

## THE CORPORATE GOVERNANCE IN UZBEKISTAN: A SPECIAL FOCUS ON THE BOARD'S SUPERVISORY ROLE COMPARED WITH GERMAN PRACTICE

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### Abstract

Today, the topic of corporate governance has become vital for the most researches and scientific controversies. The corporate governance is now playing a key role in economic and social development of a country, and it has begun to significantly matter for both industrialized and most of the developing countries. In the meantime, little is known for the world community about the state and problems of corporate governance in Uzbekistan. In this regard, in this paper we mainly address the present situation in Uzbek corporate governance as well as, as a special focus, make comparison of the Uzbek and German board's supervisory role practices. This paper may be interesting for those who are not aware of the corporate governance in Uzbekistan and who would like to more or less know about it.

**Keywords:** Corporate Governance; Corporate Legislation; Corporate Governance Framework; Supervisory Board; Board's Supervisory Role; Board Responsibilities; Uzbekistan; Germany

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### Introduction

Today, the topic of corporate governance has become vital for the most researches and scientific controversies. The corporate governance is now playing a key role in economic and social development of a country, and it has begun to significantly matter for both industrialized and most of the developing countries. Year by year there increase a number of researches, books and papers on corporate governance problems which call upon to improve the state of corporate governance in the jurisdictions or in the world as a whole, and to bring it to the generally accepted international standards and principles.

In the meantime, little is known for the world community about the state and problems of corporate governance in Uzbekistan. Current background of corporate governance in Uzbekistan shows that almost all the production enterprises are established under a principle of joint-stock companies but these joint-stock companies in smaller extent function in accordance with their status and they almost do not make use of their rights. The mechanisms needed for the joint-stock companies to function in line with their market status are weakly sprung into action. This problem also comes from the statement of Uzbekistan's President in his speech to Parliament titled "*The Concept of the Further Deepening of the Democratic Reforms and the Formation of the Civil Society in the Country*" (Karimov, 2010) saying that new

Company Law should be enacted and the powers, rights and responsibilities of the corporate governance and control bodies should be clearly specified in it.

Therefore, the main purpose of this paper is to provide information on the present state of Uzbek corporate governance as well as, as a special focus, make comparison of the board's supervisory role practices in Uzbekistan and Germany in order to reveal the disadvantages and problems in the context of board's role in corporate governance of Uzbekistan. In this regard, this paper mainly focuses on the points/questions we identified in the beginning of our research: to what extent the Uzbek corporate governance has been studied? What German best practice on the Supervisory Board's supervisory role can be applied to Uzbekistan? How can the "comply or explain" mechanism be adopted in the Uzbek corporate governance system?

For comparison purposes we have chosen the German practice on board's supervisory role as a benchmark where the international corporate governance standards prevail, and moreover, the Uzbek corporate governance structure is built on the basis of German corporate governance model. A comparative study of the Supervisory Board practice in Uzbekistan and Germany was done on the basis of Uzbek Law on "Joint-Stock Companies and Protection of Shareholders' Rights" and other by-laws as well as the German Stock Corporation Act and German Corporate Governance Code respectively. The comparison is done in the following format: DULP → DGLP → SDBP, that is, first comes the description of Uzbek legal practice (DULP), and then we describe the German legal practice (DGLP), later on, we compare the practices by revealing the similarities and differences between practices (SDBP).

This paper may be interesting also for those who are not aware of the corporate governance in Uzbekistan and who would like to more or less know about it. At the end of research we bring conclusions resulting from our analysis, and give some suggestions for improving board supervisory practice in Uzbek corporate governance system.

## **I. To what extent the Uzbek corporate governance has been studied: a literature review**

Hundreds of papers and dozens of books have been written about corporate governance in the last few years. But we become evidence that only a counted number of English papers and books describing the state and problems of corporate governance in the independent Uzbekistan have been written at all. One of the first surveys was conducted by Harry G. Broadman (1999) on behalf of the World Bank. In his paper "*Competition, Corporate Governance and Regulation in Central Asia: Uzbekistan's Structural Reform Challenges*" he identifies one of the six policy challenges for Uzbekistan that the corporate governance incentives to instill strong competitive discipline on firms' performance and to engender effective separation between government and business, especially in state owned "associations" and related holding groups are blunted. He also finds that the lines of authority for corporate governance are ill-defined and there is little discipline on corporate performance and little separation between government and business, and gives the suggestions on strengthening incentives and institutions for corporate governance and bringing them in line with international practice. Another early study by Alexandr V. Akimov (2001) more or less examines the capital market as a corporate control mechanism in the shadow of Uzbekistan's financial system.

Other works and studies on Uzbek corporate governance have come later after 2005. Curiously enough, "*The Handbook of International Corporate Governance: A Definitive Guide*" prepared by the Institute of Directors (2005) provides, alongside with other developed and developing countries, the coverage of corporate governance practice for the jurisdiction of Uzbekistan focusing on key areas such as corporate structure and ownership, legal, regulatory and institutional bodies and board structure. Unfortunately, in the 2nd 2009 edition of the book Uzbekistan as separate jurisdiction was omitted.

Some authors tried to touch upon only some aspects of corporate governance in Uzbekistan. For instance, M. Troschke and A. Zeitler (2006) investigated the privatization and corporate governance problems resulting from a corporate sector survey among companies of the food and light industry in Kazakhstan and Uzbekistan. The authors as E. Musaev and Bae Jung Han (2007) examined the corporate governance legislation from the point of view of developing the ICT infrastructure. G. Aras and D. Crowther (2009) in their book looked at the corporate social responsibility among the SMEs in Uzbekistan. Another author E.

Kurtbedinov (2009) in his dissertation analyzed the regulation of corporate governance in Uzbekistan and compared it with other transition countries.

While doing literature review it is important also to mention the reports drawn up by the international organizations, because we think that they have made an essential contribution to the study of Uzbek corporate governance system. During the last decade several official publications which, mainly, touch upon the assessment of corporate governance legal framework in Uzbekistan has been done by the European Bank of Reconstruction and Development. One of its studies is “*Commercial Laws of Uzbekistan: An Assessment by the EBRD*” (2005) which evaluates, alongside with other commercial laws, the legal framework for corporate governance in the country. Another one is “*Corporate Governance Legislation Assessment: Uzbekistan*” (2007) where the EBRD gives the results of measuring the Uzbek corporate governance legislation against principles promulgated by the Organization for Economic Cooperation and Development.

From the above literature review we see that only a few studies on corporate governance in Uzbekistan are available in English. Of course, there exist more other literature and sources on Uzbek corporate governance but they are not available for the world community due to that they are all in native language.

## **II. Corporate Governance: concept and definition**

### ***2.1. What is corporate governance: global understanding***

Today, in the world practice, it is generally known that there is no a single definition of corporate governance that could be used in all jurisdictions and in any conditions. Following the scientific and practical researches in the field of corporate governance there have been formed the different definitions for corporate governance. We assume that any definition proposed to a greater extent depends on the country and its legal condition, on the functional objectives of the institution which gives definition or on the scientific views of an author.

The term “corporate governance” historically emerged in the 1970s in the United States. Later on, this term has widely spread in Europe where the researches in the spheres of corporate management, corporate law and establishment of corporate structures (organizations) were proceeded (Veasey, 1993). We found out during our research that the first documented use of the word “corporate governance” was by Richard Eells (1960, p.108) to denote “the structure and functioning of the corporate polity”. According to Becht, Bolton and Röell (2002) the “corporate government” concept itself is older and was already used in finance textbooks at the beginning of the 20th century. Particularly, corporate relations were first studied in 1932 by the American legal scientists A.Berle and G.Means (1932) in their classical works as a process for managing the corporate and private property. Although the term “corporate governance” was not mentioned in their works, they have studied the classical agency problems: how the corporate managers being as the shareholders’ agents can be directed to manage the corporate assets and to act for the shareholders’ interests? They linked the corporate governance to separation of ownership and management which expressed in the agency relationship between trustees of property – principals (outsiders, investors) and their agents (insiders, managers). According to their saying, the shareholders are attracted owing to presence of need for the great extent of financial resources for firm’s economic development, and this circumstance serves as a ground for separation of ownership and control.

During the past years, the formation and development of corporate governance in the various corporations and countries has led to origination of a variety of definitions for corporate governance which consider the specificity of certain corporations as well as the national distinctions of the jurisdiction or region where these corporations conduct business. As the researches show, up to day there are plenty of definitions of corporate governance that have been formed by the scientists from the western countries. Among the scientific circle academics the corporate governance is interpreted as “the institutions that influence how business corporations allocate resources and returns” (O’Sullivan, 2000, p.153), “the institutional matrix in which the integrity of a transaction is decided” (Williamson, 1996, p.11). The corporate managers, investors, advocates and politicians use the relatively narrow definition: the corporate governance is the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company’s relationship with its all stakeholders.

The first significant definition was given by Sir Adrian Cadbury in the Report of the Committee on the Financial Aspects of Corporate Governance (1992) that the corporate governance is the system by which companies are directed and controlled. The pioneers of corporate governance and economics scientists R. Monks and N.Minow (1995) defined the corporate governance as the relationship among various participants (chief executive officer, management, shareholders, employees) in determining the direction and performance of corporations. Another famous American scientists A.Shleifer and R.Vishny (1997, p.738) defined the corporate governance differently and stated that the corporate governance deals with the way in which suppliers of finance to corporations assure themselves of getting a return on their investment. One more scientists K.John and L.Senbet (1998) stated in their researches that the corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected.

These all definitions later led the Organization of Economic Cooperation and Development, particularly its Directorate for Financial, Fiscal and Enterprise Affairs to standardize and draw up the common principles of corporate governance. In the document called *OECD Principles of Corporate Governance* (1999) defines the corporate governance as involving “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”. Later on in 2004 these principles were revised.

Nowadays, the OECD principles of corporate governance serve as the basic document in the sphere of international corporate governance standards and became a specific benchmark for corporate governance issues. They are now even used by other international organizations such as Financial Stability Forum, World Bank to improve the corporate governance in the certain countries they cooperate with. Revised 2004 version of corporate governance principles was enacted by the OECD that was guaranteeing the foundation for an efficient corporate governance structure. The OECD principles of corporate governance covers the following six areas: 1) Ensuring the Basis for an Effective Corporate Governance Framework; 2) The Rights of Shareholders and Key Ownership Functions; 3) The Equitable Treatment of Shareholders; 3) The Role of Stakeholders in Corporate Governance; 4) Disclosure and Transparency; 5) The Responsibilities of the Board. These principles are shortly expressed as transparency, accountability, fairness, and responsibility.

## **2.2. What is corporate governance: Uzbekistan context**

Over the last years in Uzbekistan, along with other world countries, the corporate governance has become a popular area of discussion, a great number of works on corporate governance have been done. The Uzbek researchers and scientists do not stand aside either when defining the corporate governance. The first scientist who defined and reviewed the corporate governance was T. Madiyorov (1993) stating that the corporate governance is carried out in balance with development of production activity, rational use of existing material, financial and human resources, attraction of capital and new technology. A scientist A.Zohidov (2004), in his researches, proposed to define the corporate governance as the management system ensuring the priority of shareholders’ interest in combination with increasing the company performance.

Another Uzbek scientist B.Berkinov (2005) has specified the corporate governance system. According to him “Corporate governance system is a complex and rapidly changing mechanism which includes many interrelated constituents, including a set of legislative, subordinate regulatory as well as internal standard acts which are the corporation’s internal mechanism of control by owners, managers and creditors.

One Uzbek author M.Vohidov (2007) has formed the definition to corporate governance from the legal point of view. He defines the corporate governance as the managerial activity of the company managers directed at ensuring the shareholders to participate in company governance, and held for the interests of shareholders in earning profit out of their shares, and posits that all stakeholders as creditors, company employees and partners as well as the society as a whole (customers) can and must take part in the corporate governance. Economics scientists as Sh.Zaynutdinov and D.Rakhimova (2007) in their book mention the definition by that the corporate governance is a joint activity of the stakeholders with a view to make profit.

The definition for corporate governance given by another economics scientist M.Khamidulin (2007) also deserves attention, according to which the corporate governance is a conscious, direct participation of corporation's proprietor in ensuring by them the regular real influence on determination, formulation and making of strategically important decisions aimed at capital accumulation for corporation, most effective use of capital with the purpose of making profits and equitable distribution of an income earned between the parties of the corporate relations. Another definition which is worthy to note is the one originated by the researches of the economics scientist D.Suyunov (2008), according to whom the corporate governance is a complex of the effective standards which protect the rights of the entities in the form of corporate property and the actions made for goal achievement of the enterprise on the basis of definite governance principles.

### **III. Specificity of corporate governance in Uzbekistan**

#### **3.1. The state of the corporate legislation in Uzbekistan**

Formation of a basis of corporate governance in Uzbekistan has begun with establishing corporate legislation, first of all, with enacting necessary laws regulating the corporate relations. Corporate governance in Uzbekistan is primarily based on statute law which forms a main legal sources relating to corporate governance, and consists mainly of:

- The Civil Code of the Republic of Uzbekistan (enacted in 1995, last amended in 2014);
- Law on Joint-Stock Companies and Protection of Shareholders' Rights' (enacted in 1996, revised in 2014);
- Law on Limited and Additional Liability Companies (enacted in 2001, last amended in 2014);
- Law on Business Partnerships (2001, last amended in 2014);
- Law on Bankruptcy (revised in 2003, last amended in 2014);
- Law on Securities Market (enacted in 2008, last amended in 2014);
- Law on Accounting (enacted in 1996, last amended in 2014);
- Law on Auditing Activity (revised in 2000, last amended in 2014);
- Law on Competition (enacted in 2012).

These laws set formal procedures for establishing corporations, determine the mechanism of governing and functioning of business corporations (companies) and the mechanism of interaction between governing bodies and stakeholders, specify the main rights of shareholders, determine securities market players and provide mechanisms for protecting the rights of market participants and investors, and thus constitute the legal framework for corporate governance in Uzbekistan.

The legal system in Uzbekistan is based on the Civil law, according to which its principles are codified into a referable system. Thus, the Civil Code was enacted in 1995 to effectively ensure the regulation for realization of the citizens' rights to conduct an entrepreneurial activity, and it now strictly determines the legal status of the business entities, sets the main guidelines for corporate ownership and secures the basis of corporate governance.

Main principles of corporate governance in Uzbekistan are stipulated in the *Law on Joint-Stock Companies and Protection of Shareholders' Rights*. This Law has established the particular mechanism, considering the national specificity, governance and control of the joint-stock company on the basis of one of the corporate governance models known in the world (German corporate governance model). Creation of this legal act in the sphere of corporate governance and of protection of shareholders' rights had a positive influence in development of market relations in Uzbekistan. This law has created the legal basis for issues such as the status of joint-stock company, its functioning, reorganization and liquidation, regulation of corporate governance, governing bodies of the joint-stock company and their relationship, control of company activity, its securities and stock floatation, distribution of profits and dividends. Initially enacted in 1996, this law was revised and approved in new version in 2014.

The *Law on Limited and Additional Liability Companies* and the *Law on Business Partnerships* extended the application of the standards of the *Law on Joint-Stock Companies* to limited liability companies and to business partnerships.

The *Law on Bankruptcy* was enacted in 2003 as a new version in order to establish a legislation on implementation of procedural measures related with bankruptcy as well as to create an effective judicial and administrative mechanism for solving the insolvency conditions, as we know that declaring the insolvent commercial enterprises including financial organizations bankrupt is one of the decisive elements of effective corporate governance system.

The *Law on Securities Market* enacted in 2008 is a single legislative act unifying the all formerly enacted laws on securities market and bringing the securities market rules in accordance with international standards. This law regulates the issuance of securities, placement and circulation of securities in the national stock exchange, professional activity of the securities market players, determines the rules for registration of securities, sets the strict requirements for information disclosure and for functioning of securities market.

The *Law on Accounting* regulates the issues relating to organizing business accounting and making financial reports by the corporations.

The *Law on Auditing Activity* sets up the legal bases of independent financial control system which promote the protection of ownership interests of the proprietors and the government.

The *Law on Competition* regulates the relations in the area of competition between companies in commodities and financial markets.

Furthermore, besides the laws we mentioned above, a number of Presidential decrees and Government resolutions have been adopted aiming at improving corporate governance system in Uzbekistan.

### **3.2. The Uzbek corporate governance framework in brief**

The corporate governance framework of Uzbek companies has been improved for many years in accordance with national legislation and taking into account the international practice. We visually bring the typical corporate governance framework which is applied in almost all joint-stock companies (exception may be banks and other financial organizations) operating in the territory of Uzbekistan in the following figure.

According to the current Law (the *Law on Joint-Stock Companies and Protection of Shareholders' Rights* is implied) in Uzbekistan, the General Meeting of Shareholders, Supervisory Board and Executive Body are the governing bodies of the joint-stock company (hereinafter "company").

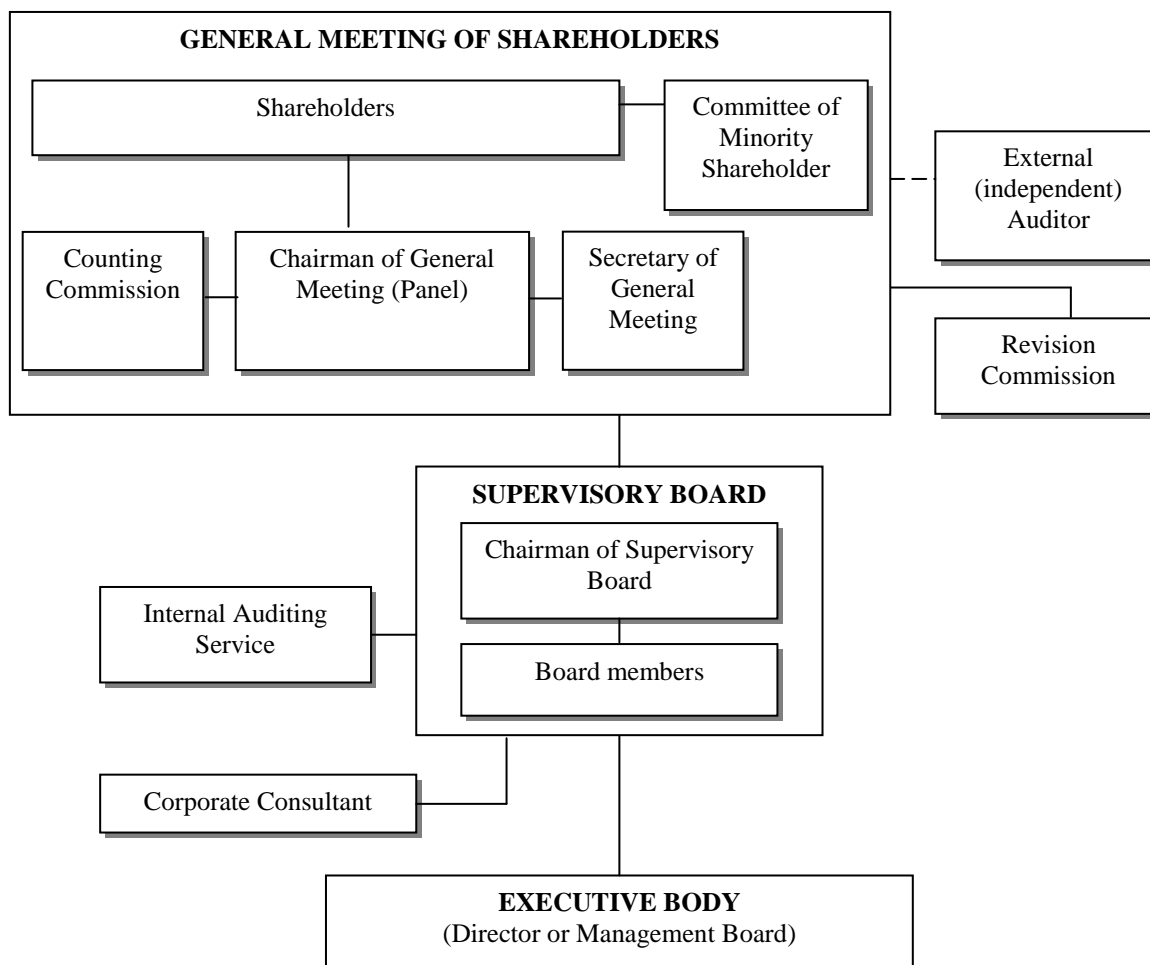
The General Meeting of Shareholders, according to the Article 58 of the Law, is the superior body of the corporate governance in company and is compulsorily held at least one time in a year and thus annually. Its function includes giving opportunity to owners to obtain from the other governing bodies the detailed and reliable information about a policy pursued by the company, about the prospective achievements and plans, to participate in discussions and making decisions on the more crucial issues of the company's activity. The general meeting is often the opportunity for the shareholders to obtain information about the company's performance and ask the management all interesting questions. Only the shareholders who are secured in the register of company's shareholders which was generated 3 calendar days before the official announcement about the date of holding General Meeting of Shareholders have right to participate in the general meeting.

The General Meeting of Shareholders is usually led by the chairman or panel of general meeting which is approved by the general voting of the shareholders attending the general meeting. There often elected a chairman of the Supervisory Board as a chairman of the General Meeting of Shareholders.

The Counting Commission is organized for counting of votes, registration of shareholders attending the general meeting as well as for distribution of voting ballots. A quantitative and personnel composition of the counting commission is confirmed by the General Meeting of Shareholders but it must not comprised of the members of Supervisory Board, Revision Commission, Executive Body, proxy manager and also the persons nominated to these positions. The Counting Commission determines the existence of a quorum of the General Meeting of Shareholders, explains questions arising in regard to realization of the right of voting by the shareholders, explains the procedure of voting with regard to questions submitted for voting, ensures the established procedure of voting and the right of shareholders to participate in the

voting, counts the votes and summarizes the results of the voting, draws up and signs a minutes on the voting results, and consigns the voting ballots to the archives.

**Figure.** Typical corporate governance framework of Uzbek joint-stock companies



Source: generated by the author on the basis of national legislation

The Secretary of General Meeting keeps the minutes according to agenda of the General Meeting of Shareholders. The Secretary of General Meeting draws up the minutes of the general meeting not later than 10 days after the closing of the General Meeting of Shareholders in two copies which should be signed by him/her and the person presiding the general meeting.

The Committee of Minority Shareholders is new in the corporate governance practice of Uzbekistan. It was introduced in the national corporate governance system following the revision and enactment of the new version of the law on joint-stock companies in 2014. Actually, the Committee of Minority Shareholders can be established in the companies among minority shareholders in order for their rights and legal interests to be protected. Number of members of this committee is determined by the company's Article of Association. The main competences of the committee include participation in preparation of suggestions for the review of General Meeting of Shareholders or Supervisory Board on matters about concluding big deals and deals with affiliated persons; examination of requests of the minority shareholders related to protection of their rights and legal interests; addressing to the state security market regulating authority with protection of rights and legal interests of minority shareholders.

The external auditor, who is also considered independent from the company, participates in corporate control to conduct a verification of the financial and economic performance of the company, and presents

an auditor's conclusion in the prescribed manner. The auditor, whether it is one person or a whole auditing organization, legally bears responsibility to the company for damage caused as a result of its auditor's statement containing an incorrect conclusion about financial reporting and other financial information of a company.

The Revision Commission is considered one of the bodies of corporate control in the company. According to Law the Revision Commission is elected by the General Meeting of Shareholders for serving the functions of internal financial, economic and legal control over company's activity, its departures and services, its branches and representative offices. More accurately, the Revision Commission effectuates the verification (or revision) of the financial and economic activity of a company with regard to the results of the activity for a year or other period on initiative of the revision commission, on decision of the General Meeting of Shareholders, Supervisory Board, or at the request of the shareholders possessing in aggregate not less than five percent of the voting shares. This commission has also the right to request from the person holding offices in the governing bodies in a company to present it the financial and economic documents. Upon completion of verification of the company's financial and economic activity the Revision Commission draws up a statement which contains the evaluation of data adequacy of the reports and other financial documents, the information on the facts of violation of accounting procedures and financial reporting as well as of legislation when holding a financial and economic activity.

The Supervisory Board, being as a corporate governance body, acts as a nexus between owners and company managers. It provides a strategic management of the company, quality control of management performance as well as takes the ad hoc measures in cases when managers cease coping with operational management. In accordance with Law the Supervisory Board effectuates the general management over company's activity, except for deciding of issues relating to the exclusive competence of the General Meeting of Shareholders. In the Chapter IV of this paper we will analyze the role and functions of the Supervisory Board in Uzbek companies in more detail.

The Internal Auditing Service is a structural unit of the company which is usually established in those joint-stock companies which have assets with book value of more than one hundred thousand of minimum wage (approximately 4.54 mln. US\$ as of October 2014). It means that the internal auditing service should be established in the companies with required asset value and is not mandatory to be established in those companies which have assets with book value of less than one hundred thousand of minimum wage. The Internal Auditing Service may consist of 2 to 4 persons, and is independent and directly accountable only to the company's Supervisory Board. Within the company it performs an internal audit by means of conducting inspection and monitoring of the business plan execution progress, the observance of corporate governance principles, the state of accounting and financial reporting, the correctness of calculation and payment of taxes, the observance of legislation on financial and economic activity, the state of assets and internal control. In fact, in the framework of Uzbek corporate governance the Internal Auditing Service is also considered one of the bodies of corporate control.

The Corporate Consultant is relatively new for the corporate governance framework in Uzbekistan. It has come out since 2006 as a separate institute in the governance structure as for enhancing the level of corporate governance in the company. According to Law the corporate consultant is appointed by and accountable to the company's Supervisory Board, if introduction of such position is stipulated in the Article of Association. The role and functions of the corporate consultant to control over observance of corporate legislation is not so far regulated in detail in the Law, but however, they should be stipulated in the by-laws approved by the Supervisory Board. At present, this institute of corporate governance is not deeply adopted by the Uzbek companies, but, none the less, some companies use it to increase their level of corporate governance.

The key link of corporate governance in company is the Executive Bodies which are imposed by the Law to manage a day-to-day operation of the company, except for issues relating to the exclusive competence of the General Meeting of Shareholders or the Supervisory Board. The Executive Body, being responsible for implementation of goals, strategies and policy of the company, is obliged to effectuate the management of company's activity so that to ensure the shareholders to obtain dividends and to provide company development. At the same time, keeping performing the functions charged, the executive body possesses the considerable credentials to dispose of the assets of company, therefore its activity should be organized thus so that to exclude a distrust from the side of shareholders. The trust must be ensured with



high requirements to personal and professional merits and competence of the executive officers as well as with accepted procedures in the company which impose them under the effective control of shareholders.

To say more about executive body as one of the governing bodies of a company, it should be stated that according to Law the executive body may be in the form of a one-man executive body which is usually called Director, or in the form of a collective executive body which is generally referred to as Management Board. If the management of current activity of the company is carried out by the Management Board, the company's Article of Association should also specify the competence of the head of Management Board (Chairman). By decision of the General Meeting of Shareholders, the credentials of the Executive Body may be transferred to a commercial organization (or proxy manager) on the basis of contract. With every member of Executive Body there made a contract for one year which, on behalf of the company, is signed by the Chairman of Supervisory Board or by the person authorized by the Supervisory Board. The contract is subject to prolongation (renewal) or termination (cancellation) every year by the decision of the General Meeting of Shareholders.

Hereinafter, we will not examine the whole Uzbek corporate governance framework in detail but will touch upon only the issues related to the role and functions of the Supervisory Board and try to compare it with practice applied in Germany.

#### **IV. The Supervisory Boards in Uzbekistan compared with German practice**

##### ***4.1. The Supervisory Board: basic regulations***

Both in Uzbekistan and Germany the stock corporations have a two-tier board structure: Supervisory Board and Management Board. But we will review the basic regulations for Supervisory Board.

In Uzbekistan the activity of the Supervisory Board is regulated by the *Law on Joint-Stock Companies and Protection of Shareholders' Rights* (hereinafter "Uzbek Company Law"), basic Articles 74-78, and the *Standard Regulations on Supervisory Boards of the Joint-Stock Company* (hereinafter "Uzbek Supervisory Board Regulations") enacted by the Governmental Resolution No.189 as of April 19, 2003. Every joint-stock company, regardless of private, public or state-owned, should have a Supervisory Board as a governing body of the company.

In Germany the activity of the Supervisory Board is regulated by the *Aktiengesetz – German Stock Corporation Act* (1965, last amended in 2013) (hereinafter "German Company Act"), basic para.95-116, *Mitbestimmungsgesetz – Co-Determination Act* (1976) which provides for the election of half members of Supervisory Board by the employees in companies with more than 2000 employees, *Drittelbeteiligungsgesetz – One-Third Participation Act* (2004) which establishes codetermination rights for employees of companies with between 500 and 2000 employees as well as by the *German Corporate Governance Code* (2002, last amended in 2013) (hereinafter "German Code") which, inter alia, recommends a standard of control rights for Supervisory Board, rules for cooperation between Supervisory Board and Management Board, personal qualifications set for Supervisory Board members, rules for their remuneration and transparency obligations.

Further, we will make comparison of Uzbek and German practice on the basis of analyzing above-mentioned laws and regulations.

##### **4.1.1. Board size**

According to the Uzbek Company Law the size of Supervisory Board of a company is determined by the Articles of Association or by the decision of the General Meeting of Shareholders. For the joint-stock company with a number of shareholders of:

- more than 500 – not less than 7 members,
- more than 1,000 – not less than 9 members.

According to the German Company Act the Supervisory Board normally consists of three members. The Articles of Association may provide for a specified higher number and such number shall be divisible by three. The maximum number of members of the Supervisory Board for companies with a share capital of:

up to 1,500,000 euros – 9 members,  
more than 1,500,000 euros – 15 members,  
more than 10,000,000 euros – 21 members.

Is it evident that in contrast to German practice, the size of Uzbek Supervisory Boards is related to the number of shareholders of a company but not to the size of share capital. However, it is not a limitation for board size in Uzbek companies and the General Meeting of Shareholders, in the frame of law, may decide on how many members the Supervisory Board should have in their company and may increase the board size, if necessary.

#### **4.1.2. Board composition**

In Uzbekistan the company's Supervisory Board may be composed of anyone. As practice shows, the Supervisory Board may be consisted of shareholders of that company, representatives of parent and affiliated companies, representatives of banks, suppliers, partner companies and other organizations, government attorney if the share of government in a company's authorized capital (share capital) is more than 25 percent, as well as government officials *ex officio*. However, according to the Uzbek Company Law the members of a one-man and collective executive body as well as the persons working on labor contract in the same company cannot be the members of the Supervisory Board. This legal requirement introduced in 2003 has substantially improved the corporate governance level in Uzbekistan, and thus, not allowing the executive management to act as a member of the Supervisory Board.

There is also another case having impact on the composition of the Supervisory Board in Uzbekistan. According to the Uzbek Company Law if in regard to the joint-stock company there made decision to introduce a special right for government's participation in company governance ("golden share"), a government representative is appointed by the *Commission on Monitoring of Effective Use of the State Share in the Joint-Stock Associations and Companies*, and the quantitative composition of the Supervisory Board, which was previously specified in the company's Article of Association, will be increased and the specially appointed government representative will be introduced in it.

In Germany, according to the German Company Act, the Supervisory Board for all the stock corporations should be only consisted of representatives of the shareholders. However, there are some other cases for board composition depending on the type of company. In case of companies subject to the Co-Determination Act the Supervisory Board should consist of representatives of the shareholders and the employees; in case of companies subject to §§ 5 to 13 of the *Mitbestimmungsergänzungsgesetz – Supplementary Co-Determination Act (1956)* – representatives of the shareholders and the employees plus one additional member; in case of companies subject to § 76 (1) of the *One-Third Participation Act* – representatives of the shareholders and the employees. If it is disputed or uncertain which case should be applied for the board composition then it is subject to be decided judicially.

The German Company Act also states that the members of the Supervisory Board have to be natural persons with full legal capacity. The German Company Act stipulates that individuals who are already members of a mandatory Supervisory Board in ten other German commercial companies or who are legal representatives of an entity controlled by the company will be excluded from the membership of the Supervisory Board. A member of Supervisory Board cannot at the same time be a member of the Management Board, a registered authorized officer or General Manager of the company. From the other hand, the German Code recommends to have the independent members of the Supervisory Board and according to it, such board member is considered independent if he/she has no business or personal relations with the company or its Management Board which cause a conflict of interests. No more than two former members of the Management Board are recommended to be members of the Supervisory Board.

In contrast to Germany the board composition in Uzbekistan, as we assume, is simple. There is no limitation that the only shareholder (or his/her representative) should be a member of Supervisory Board. Moreover, although it is possible in Germany, but according to Uzbek legislation the employees are not allowed to be the member of Supervisory Board, under no any circumstances. The employees used to be board members until 2003 when the Presidential Decree No.3203 was adopted forbidding the combining

of activity of board members with work on hiring in the same company. Thus, we think that the independence of board members from the management of a company was provided.

Also, there is no any restriction in the Uzbek corporate legislation regarding the maximum membership of a person in the Supervisory Boards of different companies. It means that a person in Uzbekistan may be a member of Supervisory Boards of many companies. But in practice, it is difficult to find such person who is a member of the Supervisory Board of ten or more companies. Regarding the independent board member, in Uzbekistan, still, neither corporate legislation, nor any regulations define it or set the rules for it. The institute of independent board members is not developed yet in the country. What mainly coincides in both legislations is that a member of Supervisory Board cannot be a member of the Management Board or the General Manager of the company. That is most essential in our corporate world that independence of board members from the management is the main condition of good corporate governance.

#### **4.1.3. Election of board members**

According to Uzbek legislation the members of the Supervisory Board are elected by the General Meeting of Shareholders for one year period, and besides, persons to the Supervisory Board may be re-elected for an unlimited number of times. Only the owners of the common share have rights to elect the board members. As it was said before, the members of a collective and one-man executive body may not be elected to the Supervisory Board as well as the persons working at the same company on labor contract may not also be elected to the Supervisory Board. A member of the Supervisory Board can be anyone whom we described in the board composition subchapter.

It is generally also accepted in practice that election of members of the Supervisory Board is implemented on the basis of cumulative voting rule. According to this rule a number of votes (shares) each shareholder owns is subject to multiply by a number of candidates to the Supervisory Board, and thus, a shareholder has a right to give his/her votes fully to one candidate or allot the votes between two and more candidates. The government representative or government attorney is appointed by the appropriate authority to be a member of the Supervisory Board and is not subject to election (re-election) by the General Meeting of Shareholders.

According to the German Company Act the members of the Supervisory Board are elected by the General Meeting of Shareholders, unless they are to be appointed to the Supervisory Board or elected as employee representatives. The deputies for members of the Supervisory Boards may not be appointed. But, for each member of the Supervisory Board it is permitted to appoint a substitute member who may become a board member in case the regular member ceases to hold office prior to the expiration of his/her term of office. Such substitute member may only be appointed at the same time as the respective regular member of the Supervisory Board. The maximum term of office for members of the Supervisory Board is five years and the related service agreement may not have a longer term. Their term of office must end at the general meeting which decides on their discharge for the forth financial year after the beginning of their term.

The German Code only highlights that the elections to the Supervisory Board should be made on an individual basis. An application for the judicial appointment of a Supervisory Board member should be limited in time up to the next general meeting. It also recommends for proposed candidates to the Supervisory Board to be announced to the shareholders.

The German Company Act also sets the personal qualifications for the person to be elected to the Supervisory Board, and the German Code recommends for the board member to possess the knowledge, ability and expert experience required to properly complete its tasks. Under the German law a contract for provision of professional services which does not establish an employment relationship or a contract for undertaking a special assignment may be made with members of the Supervisory Board.

As it is common even in the world corporate governance practice, both in Germany and Uzbekistan the members of the Supervisory Board are elected by the General Meeting of Shareholders. If in Uzbekistan they are elected on the basis of cumulative voting of which the rule is described in the Uzbek Company Law, the German law, as seems, does not give any rule for voting procedure. However, unlike the German practice, in Uzbekistan term of office of the member of the Supervisory Board is one year whereas it is five years in Germany. We think it is conditional on that the board practice in Uzbekistan is

on a stage of development, and is related on a trust to each member of the Supervisory Board. Perhaps, the situation will change in future, more trust to board members is created, the term of office can be increased.

It is also evident from the comparison that the Uzbek companies never practice in electing the substitute members of the Supervisory Board. Instead, in case of voluntary dismissal of one or more members of the Supervisory Board, the extraordinary General Meeting of Shareholders is convened to elect the new members for the Supervisory Board of a company. One more distinction between practices is that after the board members elected, the Uzbek legislation does not obligate to conclude with the members of Supervisory Board any contract on performance of their duty. The members perform their activity on the basis of Articles of Association and Internal Regulations on Supervisory Board. However, a possibility for conclusion with board members the contracts of civil and legal nature is not exception.

The Uzbek legislation doesn't set forth any special or personal requirement for the persons to be elected to the Supervisory Board. However, it is stipulated in the Uzbek Company Law that such requirement can be determined in the Articles of Association of a company or by the decision of the General Meeting of Shareholders.

#### **4.1.4. The Chairman of the Board**

According to Uzbek Company Law the chairman of the Supervisory Board is elected by other board members from among board members by a majority of votes of the total number of board members unless provided otherwise by the Articles of Association of a company. The chairman of the Supervisory Board may be re-elected by a majority of votes of the total number of board members.

The chairman of the Supervisory Board organizes the work of the board, calls and leads the board meetings, organizes keeping of minutes, and if it is stipulated in the Articles of Association, presides the General Meeting of Shareholders. In case of absence of the chairman his functions will be effectuated by one of the members of the Supervisory Board. The chairman, on behalf of a company, has right to sign a contract with one-man executive body, with the chairman and members of the collective executive body as well as with proxy manager.

According to the German Company Act the Supervisory Board should elect from among its members a chairman and at least one deputy chairman for internal organization of the Supervisory Board. The deputy chairman has rights and duties of the chairman only if the chairman is incapacitated. It is the main responsibility for chairman to keep and sign the minutes of the board meetings.

According to the German Code the chairman of the Supervisory Board coordinates work within the Supervisory Board and chairs its meetings and attends to the affairs of the Supervisory Board externally. It also recommends the chairman of the Supervisory Board to chair the committees that handle contracts with members of the Management Board and prepare the Supervisory Board meetings but not lead the Audit Committee. The chairman of the Supervisory Board regularly maintains contact with the Management Board, in particular, with its chairman and consults with him on strategy, business development and risk management of the enterprise. The chairman of the Supervisory Board will be informed by the chairman of the Management Board without delay of important events which are essential for the assessment of the situation and development as well as for the management of the enterprise, after which the chairman of the Supervisory Board should inform the members of the Supervisory Board and, if required, convene an extraordinary meeting of the Supervisory Board.

As seen above, the Supervisory Board in both systems is led by the chairman of thereof, and he/she is elected by and from among its members. In both legislations the functions and responsibilities of the chairman of Supervisory Board are clearly determined. Moreover, the legislations provide for that in case of absent or incapability of the chairman of the Supervisory Board another person should effectuate his/her functions. In Germany it is deputy chairman of the Supervisory Board, and in Uzbekistan it is one of the members of the Supervisory Board. But the Uzbek legislation does not say anything who should be this person. So, we think that this legal provision should be clarified in the Uzbek law.

The Uzbek law clearly sets the exact responsibilities of the chairman of Supervisory Board. But in German law there are only little provisions regarding the chairman's responsibilities. The tasks and authorities of the chairman are mainly stipulated as recommendations in the German Code.

#### ***4.2. The role and responsibilities of the board in corporate governance***

##### ***4.2.1. Legal responsibilities and duties***

According to Uzbek Company Law all members of the Supervisory Board bear responsibility to the company and its shareholders. At the same time, the members of the Supervisory Board who have not taken part in voting process or who have voted against decisions, which brought to the causing losses to the company are exempted from the responsibility. Regarding the duties of board members the Uzbek Supervisory Board Regulations states that a member of the Supervisory Board having concern in doing an insider trading with the company he/she is obliged to inform about his/her concern to the Supervisory Board before conducting such trading, but the decision on this trading is made by the Supervisory Board or by the General Meeting of Shareholders, consequently by a majority of members of the Supervisory Board or shareholders who don't have such concern. Moreover, the Uzbek Supervisory Board Regulations states that the members of the Supervisory Board are obliged to perform their functions in good faith, and also through the way which they consider the best in the interests of a company.

The Uzbek Company Law and the Uzbek Supervisory Board Regulations clearly set forth the duties of the Supervisory Board as its competence in order to differentiate them from those of the General Meeting of Shareholders or management. According to those the basic competences of the Supervisory Board include: determination of priority direction of a company activity, convening and organization of annual and extraordinary general meetings of shareholders, organization of determining the market value of a property, making contract with the members of executive body, approving the annual business plan of a company, establishing the internal auditing service. Also, the functions of the Supervisory Board are control of tasks to be fulfilled by the executive body, hearing the reports of the executive officers, hearing the reports of the Internal Auditing Service.

According to German practice the Supervisory Board is responsible for appointing, supervising and advising the Management Board. It is not entitled to instruct the management or to take the operational decisions. However, the Articles of Association and the rules of procedure may subject certain management decisions to Supervisory Board approval. The Supervisory Board also represents the company in relation to the members of the Management Board and determines their remuneration scheme. The Supervisory Board has to act in the best interest of the company as opposed to the interests of its shareholders. The duties of the board members are therefore primarily owed to the company.

The members of the Supervisory Board have equal legal duties. In most cases, however, the specific experience of a particular individual will be the primary reason for the respective appointment. By the German Code, at least one independent member of the Supervisory Board of stock corporations, which have issued securities to trade on a stock market must have expert knowledge in accounting and auditing.

We suppose that in both German and Uzbek legislations the legal responsibilities and duties of the Supervisory Board are enough described. However, we think that a special corporate governance code or guidelines of best practice should be established in Uzbekistan in order to set more responsibilities of the members of the Supervisory Board as well as responsibilities for interacting with management and shareholders.

##### ***4.2.2. Delegation of board responsibilities***

According to the Uzbek Company Law the responsibilities of the Supervisory Board can be delegated but in proper legal manner and following the requirement. In a company with a number of shareholders/owner of the voting shares of less than thirty the functions of the Supervisory Board may be entrusted to the General Meeting of Shareholders. In this case, the Article of Association of a company must contain an instruction concerning the specified person or body that would be in competence of deciding the issue of organizing and holding of the General Meeting of Shareholders.

Although the German Company Act expressly allows and the German Code expressly recommends to establish subcommittees in the Supervisory Board but a number of important tasks and responsibilities are still reserved for the Supervisory Board itself and may not be delegated to subcommittees or to other persons. According to the German Code the Supervisory Board can delegate preparations for the appointment of members of the Management Board, as well as for the handling of the conditions of the employment contracts including compensation, to committees.

Delegation of board responsibilities takes different characters in both systems. In Uzbekistan the functions/responsibilities of the Supervisory Board can be delegated to the General Meeting of Shareholders but, in case if the company has less than thirty shareholders and upon the unanimous decision of all shareholders. If such decision is made by shareholders the Supervisory Board will no longer exist and the General Meeting of Shareholders will in fact effectuate its function. In contrast, the German practice does not have such delegation of functions and the Supervisory Board should exist regardless of how many shareholders a company has. Moreover, a delegation of some responsibilities to subcommittees is practiced.

#### **4.2.3. Board meeting practice**

In Uzbekistan the meeting of Supervisory Board is usually called by the chairman of the Supervisory Board on his own initiative, and also may be called at the request of member of the Supervisory Board, Revision Commission or auditor, executive body and other persons determined by the Articles of Association. The procedure for calling and conducting of board meeting should be determined in the Article of Association.

The board meeting should be held at least one time in a quarter. A quorum for holding board meeting is determined by the Article of Association but must not be less than 75 percent of the number of board members. In case when a number of board members become less than 75 percent of a number specified by the Article of Association, the company should call the extraordinary General Meeting of Shareholders in order to elect the new members of the Supervisory Board. The remaining board members have right to make decision only regarding the call of such extraordinary General Meeting of Shareholders.

The decisions in the board meeting are made by a majority of votes of the persons attending the meeting. In making decisions at the meeting each board member should have one vote. It is not permitted to transfer the vote by one board member to another. In each board meeting there should be kept the minutes of meeting. The minutes of the board meeting is usually drawn up not later than 10 days after holding thereof. According to Uzbek Company Law the following should be specified in the minutes: place and date of holding the meeting, persons attended the meeting, agenda of the meeting, issues put for voting and the results of voting, decisions made. It is of importance and obligatory that the minutes are signed by the all board members participated in the board meeting and who also legally bear responsibility for its accuracy.

According to the German Company Act each member of the Supervisory Board or the Management Board may, upon stating the grounds for this, request that the chairman of the Supervisory Board promptly call a meeting of the Supervisory Board. The meeting should be held within two weeks from the date on which notice thereof has been given. In Germany the Supervisory Board of a listed stock corporation should meet at least twice in every six calendar months. For non-listed companies, the Articles of Association can reduce this requirement to only one meeting every six calendar month. Furthermore, each member of the Supervisory Board can by reasoned request ask the chairman of the Supervisory Board to promptly call a meeting of the Supervisory Board.

Board meetings are only attended by the members of the Supervisory Board, and the persons who are not members of the Supervisory Board or the Management Board are not permitted to attend such meetings. However, the German Company Act permits the persons who are not members of the Supervisory Board to attend the meetings of the Supervisory Board and its committees in lieu of members of the Supervisory Board who are unable to attend, provided that such members have authorized such persons to attend in writing. Besides, the experts and persons needed to give information may be invited to the board meetings for consultation on individual matters.

By the German Company Act, the quorum required for the Supervisory Board may be set by the Articles of Association but to the extent not determined by law. If the quorum is set neither by law nor the articles, a quorum of the Supervisory Board should be not less than one-half of the number of members who take part in the passing of the resolution. In any event, the German Company Act permits at least three members to take part in the passing of a resolution. In case the board members are not present they may take part in the passing of a resolution in writing and then submit it to the meeting. It is permitted such votes be submitted by other members of the Supervisory Board. The votes may also be submitted by persons who are not members of the Supervisory Board, provided that such persons are entitled to attend the meeting pursuant. The German Company Act also permits the resolutions of the Supervisory Board be adopted in writing, by telegraph or telephone, if the Articles of Association provides for more detailed regulation on it and no member objects to such procedure.

The minutes of the board meeting should be kept and signed by the chairman. The following should be stated in the minutes: the place and date of the meeting, the persons attending, the items on the agenda, the essential contents of the proceedings, and the resolutions of the Supervisory Board. A copy of the minutes of the board meeting should be provided upon request to each member of the Supervisory Board.

From the above legal provisions it is apparent that there are some similarities in Uzbek and German board meeting practices. In both jurisdictions the meeting of the Supervisory Board is called by the chairman of the Supervisory Board, and at the request of other members of the Supervisory Board as well as management. In contrast to German practice, in Uzbekistan the meeting of the Supervisory Board may also be at request called by the Revision Commission or auditor of a company. We think that this gives the Revision Commission and auditor more rights to call the meeting in case any financial failures are found in the company during their auditing.

The frequency of holding board meetings is the same. The Supervisory Boards in Uzbekistan and Germany hold meetings at least once in a quarter. However, in Uzbekistan frequency of holding board meetings is not distinguished between listed and non-listed companies, and all the Uzbek joint-stock companies should follow the same frequency. In both countries the Supervisory Boards adhere to the quorum requirements for holding the meeting: in Uzbekistan it is 75 percent of the number of board members, in Germany it is not less than one-half of the number of members taking part in the passing of the resolution.

What is notable in Uzbek law is that it sets voting rule for board meeting stating each member of the Supervisory Board has one vote, whereas the German law does not. In both jurisdictions the Supervisory Boards keep minutes of their meetings, and both laws clearly determine what should be stated in the minutes of meeting. The only difference in keeping the minutes by the Supervisory Boards is that in Uzbekistan the minutes should be signed by the all board members including chairman but in Germany the minutes should be signed only by chairman. This legal provision was introduced as an amendment to Uzbek Company Law against falsifying the minutes by the chairman, following the falsification cases occurred in the early period of incorporation processes in Uzbekistan. We think that the same situation with attending the board meetings and passing the resolutions. So, in Uzbekistan every member of the Supervisory Board must attend the meeting and pass the resolution in person, in contrast to Germany when it is allowed for board member who is not present in the board meeting to pass the resolution in writing, by telegraph or telephone.

#### **4.2.4. Board committees**

In Uzbekistan the legal requirements for establishing the committees in the Supervisory Board are specified neither by the Uzbek Company Law nor in any regulations. So, the practice of establishing and functioning of the board committees is not widespread, even voluntarily. As it is commonly known, the board committee practice implies distribution of special tasks and functions between board members in the view of specially established committees.

The German Company Act generally does not provide for mandatory committees of the Supervisory Board. However, it states that the Supervisory Board may appoint from among its members one or more committees, in particular for purposes of preparing its deliberations and resolutions or for supervising the execution of its resolutions. Particularly, there may be appointed an audit committee to deal with the

supervision of the accounting process, the efficiency of the internal control system, the risk management system and the internal revision system as well as with the annual auditing.

The German Code recommends the Supervisory Board to form committees with sufficient expertise depending on the specifics of the enterprise and a number of board members. More exactly, the German Code also suggests the Supervisory Board to establish an audit committee to deal with issues related to accounting, risk management, the appointment of the statutory auditors as well as ensuring the auditor's independence. In addition, the German Code recommends a nomination committee, consisting only of shareholder representatives (no employee representatives). The nomination committee has to look for suitable candidates for the Supervisory Board, and should present such candidates to the Supervisory Board before the Supervisory Board puts them on the election list for the respective general meeting. According to the German Code, additional expert committees may be formed for specific complex issues such as strategy, compensation, investments financing, to improve the efficiency of the work of the Supervisory Board.

From the above comparison we see that establishment and functioning of the committees within the Supervisory Board is practiced in Germany unlike in Uzbekistan. However, in Uzbekistan although the Uzbek Company Law does not determine establishing such committees but as stated in the Uzbek Supervisory Board Regulations that distribution of functions between the board members is carried out by the chairman of the Supervisory Board specifically for each member. So, the board members may work on special tasks but without establishing special committees.

#### **4.2.5. Remuneration of board members**

In Uzbekistan, according to the Uzbek Company Law the members of the Supervisory Board of a company may, in the period during which they perform their duties, be paid remuneration and/or expenses be contributory compensated which are related with the performance of functions of board members. The amounts of such remuneration and contributory compensation for each board member are established by the decision of the General Meeting of Shareholders. In addition to this, the Uzbek Supervisory Board Regulations states that the amounts of such remuneration for each board member are determined by the General Meeting of Shareholders against the effective performance. But, as we noticed at the same time, it is not clear: should the amount of remuneration depend on effective performance of the company or of the certain member of the Supervisory Board? If it suspects the effective performance of certain board member then it is not clear: on the basis of which criteria should the General Meeting of Shareholders determine the amounts of remuneration?

According to the German Company Act the members of the Supervisory Board may be paid remuneration for their services. Such remuneration is either set out in the Articles of Association of the company or is determined by a resolution of the shareholders adopted at the general meeting. As both the German Company Act states and the German Code recommends, this remuneration should take into account the duties and scope of tasks of each member of the Supervisory Board as well as the economic situation and performance of the company. Also, there considered the exercising of the chairman and deputy chairman positions in the Supervisory Board and membership in the committees. Under the German Code the members of the Supervisory Board receive fixed as well as performance-related compensation. Performance-related compensation also contains components based on the long-term performance of the company.

As observations show, the practice of remuneration of the board members is not also widespread in Uzbekistan, owing to, in our supposition, firstly, some joint-stock companies do not consider it necessary because of that the members of the Supervisory Board do not show activism, secondly, this is conditional on financial difficulties in the companies.

#### **4.2.6. Disclosure of board practice**

In Uzbekistan, at least once in a year, the Supervisory Board of a company reports in the annual General Meeting of Shareholders on the issues of its competence including on observance of the requirements for company governance set forth in the legislation. According to Uzbek legislation the member of Supervisory Board is considered an affiliated person. Therefore, the company is obliged to keep records



of members of the Supervisory Board as affiliated persons and disclosure information about them in a centralized publication.

In addition to this, the Internal Auditing Service of a company while carrying out the verification and monitoring of observance of the corporate governance principles, draws up a report about the results of observing the corporate governance principles which should include an effectiveness analysis of the decisions to be made by the Supervisory Board, description of violation facts of the legislation in the sphere of corporate governance (observance of constituent documents, holding of General Meetings of Shareholders and meetings of governing bodies of a company, correctness of calculating and timeliness of paying the dividends).

In Germany the Supervisory Board of listed and specific other corporations must annually publish a statement on the company's website whether and to what extent the company complies with the recommendations of the German Code, and give reasons in case recommendations were not applied (so-called compliance statement). Also, a listed company must publish a formal statement on corporate governance annually in the financial report of the accounts or on the website of the company. The statement on corporate governance must at least provide the following information:

- the above-mentioned compliance statement;
- information about corporate governance practices beyond the legal requirements; and
- information about the working methods of the Supervisory Board as well as the composition and working methods of committees.

In addition, the German Code recommends to include the following information: a detailed and individualized description of the compensation granted to the Supervisory Board members; the specific targets of the Supervisory Board regarding its composition and the status of implementation; and the ownership of shares in the company or related financial instruments by Management Board and Supervisory Board members if these directly or indirectly exceed a certain percentage.

The Supervisory Board must present a written report to the General Meeting of Shareholders setting forth, inter alia, how and to what extent it has supervised the activities of the Management Board during the financial year. In case of listed companies, the Supervisory Board report has to specify which committees have been established and state the number of board and committee meetings held. Furthermore, according to the German Company Act the management should promptly publish announcement in case of changes in the membership of the Supervisory Board happen. A list of members of the Supervisory Board stating each member's last name, first name, occupation and place of residence should be also submitted to the commercial register.

The German Code recommends that the information about compensation of the members of the Supervisory Board should be reported individually in the so-called Corporate Governance Report. This report should also include separately on an individual basis the payments made by the company to the members of the Supervisory Board or advantages extended for services provided individually, in particular, advisory or agency services.

From the above comparison it can be concluded that the disclosure requirements for board supervisory practice are broad in Germany than in Uzbekistan. In Germany the companies must publish a so-called compliance statement on to what extent the company complies with the recommendations of the German Code and give reasons in case recommendations were not applied. This is the requirement of "comply-or-explain" principle, and it seems that it is working in Germany. Whereas in Uzbekistan, there is no any corporate governance code or guidelines of best practice, and no any other legal document exists to regulate the question whether the board complies to any "comply-or-explain" recommendations or not.

In Uzbekistan the disclosure about the Supervisory Board is only limited to publishing the names and other information about the board members as affiliated persons in the specialized newspapers or websites as well as to including the Supervisory Board's activity in the report of the Internal Auditing Service. Sometimes this report is formally only for information of the members of the Supervisory Board but is not for public. However, it is strictly set forth by law that in case any changes in the composition of the Supervisory Board the company must publish these changes, and at least every company observe this regulation. In contrast to German disclosure practice the Uzbek companies do not disclose information

about the working methods of the Supervisory Board and its committees, information about corporate governance practices beyond the legal requirements, compensation/remuneration of the Supervisory Board members. This, we think, impedes further development of corporate governance in the country.

## **Conclusions and suggestions**

The analysis we made and the ideas we put in this paper led us to conclude the following:

1. In Uzbekistan, as developing country with transition market economy, the corporate governance reforms is yet underway and still needs to be further developed. Moreover, we have accepted the fact that the present urgent problem for national corporate legislation in Uzbekistan is to bring closer and to adapt them to the global corporate governance standards.

2. We became evident from the literature review that only a few books and papers have been written in English on corporate governance in Uzbekistan. Therefore, it is not exception that a little is known about it in the world scientific community. But we think that these researches are not sufficient to study entirely the Uzbek corporate governance system. So, the more international researches and publications should be addressed on the corporate governance problems in Uzbekistan and on what aspects of Uzbek corporate governance still needs to be improved.

3. The board is a prime actor in corporate governance. So, when improving the corporate governance in one jurisdiction the role of Supervisory Board should be in the center of attention. Effective performance of the management and of a company as whole ultimately depends on the activism of Supervisory Boards. The Supervisory Boards acting in Uzbek companies need to be more effective in governing the corporation and need to fully assume their legal responsibilities and duties. The functions and roles of the Supervisory Boards in Uzbekistan should be improved and strengthened legally. For this reason, we bring some suggestions for the Supervisory Board's role and activity to be improved, and which, in our opinion, should be incorporated in the Uzbek Law on Joint-Stock Companies and Protection of Shareholders' Rights, resulting from the comparative analysis made between Uzbek and German corporate legislation:

- The Uzbek Company Law should more clearly determine the competence of the members of the Supervisory Board and set forth the strict requirements to increase their responsibility. In particular, the article concerning the competence of the Supervisory Board should include, inter alia, the followings which are not found in the Law: to establish the committees in the structure of the Supervisory Board and organize their activity; to appoint the position of corporate consultant, determine its term of office, specify the amount and conditions of its remuneration; to approve the dividend policy of a company and give recommendations to shareholders regarding the dividend amount and payout conditions.
- To form and provide functioning of the institute of independent directors in Uzbekistan. The Uzbek Company Law should include the term "independent members of the Supervisory Board" and clarify the issues on who is and who should be the independent member of the Supervisory Board, what is their term of office, what are the functions and exactly what should do the independent member of the Supervisory Board. The independent members of the Supervisory Board should make up at least one-third of the all members of the Supervisory Board.
- The Uzbek Company Law, and perhaps, the corporate governance codes, should also clarify and expand the legal norms for remuneration of the board members in specially separated article which should also take into account the clear remuneration procedure for board members. The practice on remuneration of the members of the Supervisory Board on the basis of such legal norm should be admissible for all joint-stock companies.
- In order to protect more effectively the rights and interests of the minority shareholders the Uzbek Company Law should provide, in mandatory order, at least one representative of the minority shareholders or representative from the Committee of Minority Shareholders to be elected as a member of the Supervisory Board. This could ensure protection of their rights and interests not only in the General Meeting of Shareholders but also in the Supervisory Board.
- Likewise, in the company with more than 500 or 1000 employees the Uzbek Company Law should provide the representative from the trade union of the company to be elected as a member of the Supervisory Board who may protect the rights and interests of the employees as essential stakeholders.

- The Uzbek Company Law should ensure establishment and functioning of the special committees within the Supervisory Board in order for them to review the issues related to company activity and prepare the recommendations to the Supervisory Board for solution of such issues. We think that the Supervisory Boards of Uzbek companies should have these special committees, as such committees working, for example, in the spheres of strategic planning, remuneration, nomination, audit and financial control, would favor the increase in the quality of decisions to be made by Supervisory Board as well as direct the board members to work in more responsible way, and thus, the activism of the members of the Supervisory Board will increase.

4. As we see, every country adopts its corporate governance codes or guidelines of best practice. Germany has the German Corporate Governance Code which includes recommendations which are to be observed on “comply-or-explain” basis. However, up to date, Uzbekistan has created neither a Corporate Governance Code, nor a “comply-or-explain” mechanism in the main Company Law. The power and responsibilities of the Supervisory Board are only established in the Company Law and in other by-laws regulating its functions and activity, and no any legal document exists to regulate the question whether the board complies to any “comply-or-explain” recommendations or not. Therefore, it is strongly suggested for Uzbekistan to adopt and put into practice the Corporate Governance Code of Uzbekistan in legislative level. On this basis, the Uzbek companies should report on their application of this Code and explain any deviations from its best-practice provisions. We think that the Corporate Governance Code of Uzbekistan to be developed on the basis of principles of fairness, accountability, transparency and responsibility would not only protect the investors against forging documents and unconcerned management of assets by the company but also would decrease the cost of capital to be attracted as well as increase the capital market efficiency in Uzbekistan, since existence of capital market efficiency leads to working of “comply-or-explain” principle.

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