EVOLUTION OF PRIVATE LAW – NEW CHALLENGES

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Preface

We are pleased to present you with this book which is the effect of the international cooperation between the Research Group of the Commercial Law acting at the Faculty of Law and Administration of the University of Silesia and representatives of foreign university departments of private law from Austria, the Czech Republic, Slovakia and Ukraine. The "Evolution of Private Law – New Challenges" continues the collective publications issued in 2014, 2015 and 2017. Private law is not a subject that currently suffers from a scarcity of interesting and great scientific publications, but our first thought was to create some space for authors from different European countries to present new visions and development paths for that area of law.

This year's edition is dedicated to the new challenges facing national legislators regarding the adjustment of their legal systems to some international regulations on private law. A broad range of authors – academics from the above mentioned countries – substantially contribute to strengthen and widen the comparative law research.

This publication is dedicated primarily to civil law academics, but it also addresses the issues relevant to the legal practice. Most of the articles can be useful in the didactic process at law studies as well.

Piotr Pinior, Wojciech Wyrzykowski, Mateusz Żaba
Katowice, October 2020

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Anatoliy Kostruba

Corporate Governance: the Main Issues

The term "corporate governance" has different variations. One of such notions of corporate governance is a system under which business corporations are managed and controlled. This term describes the procedures, customs, policies, laws and institutions that govern the corporation[1].

We are convinced that *corporate governance is a form of organization of activity of a corporation through the orderly influence of the subjects of such governance, its interactions at microeconomic processes, which ensure its optimal socio-economic existence in the macroeconomic environment.* The optimality of social and economic existence reflects the level of achievement of the pursued aims and corporate objective.

The concept of the term "corporate governance" should be defined by categories falling not only within legal science. The variable nature of his term, the interdisciplinary character of components that make it possible to reveal the essence of corporate governance, require a synergy of research by means of legal tools, methods of economic science and provisions of governance theory. Thus the process of corporate governance requires practice, adoption and implementation of decisions within the purposeful impact on an object of such governance.

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[1] Kajola S.O., *Corporate Governance and Firm Performance: The Case of Nigerian Listed Firms*. "European Journal of Economics, Finance and Administrative Sciences", Issue 14, 2008; Khan H., *A Literature Review of Corporate governance*, 2011 "International Conference on E-business, Management and Economics IPEDR" vol. 25, 2011.

S.P. Kokura argues that corporate governance is a system of organizational-structural relations between its differential elements that are created for the organization of production, roles, functions and methods of ordering activity in order to realize its own interests[2]. The mentioned system is of an open nature, as its purposefulness requires the combined influence of a bigger quantity of participants than the beneficiaries of the corporation's business activity only.

Without a doubt, the corporate objective is achieved by an indirect activity of persons who do not have an impact on the process of taking decisions relating to the corporation's viability, such as management. Their activity is also a form of corporate governance, but it is related to corporate management. That specified category includes the professional activity of specialists during the process of implementation of business operations.

The legal aspect of the issue of corporate governance is affected by two factors:

1. Ensuring the legal personality of the corporation, which safeguards the implementation of its proper management

The fiction of a legal entity as a participant of public relations implies its personification in the actions of real subjects. The legal capacity of the corporation is realized by the activities of certain natural persons connected with that corporation in some legal way. The activity of responsible persons is mediated by the authority of a corporation's management body with a certain volume of powers through the variability of the directions of such an implementation.

Therefore, corporate governance in a legal perspective is examined as a factor of realization of the legal entities in the civil circulation, in particular such an element as its legal capacity.

[2] Кокура С. П. Теория корпоративного управления. М.: Экономика, 2004. 478 с. – С. 118.

2. The prudence in a corporate conflict among corporate affiliates

Corporate governance is not limited to the category of legal capacity of a legal entity. Except for the institutional aspect as a method of a legal entity's implementation of its legal personality, corporate governance has a meaningful content which foresees the creation of such a model of interaction between all the corporation's stakeholders, including the participants of corporate relations, that is able to ensure the existence of the corporation in the civil circulation in compliance with the goal of its creation and activity. The management of the activities of the corporation inevitably gives rise to a conflict of interests among a specified circle of persons. The research work of Ukrainian lawyer Y.M. Zhornokui[3] is dedicated to the solution to that issue.

Corporate governance systems can thus be distinguished by the degree of ownership and control and by identification of the shareholders who control the company. Some systems are defined by dispersed ownership (insider systems), while others are characterized by concentrated ownership (outsider systems). With insider corporate governance systems, such as those in the United Kingdom (UK) and the United States (US), a conflict of interest occurs mainly between strong managers and weak widely dispersed shareholders. In outsider corporate governance systems which prevail in continental Europe and Japan, the fundamental conflict is between controlling shareholders, also known as block-holders, and weak minority shareholders. These differences primarily result from the diverse legal, regulatory, and institutional environments in those countries, as well as cultural norms and historical factors[3].

In terms of economics, corporate governance is a process of decision-making that ensures a maximal microeconomic effect. In terms of management theory**, governance is an element and at the same time a function** of organized systems of different nature (biological, social, technical, etc.), which ensures the preservation or change of a structure

[3] Al-Faryan, M. A. S.*, Corporate governance in Saudi Arabia: An overview of its evolution and recent trends*, "Risk Governance and Control: Financial Markets & Institutions", 10(1), 2020, pp. 23-36. http://doi.org/10.22495/rgcv10i1p2.

of those systems, support of the regime and the implementation of the goal of its activity. From the standpoint of law, governance is the process of exercising power as a means of functioning of any social community.

As specified above, corporate governance should be examined in a general and proper manner. Corporate governance is in general a process of making organizational and administrative decisions regarding the activity of a management entity. In this sense, corporate governance is a sphere of management dominated by a human factor shaping the relations inside the group. In other words, in addition to corporate governance, that process also includes corporate management. In the proper meaning of the term, corporate governance has exclusively a legal component and is limited by the category of a legal entity.

Despite the fact that a legal person is an artificial entity whose goal is a separate capital concentration or an interest from its founder resulting in a creation of a separate legal entity, its existence is impossible in the civil legal framework without the participation of the human factor that provided its foundation.

The synergetic connection between a legal person and its founder is so obvious that notwithstanding the actual prevailing fiction theory in law, an increasing trend of the modern theory of corporate law in the 21st century is the *factor of conditionality of the corporation's activity by the behavior of its founders*. It is clearly seen in the regulatory changes in the corporate liability terms.

Corporate governance is achieved by the activity of the *corporation management entities* which ensure the corresponding organizational influence. Despite the polyvariety of entities involved in the activity of the corporation and exerting some influence on its management, *the corporation management entity is the one that has direct influence on management governance decision-making and its realization*. Therefore, the category of corporate governance personality is revealed through a feature of connectivity in making decisions relating to the corporation's activity. *Such an entity is a responsible authority of corporate governance.* Due to the vivid activity of those entities, the functioning of the legal entity as a participant of civil relations ensures it a legal personality.

We may see from the above that the *formula of corporate governance consists in the fact that the entity of corporate governance is a person who ensures it a legal personality.*

Consequently, in the aspect mentioned above, we offer to divide the legal status of the participant of corporate relationship and the entity of corporate governance. This way, the participant (founder) of the corporation does not realize direct management and cannot therefore be a corresponding management entity. He/she exercises the appropriate right to management by participating in the formation and activity of an appropriate authority of corporate governance, which is the General meeting. No decision of the participant (founder) of the corporation on the aspects of corporate governance has an independent sense. Such decision should be of a consistent nature with respect to all stakeholders (participants of the corporation) on a corresponding management issue. Agreement and adoption of that decision result in the creation and activity of a management body empowered to express a public position on behalf of the participants (founders) of the corporation through the adoption of a relative act of corporate governance (act of corporate rulemaking). As a participant in corporate legal relations, the participant (founder) of the corporation exercises exclusively his/her corporate capacity.

The phenomenon of "artificiality" in the nature of a legal entity made it possible to separate the subtract of will, interest and capital from the human being, give it its own legal embodiment, which led to the creation of a new participant of legal relations. Such a participant does not have a biological nature of its origin, at the same time, its occurrence is conditioned by human activity itself. Notwithstanding the acquired autonomy of the status of legal person, the formation of its legal capacity, its capacity as a component of legal personality, can be ensured by a person only. But at the same time due to the legal abstractness of a legal person from an individual, the corporation's capacity is realized by a certain circle of subjects, as mentioned above.

Due to the differentiated nature of corporate governance, the multidimensional nature of the steps towards the realization of the legal personality by the corporation, its governance is concentrated within the poly variative limits. Due to the imbalance of law enforcement and the level

of general competence, the concentration of management leverages of governance within the limits of one subject inevitably influences the efficiency of taking and implementing management decisions.

Thus the activity of the subject of corporate governance has a variable nature and competence component, meaning that the subjects of governance are differentiated in relation to the area of their competence. This way the relevant bodies realize the legal personality of the corporation. Their systematization requires the construction of a coordination model between them.

The first (basic) level of the construction is the governing body, which is formed by a participant (founder) of the corporation and is a legal means of self-organization of collective interest. Thus it is a source in the governance system of corporate governance, as it unites the key participants of corporative legal relations in it and exercises corporative rulemaking. Such a body defines the model of the governance system of the corporation in general. Its formation from the participant (founder) of the corporation gives him/her exclusive powers of definition of the fate of the corporation, directions of its activity. In addition, such authority forms other authorities of corporate governance underlying that process, including the subject-functional aspect of their competence, organization of their activity.

The second level is the creation and functioning of the authority of implementation of the decisions of corporate governance taken by the superior body. That level has different forms of its manifestation (board, supervisory board, directorate, director). In such a way, the overall competence of the superior body of corporate governance is diversified in special (executive) powers that are delegated to separate governance bodies. The idea of such a separation consists, on the one hand, in an increase in the efficiency of corporate management and, on the other hand, in avoidance of a conflict of interest in the competences of such bodies.

Where the first level of corporate governance is a static form of self-organization of the participants (founders) of the corporation, the second one has a dynamic structure of its construction. Such dynamics is conditioned by many factors (the organizational and legal corporation form, the quantitative composition of its participants (founders), the char-

acter and types of its activity, etc.). It determines the poly variety of the structure of the second level of management.

A combinatorial set of elements of the second level of corporate governance and a definition of the configuration of its relations according to the superior corporate governance body form a relevant model of corporate governance. That model is an explication of the practical form of corporate governance.

The doctrinal prerequisite for the formation of a corporate governance model is a relevant corporate governance theory, the main provisions of which are conditioned by the task that the beneficiaries of the corporation are seeking to accomplish. It has been found that corporate governance practices are not a standard mode (not a "one size fits all") and thus cannot operate in any standard form, but rather vary across nations and firms. This variety reflects distinct social values, different ownership structures, business circumstances, strength of competitive conditions and enforceability of contracts. The political standing of the shareholders and debt holders, and the development as well as the enforcement capacity of the legal system are all crucial to effective governance[4].

The Agency theory holds that corporate governance is performed by the management hired by a principal. The balance of interests between them is ensured by the outcome of such governance. Its decrease results in a reduction of the manager's remuneration or changes of the relevant management bodies. The control mechanism of the efficiency of corporate governance provides supervision, thereby ensuring the autonomy of managerial decision-making. Such a theoretical construction of corporate governance leads to a significant strengthening of the control bodies over the management activity in favor of the beneficiaries, which is typical in the conditions of a weak interest concentration of the corporation's participants. Such a concentration of interest of the participants (founders) of the corporation is a characteristic feature of the activity of the supervisory board of the corporation. That theory states that corporate governance is marked by the weakness of self-organization and activity of the superior body of corporate governance (due to the number

[4] Yusoff Wan F.W., Adamu Alhaji I., *Insight of Corporate governance Theories*, "Journal of Business & Management" 2012.

of the participants (founders) of the corporation, their minority), a significant strengthening of the role of the executive body of management. In that case, institutional investors make autonomous decisions regarding the evaluation of the performance of the executive management body through the use of their corporative rights with the mediation of stock market instruments. The emerging contradictions between the management body of the corporation and its participants (shareholders) are the characteristic feature of the English-American management model. The investment activity of the participant (founder) of the corporation is more labile than the changing process of the corporation management in such economic conditions.

This way, the market model prevalent in England and the USA was formed within the conditions of corporative environment with a high degree of fragmentation and diffusion of stock ownership, high emission activity, developed market of direct investments, availability of big and active institutional investors.

By contrast, the Stakeholder theory of corporate governance focuses on keeping the balance of interests of the corporation's stakeholders. Despite the fact that in that case the sense of corporate governance is significantly narrowed by the framework of the interest of a certain group of persons[5], it emphasizes the role of governance more clearly in ensuring the functioning of the corporation. Contrary to what is given above, that theory postulates that the superior body of corporate governance (due to the role of majority participants (founders) of the corporation) concentrates its main functions on corporate governance, thus reducing the role of the executive management body.

The main principle governing such a model is the concentration of capital in the hands of a narrow circle of persons and the establishment of strict control over it. Even the operating activity of the corporation is influenced by the main stakeholders.

There are several other theories in the legal science which define the model of corporate governance. A co-called "resource allocation" theory

[5] Coleman P. T., Hacking A., Stover M., Fisher-Yoshida B., and Novak A., *Reconstruction ripeness I: A study of constructive engagement in protracted social conflicts*, "Conflict Resolution Quarterly", 26 (1) 2008, pp. 3-42.

has become widespread. The theory of social contract[6], legitimation theory[7] and the political theory of corporate governance[8] which advance the thesis of an increase in the influence of society on the result of activity of a legal entity have also recently seen growing popularity.

Under the Agency theory, the model of the construction of the executive body has developed within the limits of the Stewardship theory, the idea of which is focused on the core of the organization's interest through the individualization of its management. Thus the stewardship theory focuses on structures that facilitate and empower rather than monitor and control[9].

In turn, the stakeholders include not only the participants (founders) of the corporation, but also the management of the corporation, staff, contractors, the state, etc., who, as the theory dictates, should be classified as substantive or contextual stakeholders representing the social system in which the corporation and contract stakeholders function[10].

Nowadays such legal traditions are accepted in the French corporate legislation which provides that joint-stock companies are ruled by the Administrative Board composed of not fewer than three persons, a maximum quantity of which may not exceed 18 (Article L.225-27 Code de commerce)[11]. The institution of employee participation in the management of the corporation is a form of ensuring labor rights of employees.

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[6] Gray R., Owen D., Adams C., *Accounting and Accountability. Changes and Challenges in Corporate Social Environmental Reporting*, Prentice – Hall Europe Harlow 1006, 1996.

[7] Suchman M. C., *Managing Legitimact: Strategic and Institutional Approaches*, "Academy of Management Review", 20(3) 1995, pp. 571-610.

[8] Hawley J. P., Williams A. T., *Corporate governance in the United States: The Rise Of Fiduciary Capitalism*, Working Paper, Saint Mary's College of California, School of Economics and Business Administration 1996.

[9] Davis J. H., Schoorman F. D., Donaldson, L., *Toward a Stewardship Theory of Management*, "Academy of Management Review", 22(1), 1997, pp. 20-47.

[10] Rodriguez M. A., Ricart J. E., Sánchez P., *Sustainable Development and the Sustainability of Competitive Advantage: A Dynamic and Sustainable View of the Firm*, "Creativity &Innovation Management", 11(3) 2002, pp. 135-146.

[11] Code de commerce: https://www.legifrance.gouv.fr/affichCode.do?idArticle=LEGIARTI000023519840&idSectionTA=LEGISCTA000006178759&cidTexte=LEGITEXT000005634379&dateTexte=20191224 (as of 2.11.2020).

The participation of the labor group in the management of the corporation is a factor of development of the system of social partnership.

It should be noted that due to the heterogeneity of the interests of groups of stakeholders, their correlation with the interests of the corporation is doubtful. At the same time, the emphasis placed on such interests means reasonable grounds for one of the mechanisms of opposing possible use or excessive use of the corporation in its quasi-interests. The variability of factors which influence the formation of a corporate governance model being under the impact of numerous theories, each of which has its strengths and weaknesses, leads to a set of combinations of their components. That process has a non-linear nature. Thus, none of the above-mentioned theories can be implemented in its "pure form".

An attempt to describe corporate governance requires the use of additional combinations of classical ideas developed by the aforementioned theories, the complex of which can give thorough information on the essence of corporate governance as an integral phenomenon.

The theory of the social contract provides a degree of responsibility towards society for the activity of the corporation. The foregoing implies an active and direct involvement of persons related to the corporation, since the lack of social control over the activities of the corporation can have negative social consequences. In other words, the involvement of society in corporate governance has positive leverages of influence in the context of securing employees' interests. Thus, the thesis of the social contract is absorbed by the *integrative theory of corporate governance*.

Under the legitimation theory, the corporation receives permission to use the potential of society in exchange for some level of its responsibility before it. By virtue of legitimate consolidation, the corporation making use of social recourses bears responsibility to society. Supporting the thesis of critical perception of society's primary importance in the activity of the corporation and shaping its inner policy, mention should also be made of the relevant view of extending the limits of legal responsibility of the corporation by the involvement of persons who have influence on taking management decisions in the corporation. The relevant principles take into account the concepts of the integrative theory of corporate governance presented by the author of this article.

The contradictory nature of the theory of representation, beneficiary theory and management theory as regards the difference of interests of persons who ensure the activity of the corporation doesn't raise questions. But the formula of efficiency of corporate governance involves precisely the unity of the diversity of interests. The clear identification of the interest of a separate group of persons and its representation in the process of governance of the corporation is a form of prevention of abusive use of the construction of a legal entity in the interests of another group of persons connected with the management of a legal entity. A social compromise is thus achieved due to a mutual balance of interests. At the microsocial level, its realization is ensured by the functioning of management bodies of the corporation, formation of the structure of such bodies and the interaction between the subjects of corporate governance.

Thus, the optimal way is a combination of elements of the theories of corporate governance within the limits of one integrative theory, which is a synthesis of those of their basic provisions that define the main corporate objective.

The mechanism of corporate governance involves a substantive and functional division between the structurally independent bodies of the corporation that ensure its legal personality.

The structural autonomy implies the formation of executive bodies exclusively by those persons who have no indirect interest in the corporation because of its independence from other bodies of corporate governance, the persons who constitute it.

The superior body of corporate governance is imperatively formed by its participants (shareholders). In order to ensure constant coordination between the participants (shareholders) of the corporation in the period between their meetings, which is meant to increase the efficiency of the superior body of corporate governance, the conditions of weakness of which were given above, a special presidium is formed from the number of the minority and majority participants (founders) of the corporation. Its formation occurs by a proportion of an equal representation of minority and majority founders of the corporation from the total number of participants and does not depend on the size of their share in the authorized capital of the corporation. In such a way the balance of interests of the mi-

nority and majority participants (founders) of the corporation is ensured when they take certain management decisions.

The executive body of corporate governance is of an alternatively binary nature and is composed of the board and executive director (directorate) with a corresponding division of powers. The executive body consists of persons who are not connected with the corresponding superior body of corporate governance, persons being part of it, or the corporation as a whole (external independent directors).

The quota principle of the formation of the executive body of corporate governance (board, directorate) ensures equal representation of interests of the main stakeholders of the corporation (employees, participants (founders) of the corporation).

The second component of corporate governance is its efficiency. That is why the activity of the bodies that ensure the legal personality of the corporation should be accompanied by the functioning of the bodies that create the conditions of efficient realization without taking management decisions.

The activity of the aforementioned bodies of corporate governance objectively requires a factor of external supervision conditioned, on the one hand, by the necessity to control the activity of the executive body in the event of possible abuse and, on the other hand, by the necessity to focus attention of the superior governance body, due to the weak coordination, on many aspects of corporate governance within the limits of its powers.

The audit functions of the activity of the subjects of corporate governance are ensured by a corresponding authority – the auditor‘s committee.

It is worth noting that crisis phenomena in the process of development of society are conditioned by both endogenous and exogenous factors and have influence on the efficiency of corporate governance. The complex of agreed elements, which, when interacting between themselves, diagnose the signs and manifestations of a crisis contributing to its overcoming, is the presence of the committee of anti-crisis governance in the structure of corporate governance[12].

Thus, taking into account the principle of the construction of the

[12] Hrynko T.V., *The strategy as a tool of anti-crisis management at an enterprise*, “Economist”, 2013 No. 8, p. 51-53.

system of corporate governance in relation to its goal, when defining its structure, management of the corporation must be considered beyond the legal aspect to cover also the organizational aspect. Its basis is composed of the result of activity sought by the stakeholder. The goal in the governance is a desirable, possible and necessary state of production as a managed socio-economic system that must be achieved.

In legal terms, the base of corporate governance consists of the bodies whose activity ensures the legal personality of the corporation and absence of conflicts of corporate interest of related parties.

Such bodies are the superior management body – the body of the corporate rulemaking (general meeting of the participants (founders), their presidium and executive body – the board, directorate (director), this model of interaction is based on the integrative theory of corporate governance.

The organizational aspect, except for the legal one, additionally provides for the creation of a coherent system of efficiency of management in the relation to the pursued goals.