilitating unscrupulous actions on the part of officers.[420]

Considering all these conditions during its assessment, the World Bank rated the level of compliance of Ukraine with the OECD principle requiring the board to "act on a fully

[418] *Person_1 v. "Broadcasting company "Kyiv,"* Case No. 2-6318/11 (Sh. D.C. K. May 27, 2011).
[419] *Person_1 v. Didenko O.V.*, Case No. 2-86 (Vas. D.C. Zap. April 6, 2011).
[420] Yefymenko, *Corporate Governance, supra* note 127.

informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders" as being "Not observed".[421]

3.4. RESPONSIVENESS OF MANAGEMENT TO SHAREHOLDER INTERESTS

In the opinion of the author of this research, and this position seems to be widely supported by scholars,[422] the German two-tier board model tends to address the needs and interests of the whole corporation with particular attention paid to its employees, while the United States unitary board system is much more oriented to satisfy proprietary shareholder interests.

Primarily, the German approach to management is considered to be less responsive to shareholder interests, since the law requires that the authority of shareholders to elect members of the supervisory board was limited in favor of company employees, whose interests must be represented in the boardroom as well.[423] In addition to employee presence in the supervisory board, German managers pay due regard to the interests of other constituencies, namely, creditors, consumers and the society, trying to maintain a balance between them. The ultimate aim of this "stakeholder" corporate governance model is a "sustainable, stable and continuous economic growth."[424] All this differs greatly from the approach of the U.S. management, seeing the maximization of short-term shareholder profits as their top priority.

Also, in the long run, potential investors cautiously treat the German model of governing a company with a mandatory co-determination element present in the supervisory

[421] WORLD BANK, *supra* note 161, at 30.

[422] Cheffins, *supra* note 342, at 500-501; Henry Hansmann & Reinier H. Kraakman, *The Basic Governance Structure*, IN THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 33, 35 (Reinier H. Kraakman et al. eds., Oxford University Press 2004); Kolla, *supra* note 80, at 831-832.

[423] Hansmann & Kraakman, *supra* note 422, at 35-36.

[424] Cheffins, *supra* note 342, at 500-501.

board as being unfamiliar to them.[425] Not without reason, investors anticipate that decisions made by the management board are not that much business efficient, but rather oriented to meet parochial interests *inter alia* of a local labor union,[426] since they must be approved by the supervisory board. This situation, as well as the practice for labor representatives to divert the lion's share of their remuneration into profits of labor unions, makes it questionable whether management is able to truly work for the benefit of shareholders.[427]

At the same time, despite the U.S. management model is said to be more effective in meeting shareholder interests, in practice, its responsiveness is impaired by provisions distracting manager responsibility from being owed exclusively to shareholders and directing its parts at a number of other constituencies.[428] To best satisfy shareholder expectations, managers should be provided with the widest possible discretion and their role as shareholder agents should not be further questioned, which in fact can hardly be implemented at present.

In Ukraine, management responsiveness to shareholder interests varies depending on whether these are majority or minority shareholders. The vector turns sharply from explicitly prioritizing interests of the former to notably disregarding those of the latter.[429] Specifically, the World Bank reports that the OECD principle of equal treatment of all shareholders is "Materially not observed" in Ukrainian companies.[430] This is *inter alia* reflected in management failure to prevent the abuse on the part of controlling shareholders and to equitably treat all shareholders of a company.[431]

Causes of such imbalance are traced from the first years of Ukraine's independence. When former state organizations were privatized and proprietary rights redistributed, managers mostly maintained their offices, and, at the same time, many of them obtained

[425] Sandrock & Plessis, *supra* note 147, at 171.
[426] Baums & Scott, *supra* note 68, at 72.
[427] *Id.*
[428] *Id.* at 71.
[429] *See generally* Yefymenko, *Corporate Governance*, *supra* note 127.
[430] WORLD BANK, *supra* note 161, at 22.
[431] *Id.* at 23-24.

shares of companies they were managing.[432] Pursuant to the other scenario, it is simply common that controlling shareholders and founders of Ukrainian companies refuse to delegate their management, because of being personally attached to their brainchildren. Even if not engaged in operational management of their companies, they usually formally manage them sitting in the supervisory board.[433] In both cases, the Ukrainian model of corporate governance is often an interaction of company owners, one of which enjoys considerable advantages arising from his position in the company management system, rather than his property rights.[434]

Finally, it is not a secret that virtually all Ukrainian political forces maintain close ties with large financial and industrial groups, whose companies owe the major part of Ukrainian industry. Political support for controlling shareholders and company managers owing large stakes was demonstrated for years by the parliament refusal to adopt legislation establishing protection of shareholder rights.

Since legal vulnerability of shareholders deterred potential investments, the new Law "On Joint Stock Companies" was approved in 2008. It primarily upholds interests of major shareholders, while the legal status of minority shareholders is still much more unprotected than that ensured by the best international practices.[435] As a result, legal insecurity of shareholders and high degree of management self-will, resulting in large-scale abuses of minority shareholders' rights by unscrupulous managers and large shareholders,[436] is so far a common practice in the state.

[432] Yagmurdzhi, *supra* note 6, at 145.
[433] Grinevskaya, *supra* note 330.
[434] Yagmurdzhi, *supra* note 6, at 145.
[435] Yefymenko, *Corporate Governance*, *supra* note 127.
[436] Yefymenko, *Reform*, *supra* note 263, at 112.

3.5. STRENGTHS AND WEAKNESSES OF MANAGEMENT AS DETERMINANTS OF ITS OVERALL EFFECTIVENESS

The level of management effectiveness in every certain case should be measured in relation to objectives that every particular company sets for itself. Still, it also inseparably depends on what trends are generally prevalent in the society of a particular state. These include not only statutory specifics of corporate governance, but also historical and cultural peculiarities.[437] The presented analysis of the legal provisions and factual data on the position of managers in German, U.S. and Ukrainian companies allows justifiably stating that the regime of company management accepted in any of the three countries has its strengths and weaknesses.

3.5.1. GERMANY

The main advantage of the two-tier board system of German companies is a clear physical separation of a body performing operational management from a body exercising monitoring and control, at the very outset preventing conflicts in the management structure.[438] In addition, the undoubted merit of German legislation is a strict distribution of functions between these bodies. The extent of competence of the supervisory board is clearly determined by law that prevents any confusion about its legal status in a company.

Scholars also stress the importance of "soft functions" of the German supervisory board that are not enshrined in law. In particular, the board is an element, providing valuable advice,[439] connecting various stakeholders and business partners of a company, and

[437] Jungmann, *supra* note 293, at 448.
[438] *Id.* at 449-450.
[439] Jean Jacques du Plessis & Ingo Saenger, *An Overview of the Corporate Governance Debate in Germany*, in GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 15, 23 (Jean Jacques du Plessis et al. eds., Springer 2012) [hereinafter Plessis & Saenger, *Corporate Governance Debate*].

maintaining the balance of their interests. These activities are considered to be of great value for a company, especially in conflicting situations.[440]

However, the physical separation of control and operational management entails several important problems, questioning ultimate effectiveness of the entire structure of company management. One of them is the problem of diluted independence of supervising directors that was addressed in the first section of this chapter.

Also, the regime establishing the need for the supervisory board's approval only in strategic matters predetermined that it stands aside from essentially influencing the course of company's development. Neither the supervisory board receives information on the majority of forthcoming decisions of the management board, nor is asked to provide its opinion on them. As a result, supervising directors control executive management only reactively and never proactively. They are entitled to provide feedback on manager decisions up to the harshest possible criticism, but are never able to get involved before these decisions are taken so that to prevent mistakes.[441]

Structurally predetermined remoteness of the supervisory board from decision making causes the other problem within the two-tier management system, namely, a sharp information asymmetry between supervisors and executive managers. Members of the management board receive authentic and exhaustive data on the state of corporate affairs from their subordinates, while this option is unavailable for supervising directors.[442] The latter rely exclusively on the management board for obtaining relevant information that may be misrepresented.[443]

Proponents of the two-tier management model deny that practical problems of manager efficiency in German companies arise due to the model's defectiveness, pointing at

440 HOPT & LEYENS, *supra* note 168, at 5.
441 Jungmann, *supra* note 293, at 452.
442 *Id.* at 453.
443 Plessis & Saenger, *Corporate Governance Debate, supra* note 439, at 20-21.

its inaccurate implementation. Possible reasons for occasional inefficiency of the supervisory board are lack of contentment, insufficient payment to supervising directors, work overload, insufficient professionalism, ritualisation of board meetings and ordinary human imperfection.[444] Likewise, statistical data reaffirm that purely structural indicators of management, such as the board's size, level of independence and employee participation, do not crucially influence company's performance.[445]

3.5.2. The United States

The one-tier board structure that does not formally anticipate a separation of strategy-setting and supervision allows establishing better coherence of management, as opposed to the German model. Particularly, there is generally no significant imbalance in the decision-making powers within the management structure of U.S. companies.[446] All directors, regardless of whether they are executives or non-executives, equally participate in making decisions.[447] Being deprived of the possibility to claim that their control over someone else's decisions is exercised exclusively *ex post*, they face strong incentives to avail themselves with all information necessary for grounded decision making. Moreover, since decision making and supervising elements of the management structure are not diverging in what relates to frequency of their meetings, the entire board is more aware of the state of company day-to-day affairs, than is the supervisory board in Germany.[448]

The U.S. model compensates the absence of physical division of supervisory and managerial functions of the board of directors by introducing non-executive or independent members into it. However, for a couple of reasons, this practice may not be sufficient to

[444] *Id.* at 23-24.
[445] BERMIG & FRICK, *supra* note 309, at 22-23.
[446] Jungmann, *supra* note 293, at 459.
[447] Gevurtz, Franklin A., *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 106 (2004) [hereinafter Gevurtz, *Origins of the Corporate Board*].
[448] Jungmann, *supra* note 293, at 459.

ensure an adequate level of monitoring and control within the board. First, an information asymmetry is in fact also present in the board of directors of U.S. companies. Compared to Germany, where the supervisory board is unable to receive information in any other way except from the separate management board, outside directors in the U.S. have access to adequate data, but factually often appear to receive filtered information stemming from executive managers,[449] which may hinder their view of a situation. The information asymmetry, thus, takes place inside the unitary board of directors, as opposed to that between two separate bodies of the management structure.

Second, a personal attitude factor also affects the quality of monitoring by outside members of the board. As full members of the board of directors, non-executive directors are mostly aware that their primary task is strategic-setting, while they do not usually pay due attention to or even understand their function of monitoring.[450] They also face the monitor-colleague-dilemma,[451] which precludes them from being impartial and honestly delivering their observations.

Finally, if considered in general terms, despite all efforts to increase effectiveness of the U.S. management system, it is being actively criticized for inability of the board of directors to exercise proper control over executives. Authority, instead of being delegated according to the sequence shareholders-directors-officers, in reality, is flowing backwards. Executives are major decision makers in both matters of corporate strategy and operational management, while the actual role of the board of directors is marginal.[452]

Furthermore, all measures introduced to improve effectiveness of manager monitoring, namely, enhanced rules on board size and composition, establishment of committees and detailed financial reporting have not significantly changed the balance of

[449] *Id.* at 460.
[450] *Id.* at 460-461.
[451] *Id.* at 461.
[452] Gevurtz, *Origins of the Corporate Board*, *supra* note 447, at 103-105.

power. Neither has compliance with corporate governance code requirements.[453] At the same time, reliance on generous compensation as a powerful incentive for managers is gradually increasing, and as a result, compound companies are "literally out of control,"[454] which is proved by recurrent corporate scandals wherein boards are mostly passive viewers.

Nevertheless, enormous economic prosperity of U.S. corporations and failure of other corporate governance models to succeed more greatly so far cannot be disregarded as clear evidence in support of this management structure being effective.

3.5.3. UKRAINE

In contrast to Germany, Ukrainian laws introducing the two-tier board model still have not clearly delimited authority of different bodies of a company. Particularly, the way powers of the general meeting and supervisory board are delineated is not the best. The general meeting is entitled to decide any matters related to company operation,[455] and even matters exclusively decided by the supervisory board may not be addresses by any other body of a company "except for the general meeting."[456]

As a result, there is the risk for the general meeting to intervene in the competence of the supervisory board and make decisions inconsistent with its strategy, while the board is obliged to comply with it. This approach contradicts to interests of a company and its shareholders, because matters assigned to be decided by the supervisory board require making properly informed, skilled and balanced decisions as elements of a coherent strategy, while the general meeting risk to be manipulated by separate groups of shareholders or executives.[457]

[453] Philippe Haspeslagh, *Corporate Governance and the Current Crisis*, 10 CORP. GOV. 375, 376 (2010).
[454] *Id.*
[455] Law of Ukraine "On Joint Stock Companies" No. 514-VI, Art. 33.1 (2008).
[456] Law of Ukraine "On Joint Stock Companies," Art. 52.3.
[457] Yefymenko, *Corporate Governance, supra* note 127.

Also, as it currently stands, the executive body of a company enjoys the excessive degree of independence, especially in cases when it is formed by the general meeting. In current conditions of the Ukrainian corporate sector, this does not contribute to transparency and scrupulousness of the management process. Specifically, the state paradoxically combines two systemic problems: unusually high concentration of ownership in hands of huge financial and industrial groups and a large number of small shareholders (by various estimates 13-15 million people).[458] Such factors as limited capacity to enforce contracts, low corporate culture and corrupted courts are also present.

Hence, although the author of this thesis generally considers the single-tier board system to be more expedient compared to the two-tier board system, for the sake of adequate protection of all groups of stakeholders, inclusion of the supervisory board in the management structure is reasonable, provided that it is indeed efficient and sufficiently strong.

Finally, one of the most vital problems of Ukrainian corporate business is inability to receive complete and adequate information on ultimate ties between company ownership and control. Companies themselves provide only basic surface data on ownership of share packages requested by law, while it is widely spread to employ privately run and offshore companies to conceal actual sources of control over a company.[459] Therefore, there exists an urgent need to improve legal requirements on the duty to disclose, in order to decrease the risk of satisfying interests of controlling shareholders aligned with management on account of minority shareholder rights and interests, as well as those of a company.

[458] *Id.*
[459] WORLD BANK, *supra* note 161, at 4.

CONCLUSION

The perception of the management process within the management science was developing gradually. At first, scholars focused their attention on the rational basis for management as a process, with later filling the gap in what relates to the role of the human factor in making it efficient. All of their advances let now characterize management as a multidimensional process of applying a fixed set of organizing and controlling techniques by one group of individuals towards the other, whose behavior and interpersonal relations, as well as the outside environment, influence its ultimate efficiency.

The most distinctive and significant feature of modern corporations is the separation of their ownership and control, giving rise to the establishment of corporate governance as a system coordinating interaction between a corporation and its stakeholders with a view to maintain the optimal balance of their interests. Theories of corporate governance suggest different models of this interaction, but they all consider management to be the central element within the corporate structure.

The purpose of this thesis was to present a profound analysis and comparison of the role of company management in Germany, the United States and Ukraine that are all following different models of corporate governance. The study has demonstrated that the factual position of management in companies of the three selected states does not always align with the regime established by law.

Considering that corporations effectively function in Germany and the U.S. for more than a century, it is understandable that laws of these states extensively cover the matter and are generally consistent with that system of law and environment, to which they belong. The Ukrainian corporate sector developed on the territory for a long time completely rejecting private property, and it is still relatively young. For this, but not exclusively this, reason, Ukrainian laws provide only the basics for determining the role of company management and still contain major gaps and inconsistencies, sometimes making it difficult to even identify the actual intent of the legislator.

The legal position of management in companies of the three states differs mainly in what relates to the management structure and the amount of authority assigned to corporate managers.

U.S. laws do not provide for the separation of supervising and governing functions of management, entrusting the single board of directors to run the business. In Germany, such separation is mandatory and is shaped as the two-tier board model. In Ukraine, the two-tier board structure of management is also applied by the overwhelming majority of companies. However, in contrast to the previous two countries, the Ukrainian legislator has not so far managed to clearly delineate powers between the general meeting and the supervisory board.

The scope of authority that U.S. laws attribute to the single board of directors is much wider than that Germany and Ukraine assign to separate bodies within the management structure of their companies. This is reflected in ample decision making powers of the board in the U.S., its ability to establish director and officer remuneration, much higher level of protection availed to business decisions of board directors and the possibility for them to be exculpated from personal liability, as opposed to their German colleagues.

The lack of the separate supervising body is, however, compensated by introduction of independent members and committees within the board of directors of U.S. companies, where these practices are much more strongly advocated, than in the other two states.

One of the biggest lapses of current Ukrainian corporate legislation is subjection of managers to provisions of labor law in what relates to their duties and liability. It virtually excludes the possibility to impose fiduciary duties on Ukrainian managers, as well as to hold them liable for failure to apply due care and loyalty, and to act in company’s best interests. Moreover, it assumes an absurd scenario, when a manager dismissed by company shareholders is reinstated in his office by court, if no sufficient grounds for dismissal are proved as per labor law norms.

The legal status of management to some degree demonstrates the general attitude maintained by the society of one of the three states towards a corporation and the role of management in achieving its purposes. Yet, when it comes to the factual standing of corporate managers, these factors are reflected even more.

In equality-oriented German society, companies tend to treat their managers as employees standing at the top of the corporate ladder. Roughly speaking, their position is determined based on the same principles as applied to ordinary employees, but obviously taking into account the scope of their responsibilities. For this reason, although remuneration of German managers is high, it is much lower than that of their U.S. colleagues. Also, German courts, although applying the business judgment rule, are much stricter in reviewing manager decisions, clearly favoring interests of a company and showing no hesitation for imposing criminal sanctions on its managers. Finally, employees have a much stronger position enabling them to defend their interests, than this is in the other two states.

The U.S. system of management is considered to be much more responsive exactly to shareholder interests. In contrast to their German counterparts, U.S. companies, clearly distinguish managers from the whole corporate structure as main contributors to company and shareholder wealth. For this reason, they are much highly paid and enjoy much higher standard for the review of their business decisions.

In this discussion, Ukrainian companies cannot be objectively put in the same plane, as companies of Germany and the U.S. Due to major regulatory lapses, companies develop individual approaches towards organization of their management and are not either obliged or motivated to disclose information on their internal practices. As a result, there is a huge problem of inaccessibility of comprehensive and adequate information on the factual standing of company management in Ukraine.

Among other issues this concerns the issue of remuneration of Ukrainian managers. Companies mainly do not have clear schemes to establish manager remuneration and, thus, pay their managers based on market and industry prices for managerial services and personal ability of a manager to facilitate company's welfare in modern conditions of the Ukrainian market. However, almost no exact numbers of individual remuneration are available.

In general, managers in Ukraine are provided with substantial factual freedom of actions and ability to even derogate from legislative prescriptions without experiencing rigid control. However, as opposed to the highly authoritative corporate management in the U.S., Ukrainian situation is a result of legislative omission, rather than legislative provision.

At the same time, it is clear with regard to all the three states that the factual position of management in their companies to a certain extent differs from what has been intended by laws.

The difference is particularly apparent when it comes to the monitoring unit within the management structure. Despite being formally introduced in accordance with legal requirements, supervising elements often appear to be inefficient. This is caused by independent directors' insufficient competencies, lack of understanding of their role, monitor-colleague-dilemma, possibility to act only reactively and information asymmetry. Although in a different manner, all this is true for both Germany and the U.S. In Ukraine, the problem is that the practice to involve independent directors in supervisory boards is not familiar to companies, and again, almost no information on this matter is disclosed.

Based on the analysis of Ukrainian corporate law and practice as compared to German and U.S. approaches to the status of company management, there are several very important recommendations for improvement that are worth to be implemented in Ukraine.

First, all inconsistencies regarding distribution of powers of the general meeting and supervisory board should be eliminated.

Second, legislative gaps concerning composition and operation of the supervisory board should be filled. This particularly relates to participation of legal persons in the board and securing its independence. The latter provides for not merely technical inclusion of formally independent members to the board, but ensuring that they understand their monitoring function and receive all adequate information for its proper performance.

Third, companies should be forced to comply with the comprehensive duty to disclose. It should primarily cover actual relationship between company shareholders and its managers and details of manager remuneration, including payment data divided by categories for every individual manager and company's rationale behind remuneration schemes.

Fourth, the concept of manager fiduciary duties owed to a company should be introduced in Ukrainian corporate law instead of the attachment of manager office to labor law norms. At the same time, it is necessary to introduce in Ukraine the modified version of the business judgment rule, possibly such as accepted in Germany.

Fifth, shareholders, especially owners of small share packages, should be provided with effective tools of protection of their rights and interests from abusive and unscrupulous activities of managers, possibly in the form of a derivative suit.

The main merit of this research is in filling the scholarly gap in comparative corporate governance, principally by providing analysis of the role of company management in Ukraine that has never been done before. It is performed by contrasting the legal and factual positions of management in Ukrainian companies to the more developed regimes accepted in Germany and the U.S. As a result, this thesis presents a multidimensional study of different aspects of company management as legal prescriptions versus actual business practices, all this in a comparative perspective.

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