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MASTER'S THESIS

"Formation of Corporate Boards: Comparative Analysis"

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ABSTRACT AND KEY WORDS

The work analyses the legal framework of the formation of corporate boards in three countries – UK, Germany and Lithuania, determines problems, emerging in the course of appointment of the board with the focus on social responsibility and stakeholders theory of the purpose of the firm and the place, that artificial intelligence can have in the formation of corporate boards of the mentioned countries. The object of the work is governing the composition and procedure of appointment of board of directors in three jurisdictions – UK, Germany and Lithuania and the role that artificial intelligence can have in the course of formation of corporate boards of those countries.

Keywords: corporate governance, board of directors, supervisory board, management board, artificial intelligence.

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INTRODUCTION

The relevance of the topic. Corporate governance is an important area of company law, that establishes the rules of how company is controlled and directed. The legislators and business are constantly in the search of ways to improve the governance of the companies. Corporate board is a governing body of the company and its' formation is a significant aspect of company's functioning. Nowadays the concepts of socially responsible business and sustainable corporate governance are becoming more popular and thus, protection of interests of the stakeholders, including employees of the companies attract more attention. Moreover, the modern technologies, particularly artificial intelligence are becoming more involved in law and business, so its' place in corporate governance and in particular, in corporate board formation is a relevant matter. There were already cases, when companies attempted to appoint the artificial intelligence as a board member, thus its' role in the corporate boards' formation is a relevant issue.

The aim of the Thesis is to make the comparative analysis of the composition and procedure of appointment of boards of directors in three countries – UK, Germany and Lithuania, to determine and discuss possible problems, emerging in the course of appointment of the board with the focus on social responsibility and stakeholders theory of the purpose of the firm and to determine the place, that artificial intelligence can have in the formation of corporate boards of the mentioned countries.

To fulfill the aim, the author of the Thesis will do the following *tasks:*

1) to analyze the legal framework of formation of corporate governance bodies of three countries – UK, Germany and Lithuania and to do the comparative analysis of legal regimes of formation of corporate boards in those three countries and identify their advantages and disadvantages;

2) to identify problems, appearing in the course of the corporate board formation and to analyze the issue of protection of stakeholders, particularly employees and other concerned persons in the course of formation of corporate board;

3) to identify the place and role of artificial intelligence in the formation of corporate board.

In Chapter 1 "Composition of the Corporate Board" we will briefly mention some general theoretical issues regarding corporate governance models and moved to analysis of

board composition in UK Germany and Lithuania. By "composition" we mean the circle of entities, that can be elected as board members and requirements to them. The closing point discussed in Chapter 1 related to representation of employees interests on the board and gender diversity issue in the board composition.

In Chapter 2 "Procedure of Appointment of Corporate Board" we will focus our attention on the procedural part of formation of board of directors in UK, Germany and Lithuania, comparative analysis of the procedure in those jurisdictions and on problems, that might emerge in the course of board appointment, particularly, protection of minority shareholders' and employees rights.

In Chapter 3 "Role of Artificial Intelligence in the Formation of Corporate Boards" we will consider the place of artificial intelligence in corporate governance and tried to analyze, whether it can be appointed as a member of corporate board of the company.

The objective of the Master Thesis is legal framework, governing the composition and procedure of appointment of board of directors in three jurisdictions – UK, Germany and Lithuania and the role that artificial intelligence can have in the course of formation of corporate boards of those countries.

Methodology. Logical analysis method was used in order to study and analyze the certain provisions of the company legislation of three countries. Synthesis method was used to draw up the conclusions and to outline the particular problematic points in the researched materials. The comparative method was used in order to make the comparative analysis of the legal framework for board appointment in three researched jurisdictions.

Originality. In this Master Thesis we will make the comparative analysis of the composition and appointment of corporate boards of three countries – UK, Germany and Lithuania, with the attention on the role and interests of employees and on other possible problems, that emerge in the process of corporate boards' formation and will try to determine the role, that artificial intelligence can have in the formation of corporate boards in these jurisdictions.

The literature used in the Master Thesis. In the course of research the author of the Thesis used the normative acts of the UK, Germany and Lithuania, such as Company Laws, norms of soft law of those countries, i.e. Corporate Governance Codes, scientific articles and books, covering the topics of corporate governance, company law, artificial intelligence and

its' place in corporate governance. The most important sources are: legislation of the countries subject to comparative analysis, such as UK Companies Act, German Stock-Corporation Act, German Co-determination Act, Co-determination Act; books and articles in the area of company law and corporate governance, such as Luca, N. and Carli, L.G. European company law: text, cases and materials, Gerner-Beuerle, C. and Schillig M. Comparative Company Law, Bruner, C.M. Distributed Ledgers, Artificial Intelligence and the Purpose of the Corporation; other sources, such as Corporate Governance Codes of Germany, UK and Lithuania. For full list of literature, please refer to the List of References.

CHAPTER 1. COMPOSITION OF THE CORPORATE BOARD

Sub-chapter 1.1. Theoretical aspects of corporate board composition and types of management systems

When one is speaking about the corporate board, board of directors, management board, etc. – he is referring to the central governance body of the company, that is in charge of the company's day-to-day activity management and supervision, unlike the general meeting of shareholders, that is focused on strategically planning of the business. The board composition plays the crucial role in the company's success. Effective oversight of the executive directors by non-executive or by supervisory board leads to successful governance of the company. Diversity of competences and views among the board members is important. Insufficient diversity would lead to fewer ideas and potentially less effective oversite of the management board by non-executive directors. (Luca, Carli,2017)

The corporate board consists of directors and is an elected body; its' members are appointed by the shareholders. The composition of the board, i.e., the amount of the directors, requirements to their qualifications, education, conflict of interest matters, etc. are determined by company's articles of association and by national legislation. The requirements to board composition may differ depending on legal structure of the company, whether it is public or private, listed or non-listed. Usually, public and listed companies have more strict requirements. The board members are divided into executive and non-executive (independent) directors. Executive directors are in employment relations with the company and have management functions, while independent directors not company's employees and act separately from management. (Gerner-Beuerle, Schillig, 2019) The purposes of having non-executive directors on the board may be prevention of conflict of interest, representation of particular important stakeholders, such as creditors or investors. Often such directors are as well independent from the company's management functions as well. (Gerner-Beuerle, Schillig, 2019) In several jurisdictions, e.g. Germany, Netherlands, France law requires to have directors, representing interests of employees. (Videbæk Munkholm, 2019, p.5) Besides directors themselves, the decisive role plays the management system type. In various countries

the functions of the board are performed based on different models – either one-tier (monistic) or two-tier (dualistic) or a mixed system. (Gerner-Beuerle, Schillig, 2019)

The monistic system is typical for common law jurisdictions. (UK, USA). Company with such management system has two principle governing bodies – shareholders meeting and management board (or board of directors). Shareholder's meeting appoints the board. In companies with one-tier management systems the board has both managing and supervisory roles, in some jurisdictions the roles of chairman of the board and CEO are combined, e.g. in the USA. (Kraakman, *et al*., 2017)

The dualistic board structure is common for civil law systems. Under two-tier systems the board is divided into executive board and supervisory board. Executive board is responsible for day-to-day operations of the company. The supervisory board monitors activity of the executive board. Usually, in entities with two-tier boards general meeting appoints the supervisory board which, in turn, elects the executive board. (Luca, Carli,2017)

It is important to understand, that in corporate governance of both – companies with monistic and with dualistic boards the actual division of executive and supervisory functions is present. However, in entities with one-tier boards a lot of executive functions are usually entrusted with officers. (Gerner-Beuerle, Schillig, 2019)

The officers are persons, employed by the company and appointed for important management positions by the board of directors. Examples of officers' positions are: Chief Executive Officer (CEO), Chief Operating Officer (COO), Chief Accounting Officer (CAO), Chief Financial O fficer (CFO). Officers should not be confused with directors, as not in all jurisdictions they are board members. (Gerner-Beuerle, Schillig, 2019)

Currently there is an increasing number of legal systems (e.g. Lithuania, France, Italy, Portugal.) with mixed (hybrid) corporate governance systems. Under such management model companies are free to either choose between the monistic and dualistic boards, or compound the features of both corporate governance models in their boards of directors. (Gerner-Beuerle, Schillig, 2019) European company (SE) is as good example of mixed corporate governance structure and an illustration of directors' functions in both -one-tier and two-tier systems. The Statute of European Company gives the possibility to choose between one-tier system, having one administrative organ or two-tier system, establishing a management and supervisory organs. (Council Regulation No 2157/2001, 2001) In SE with two-tier system the executive

board in charge of managing the entity is appointed by the supervisory board and obliged to periodically report to it on the business development and to provide requested information. The supervisory board monitors the work of executive organ and can not itself have the power to manage the company. It is appointed by the general meeting of shareholders. (Council Regulation No 2157/2001, 2001) In SE with one-tier management system the administrative body is responsible for day-to-day management and is appointed by the general meeting of shareholders. (Council Regulation No 2157/2001, 2001)

Now we will move to analyzing legislation on composition of corporate boards in three countries – UK, Germany and Lithuania, particularly – the board models, requirements to directors, representation of stakeholders and diversity matters.

Sub-chapter 1.2. Requirements to composition of the corporate boards in the UK, Germany and Lithuania

In sub-chapter 2.1. we are going to analyse composition of the corporate boards of three countries – United Kingdom, Germany and Lithuania. We will look over legislation of those countries and other norms, that establish who is entitled to be board members, the number, the requirements to the number of board members and their qualification.

United Kingdom

United Kingdom is a country, representing the common law system, where one-tier management model is usual for the companies. In terms of sources of law, for UK we will analyze the following, as they are basically the core norms in terms of board composition:

- Companies Act 2006 (Companies Act, 2006) covering all aspects of company law, including corporate governance;
- Model Articles of Association for private and public companies, used by UK companies and governing directors responsibilities, rules of decision-making, etc. (Model Articles of Association, 2014)
- UK Corporate Governance Code covering and concretizing matters, not provided by the Companies Act stating principles required from listed companies, and at the same time can be used by all companies as a set of recommendations. (UK Corporate Governance Code, 2018)

The Companies Act's provisions in terms of board composition are very broad and general, as the law gives the UK company's founders enough freedom to decide on the management body. (Gerner-Beuerle, Schillig, 2019) Part 10 "A company's directors" requires, private companies to have at least 1 and public companies not less than 2 directors. At least one director must be a natural person, and this requirement is considered met if the position of director is given to a natural person as ***a corporation sole****[1] or otherwise. The minimum age for the person, appointed as director is sixteen years. Board of directors as a body is first being mentioned in Part 15 of the Act in the context of its obligation to approve the directors reports and the accounts. (Companies Act, 2006)

[1] Corporation sole is a legal entity, consisting of one registered office occupied by one natural person.

In our opinion, the main thing about the Companies Act in terms of corporate board formation is its' silence on the actual board model. It neither requires the company to have a supervisory board, nor states that one-tier system is mandatory, thus giving the founders the freedom to choose the management system more suitable for their business model.

More detailed provisions on board composition can be found in Model Articles of Association**.** Model Articles provide, that any person who is willing to act as a director, and is permitted by law to do so can be the director. A person ceases to be a director in the following cases: 1) bankruptcy order against it; 2) settlement with person's creditors generally in satisfaction of that person's debts; 3) Incapability to fulfil the director's duties due to health. (Model Articles of Association, 2014) Model Articles are built in such a way, that one-tier management system is presupposed for companies using it. Particularly, Model Articles provide that the company must have a board of directors, that perform executive functions and can delegate those functions to officers. The separate body, entrusted with supervisory functions is not mentioned. (Gerner-Beuerle, Schillig, 2019)

The most detailed document in terms of composition of corporate board is Corporate Governance Code. Code gives recommendations on different aspects of corporate governance, comments on matters, not covered by law, as well as interpretation and explanation of the legal acts. Usually, such Codes are issued by professional or business associations, stock exchanges, etc. and are obligatory for members of such associations and for companies, listed on stock exchanges. Most often these Codes are elaborated specifically for listed companies due to distance between shareholders and daily corporate governance in these companies, that leads to conflicts of interest in respect of corporate governance. (Corporate Governance Code for the companies listed, 2019) In the UK the Corporate Governance Code is issued by the Financial Reporting Council and recommends that appointment procedure must be based on, among other things, diversity in terms of gender, social and ethnic backgrounds, cognitive and personal characteristics. It stresses importance have a combination of various skills, experience and knowledge, necessary for running the company. The membership must be regularly refreshed, in particular the Chairman of the board should not occupy this position for more than nine years from the date of the first appointment to the board. The Code requires the roles of CEO and Chairman to be separated, so that the CEO could not be appointed as a Chairman and recommends the company to have a sufficient number of independent directors

on board, but not specifying the amount of those directors. (UK Corporate Governance Code, 2018)

To briefly summarize, the legislation of UK doesn't specifically indicate the type of management model, however the Model Articles are drafted for the company with one-tier board. Using of Model Articles of Association is not mandatory, and the company can modify them or use only suitable parts. At the same time nothing in the legislation prevents from establishing a supervisory board. The maximum freedom is given to founders in this regard. The directors of the company can be either legal, or natural persons, however the presence of director natural person is mandatory. The law doesn't establish requirements to qualification of directors however, the corporate governance code recommends to have independent directors and in support if board diversity, advices to appoint directors with different qualifications and personal characteristics.

Germany

Germany is a country with civil law system and is one of those jurisdictions, where corporate legislation explicitly provides for two-tier board for certain types of companies. Among major German norms, regulating issues of corporate governance are German Stock Corporation Act and Act on Limited Liability Companies, regulating the most widespread types of companies, Co-Determination Act and One-third Participation Act governing matters, related to employee's representation in company's management, and a Corporate Governance Code.

German Stock-Corporation Act requires public limited companies (AG) to have a management board and a supervisory board. The management board of such a company have responsibilities to formulate overall direction of the affairs of the company and to conduct day-to-day business operations. (Gerner-Beuerle, Schillig, 2019) The supervisory board in German AG is a controlling body and its' activity in respect of management of the company is very limited. (The German Supervisory Board, 2021) The main functions of the supervisory board are appointment of the member of management board and monitoring of the management board's performance. Moreover, according to Stock-Corporation Act, in public companies certain transactions are subject to authorization by the supervisory board, particularly, approval is needed for the decisions 'that fundamentally change the company's net assets, financial status or results of operations". (Gerner-Beuerle, Schillig, 2019) The

examples of such decisions are: issues related to mergers and acquisition, budget matters, opening or closure of branches. (The German Supervisory Board, 2021)

According to Stock-Corporation Act, management board may consist of one or several persons. In companies with share capital of more than three million euros, the management board is to be comprised of at least two persons. Solely a natural person having legal capacity without any restrictions may be a member of the management board. (Stock-Corporation Act, 1965)

The supervisory board of the joint-stock company must consist of at least three members and not more than:

- *nine* for companies with share capital *up to EUR 1,500,000*;
- *fifteen* for companies with share capital of more than *EUR 1,500,000*;
- *twenty one* for companies with share capital of more than *EUR 10,000,000* (Stock-Corporation Act, 1965)

Should the company be subject to co-determination laws,[2] number of directors may be different. (Stock-Corporation Act, 1965) The supervisory board consists of members, representing the shareholders and, where the co-determination norms apply, the employees. (Stock-Corporation Act, 1965) In listed companies subject to co-determination norms, the supervisory board is to be composed of women at a minimum ratio of 30 % and of men at a minimum ratio of 30% per cent. The minimum ratio is to be fulfilled by the supervisory board as a whole. (Stock-Corporation Act, 1965)

Act on Limited Liability Companies

A private limited liability company (GmbH) must have at least one director, and only a natural person can hold that position. A shareholder is allowed to be appointed as director. Limited liability companies with *more than five hundred employees* are required to have a supervisory board. Limited liability companies in certain conditions are subject to rules on gender composition of the board. Where a supervisory board is to be appointed in accordance with the One-Third Participation Act, the meeting of shareholders sets targets regarding the proportion of women on the supervisory board and of women directors, unless it has delegated this task to the supervisory board. Where a supervisory board is to be appointed in accordance

[2] Institute of co-determination – is a set of legal norms, allowing employees to participate in governing the company.

with legislation on co-determination, the supervisory board sets targets regarding the proportions of women in it and women directors. (Act on Limited Liability Companies, 1892)

Corporate Governance Code

Based on the German Corporate Governance Code, composition of the supervisory board has to ensure that its members collectively possess the knowledge, skills and professional expertise required to properly perform their duties. The company must determine sufficient age limit of the supervisory board members and indicate it in the Corporate Governance Statement. (German Corporate Governance Code, 2022) German laws don't prohibit a person to be a supervisory board member in more than one company, however Corporate Governance Code recommends that a supervisory board member who is not a member of any management board of a listed company not to accept positions in more than five supervisory boards at non-group listed companies. Similarly, members of management boards of listed companies are recommended not to have cumulatively positions in more than two supervisory boards of non-group listed companies. (German Corporate Governance Code, 2022)

The supervisory board is recommended to have an appropriate amount of non-executive directors, that are independent from the group of shareholder representatives. It means, that a supervisory board member is considered independent if he/she has no personal or business relations with the company and its management board, as well as from any controlling shareholder. More than half of the shareholders' representatives must be independent from the company and the management board. (German Corporate Governance Code, 2022) Should the company with more than two supervisory board members have a controlling shareholder, at least two members shall be independent from the controlling shareholder. In case of six members or less, at least one shareholder representative shall be independent from the controlling shareholder. A supervisory board member is considered independent from the controlling shareholder if he/she, or a close family member, is neither a controlling shareholder nor a member of the executive governing body of the controlling shareholder, and does not have a personal or business relationship with the controlling shareholder that may cause a substantial – and not merely temporary – conflict of interest. (German Corporate Governance Code, 2022)

Based on all the abovesaid, Germany is the country of continental law system, where two-tier corporate board is typical. However, not all German companies are required to have a supervisory board, but this requirement apply to public limited companies and limited liability companies with more than five hundred employees. German is one of the countries, where the law provides for mandatory employee board-level representation in certain cases, as well as gender quotas. This will be discussed in more details in the next sub-chapter. The corporate governance code pays a lot of attention to independent directors on the supervisory board, giving criteria of independence from the company, management board and controlling shareholders.

Lithuania

Lithuanian legislation allows companies to choose the structure of their boards freely, subject to several restrictions in respect of listed companies. In terms of Lithuanian legal framework, we will mostly concentrate on Lithuanian Law "On Limited Companies" and the Corporate Governance Code for Lithuanian companies listed on Nasdaq.

Law of Lithuania "On Limited Companies" governs the issues of establishment, management and operation, of public and private limited companies, including financial institutions and collective investment undertakings, but to the extent the latter are regulated by other EU and domestic legislation. According to the Law, Lithuanian companies are allowed to opt between one-tier and two-tier management systems. (Law of Republic of Lithuania On Limited Companies, 2000)

Law "On Limited Companies" requires the company to have a general meeting of and a one-person management body. If the company decides, it can have a collegial management and supervisory bodies – executive and supervisory boards. The public company is required to have at least one collegial body – either the supervisory board or the board. Should the company decide not to establish the supervisory board, it can assign the board that will have additional supervisory functions, such as: making decisions on transactions with related parties; supervision the activities of the company's manager, submitting feedback and suggestions regarding the activities of the company's manager to the general meeting of shareholders; considering whether the company's manager is suitable for the position, if the company is operating at a loss; submitting proposals to the company manager to revoke his decisions that contradict laws and other legal acts, the company's articles of association, the

decisions of the general meeting of shareholders or the board; resolving other issues of supervision of the activities of the company and the company manager assigned to the competence of the board in the company's articles of association, as well as in the decisions of the general meeting of shareholders. (Law of Republic of Lithuania On Limited Companies, 2000)

The number of members of the supervisory board is determined in the Articles of Association, but it must consist of at least 3 and no more than 15 members. (Law of Republic of Lithuania On Limited Companies, 2000) It is elected for not more than four years. (Law of Republic of Lithuania On Limited Companies, 2000) The member of the supervisory board cannot be company manager, member of the company's board, auditor or an employee of an audit company who participates and/or has participated in the audit of a set of financial statements of the company, since the completion of which a period of 2 years has not passed, member of the management body of the subsidiary company, person who, according to legislation, does not have the right to perform these duties. (Law of Republic of Lithuania On Limited Companies, 2000)

For public companies there is the requirement that more than a half supervisory board members must be independent directors – those, who have no employment relations with the company. (Law of Republic of Lithuania On Limited Companies, 2000) For listed companies requirements to independent directors are stricter. At least one third of members must meet the following criteria:

- Not to have employment relations with the company, its' parent or subsidiary for at least one year;
- Not to have been managers or board member with at least one fifth of the votes in a company, its' parent or subsidiary;
- Not to be close persons of the shareholder with more than one fifth of votes, of the manager of the company its' parent or subsidiary;
- Not to have business relations with a parent or subsidiary company or with a legal entity in which the company, its' parent or subsidiary has shares or participates in management.

- Not to have been a member of a collegial body or an employee of an audit company that provided services to a company, its' parent or subsidiary company during the last two years.
- Not to be a member of the collegial body of the company for more than 10 years. (Law of Republic of Lithuania On Limited Companies, 2000)

The management board must consist of at least three members – natural persons. The law doesn't allow a legal entity to be a member of the management board. (Law of Republic of Lithuania On Limited Companies, 2000) Members of the management board cannot be at the same time a member of the supervisory board. (Law of Republic of Lithuania On Limited Companies, 2000) Should the management board perform several supervisory functions, as required by law, independent directors must constitute more than half of the board. In case of listed company, at least one third of the members of the management board must meet the similar requirements as established for the members of the supervisory board, and as we described above. (Law of Republic of Lithuania On Limited Companies, 2000)

The manager of the company (the CEO) is a sole management organ. The CEO of Lithuanian limited company must be a natural person. (Law of Republic of Lithuania On Limited Companies, 2000)

To summarize on Law "On Limited Companies", in 2015-2017 the reform of corporate legislation took place in Lithuania, that introduced a number of significant changes in terms of organization of management structure in public listed companies. Initially listed limited liability companies, were not required to establish boards of directors and the only required governance organs were the general meeting of shareholders and the CEO. In 2015 the amendments were made to Lithuanian law "On Limited Companies", requiring listed companies to have a supervisory or a management functions of the board. Later in 2017 the further amendments were made, prescribing listed companies, that opted for one-tier management system, to establish for the management board the specific supervisory functions, and provided for the minimum proportion of independent directors on the board. (Corporate Governance in Lithuania, 2018)

As a result of the mentioned company law reform, there are three possible options for board structures for listed Lithuanian companies:

1. ***Board with mixed functions and the CEO.*** Under this structure company's management board carries out executive and several supervisory functions, that were described above. Over a half of board must be independent directors, that do not have employment relations with the company. (Corporate Governance in Lithuania, 2018)
2. ***Management board, supervisory board and the CEO.*** It is a classical two-tier structure with respective distribution of responsibilities between management and supervisory boards. The supervisory board under this structure has additional responsibilities, such as approval of the companys' operating strategy and transactions related entities. (Corporate Governance in Lithuania, 2018)
3. ***Supervisory board and CEO.*** On practice this structure means that the CEO will have the broad management responsibilities. (Corporate Governance in Lithuania, 2018)

In addition, the reform increased the board independence through introducing the above-mentioned requirement for at least one third independent board members for listed companies, prohibiting appointment of company's auditor to supervisory board, as well as prohibiting the management board members of subsidiary entities from serving on parent companies' supervisory bodies. (Corporate Governance in Lithuania, 2018)

Corporate Governance Code

Besides the Law "On Limited Companies", Lithuania, like the UK and Germany has a Corporate Governance Code. It was drafted for the companies listed on NASDAQ in Vilnius, it contains the major principles for improvement company's' governance and raising its' performance. Even though, the recommendations are intended for the public limited companies, they are relevant for other types of corporations. In the same way, as in case of the UK and Germany, Lithuanian Corporate Governance Code provides more details in terms of matters not covered by law.

Particularly, Corporate Governance Code recommends that members of both – supervisory and management boards must collectively represent the diversity of qualifications, professional experience and competences. Board members must be elected on the principle of gender equality. When selecting the candidates for the board, the balance in qualifications must be seeked and to this end it should be ensured that members of the

supervisory board, as a whole, have diverse knowledge, opinions and experience to duly perform their tasks. (Corporate Governance in Lithuania, 2018)

Chairmen of the both – management and supervisory boards are required to be free of current and /or past positions, that would prevent them from impartiality. It is not allowed to immediately appoint a former company manager or member of the management board as a chairman of supervisory board. Similarly, in companies, where the supervisory board is not established, the former company's manager should not be immediately nominated as chairman of the management board. (Corporate Governance in Lithuania, 2018)

To sum up the abovesaid, we will compare the main points of board composition the researched countries. First of all, these countries have different approaches to board management model, that is illustrated by differences and advantages/disadvantages of board compositions under laws of these countries comparing to one another.

First of all, speaking about similarities, all three jurisdictions acknowledge the importance of the diversity in terms of professional background, gender, ethnicity, social status, etc., recognizing its' importance for the best functioning of the board. All researched jurisdictions recognize the exceptional role of independent directors and establish requirements to amount of those directors on the boards. In the laws of each of the analyzed country requirements to public and listed companies are stronger and more detailed, while private companies are given more freedom in terms of board composition, which is understandable due to existence of additional requirements to companies listed on stock-exchanges and the necessity to protect interests of investors, who in case of public companies often cannot possess all sufficient information and insights and are distanced from the company management, and thus need higher extent of protection. Natural persons are required to be on board of all researched countries. Even though the UK norms allow to have the legal persons among directors, at least one natural person must be present on board, while Germany and Lithuania doesn't allow legal entities as board members at all.

While doctrine often states, that all jurisdictions provide for different board structure – two-tier board for German companies, mixed board for Lithuanian and one-tier for the UK, the analysis of doctrine brings understanding that these requirements are not absolute and are imperative subject to certain conditions. In Germany two-tier board is compulsory only for public limited companies (AG) and for those private limited companies (GMbH), that have

more than 500 employees. Laws of UK don’t prevent the company to have two-tier board, just the model articles of associations are drafted as for one-tier board, though they are not compulsory for use. Lithuania, the classical mixed board structure is applicable to public companies, that are required to give their board a compulsory set of supervisory functions and are free to choose whether to form the supervisory board.

German company legislation is prominent due to board level employee representation in companies with large amounts of employees and to certain industries and due to establishment of gender quotas on the board. Lithuania and UK at the moment are moving in that direction and diversity requirements exist only in Corporate Governance Codes.

Sub-chapter 1.3. Issues of employee involvement and diversity on the corporate boards of the UK, Germany and Lithuania

There are two theories explaining the purpose of the company. The shareholder primacy theory states that the only purpose of management is to maximize firms' profits. The stakeholder theory states that the interests of stakeholders – employees, society, etc. must also be protected in the course of company's activity. (Luca, Carli,2017)

Stakeholder theory relates to concept of sustainable companies, that is becoming popular nowadays, that focuses among other things, on the employees' role in corporate governance and board diversity. European Commission in its' Action Plan "European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies" 2012 recognizes, that employee involvement, including by participation on the board, is necessary for good-functioning corporate governance framework. (Luca, Carli,2017)

UK

In 1992 the UK Cadbury Committee (Committee on the Financial Aspects of Corporate Governance) issued the report "Financial Aspects of Corporate Governance". Its' aim was to reassess current company legislation of the UK, with the focus on corporate governance and financial matters. (Sheikh, Rees, 1995) In terms of employee participation, Report recognized the necessity to protect their rights on the company level, however recommended ensuring they have rights to information on the standards of conduct, expected from them. There was a discussion on whether the employees should be given the access to financial information on company's performance. Cudbury Committee adhered to shareholder-oriented approach without arguing on the necessity of board-level representation. (Report of the Committee on the Financial Aspects, 1992) Before Cudbury report there were a number of proposals to give employee representatives the right to participate on the board level, e.g. in a White Paper Industrial Democracy 1978, however they were not implemented. (Fulton, 2007, p.39)

Contemporary UK legislation doesn't require having employee representatives on the board. However, a number of UK companies, e.g. FirstGroup, Capita, Sports Direct International, have appointed employee directors. These are large companies with big amount

of personnel, that decided to appoint employee directors because of valuable insight and feedback that employees could provide. (Employees appointed to UK boards,2022)

Regarding gender diversity the situation is different. Recently, in April 2022 the Financial Conduct Authority issued a policy decision "Diversity and inclusion on company boards and executive committees" setting targets on the representation of women for listed companies in amount of at least 40%, and provided that at least one senior board position should be given to a woman. (FCA finalizes proposals,2022) Policy requires listed companies will to disclose in their financial reports, whether they met the set targets and provide explanations in case if the targets were not met. (Diversity and inclusion in company boards, 2021) This is supposed to help companies in analysis of their approaches to formation of the board, to reconsider and improve it, should the targets not be met.

Germany

Co-determination is a traditional concept of German law. It means workers participation in the decision-making of the company and aims to ensure equal participation of shareholders and employees in governing the company. (Co-determination in Germany, 2016)

Co-determination can be realized through work councils and through employee board representatives. German institute of codetermination originates from the period after WWII, when British military administration, controlled the region of German heavy industry (Ruhr) and enacted laws providing employees board-level representation, giving them instrument to protect their interests from shareholders violations. (Gomez, 2018, p.267)

Nowadays institute of co-determination is governed by Act on Limited Liability Companies, Stock-Corporations Act, Co-determination Act, Law on One-Third Employee Representation, governing codetermination on the board level and Work Constitution Act, regulating work councils. (Federal Ministry of Labour and Social Affairs,2019)

The level of employee representation on the board depends on the number of employees in the company. Where the company not operating in coal and steel industry have more than 2000 employees, *Co-determination Act* applies. (Co-determination Act, 1976) Based on the Act, company's supervisory board must be made up of employee and shareholder representatives in equal measure. In particular, supervisory board in companies that are normally employing:

- not more than 10,000 employees must consist of *six shareholders* representatives and *six employees* representatives, provided that *four of the latter* will be company's employees and *two – members of the trade unions*; (Co-determination Act, 1976)
- more than 10,000 but not more than 20,000 employees shall consist of *eight shareholders* representatives and *eight employee* representatives, provided that *six of the latter* will be *company's employees* and *two – members of the trade unions;* (Co-determination Act, 1976)
- *more than 20,000 employees* shall consist of *ten representatives of shareholders* and *ten of the employees*, provided that *seven of the latter will be company's employees* and *three – members of the trade unions*. (Co-determination Act, 1976)

To the companies having from 501 to 2000 employees One-Third Participation Act applies. The supervisory board of these companies must consist of one third employee representatives. (Federal Ministry of Labour and Social Affairs, 2019, p.12)

Iron and steel industry has its' own special Act on Codetermination in the Coal, Iron and Steel Industry, applicable to all types of companies with more than 1000 employees and requiring equal numbers of members representing shareholders and employees and one neutral supervisory board member. Executive board in coal and steel industry companies must as well include labour director. (Federal Ministry of Labour and Social Affairs, 2019, p.12)

In Germany institute of codetermination goes together with norms on gender equality on the board, and according to Co-determination Act and to the Stock-Corporations Act, the board of listed public limited companies must consist of women at a minimum ratio of 30% and of men at a minimum ratio of 30%. The management board of the companies subject to Co-determination Act, that consists of more than three members must have at least one woman and at least one man. (Stock-Corporation Act, 1965)

In 2015 Act on the Equal Participation of Women and Men in Executive Positions in the Private and the Public Sector was enacted, which sets the gender ratio of at least 30 % for the members of supervisory boards of companies listed at the stock exchange and subject to co-determination with equal representation. (Federal Ministry of Labour and Social Affairs, 2019, p.11)

Lithuania

Lithuanian legislation does not stipulate for board-level representation of employees, neither it requires gender quotas on the board. However, employees are allowed to realize their right for representation through work councils. The Corporate Governance Code requires from the supervisory boards to "ensure that rights of persons, other than shareholders (e.g. employees), are duly respected". As an examples of employees involvement in corporate governance the Code brings: their engagement in making particular important decisions, being consulted with on corporate governance matters, their participation in the company's share capital, etc. (Corporate Governance Code for the companies listed, 2019)

Nowadays, there are a lot of discussions on increasing female presence on boards and impact of such increase on the company performance. On the EU level the objective was set to have 40% of women on boards of listed companies. The reaction of companies and investors on setting such a target is controversial. (Choudhury,2015, p.229) There were a number of research evidence, that gender quotas led to a number of inexperienced women on board, that impaired performance of companies. (Brahma, *et al.*, 2021, p.5705)

There were as well a number of studies trying to determine how increasing number of women on boards influence the firms profits and the majority, that came to equivocal results. (Choudhury,2015, p.231) In the article "Gender Diversity on Board Beyond Quotas" the author reviewed the results of different studies and concluded, that there were two main arguments in favour of gender quotas: 1) equality, meaning that promoting women participation helps to ensure justice and build more equal and balanced society; 2) economic reasons, explaining the contribution women can make to firms' performance. The scholars came to conclusion, that gender composition of the board doesn't have direct effect on economic indicators. However, it can impact on how effectively boards perform their tasks and this can be explained by strategic management theory, that views women contribution through the framework of three board processes: level of efforts, that individual makes to perform the task, difference in views and ideas on how the tasks should be performed and degree of qualification and skills required to fulfil boards' tasks. (Choudhury,2015, p.232) Particularly, the studies identified that women spend more time to prepare to board meetings, have better attendance records and positive effect on board instructions and evaluation, tend

to encourage discussions and better understand the stakeholders issues. (Choudhury,2015, p.235)

The authors of article "Board gender diversity and firm performance: The UK evidence" focuses on particular listed UK companies belonging to experience in giving women the positions on board. The authors mention UKs' choice not to impose compulsory gender quotas and believe, that it led to systematic changes and increase of the number of women in the boards. The article analyses different surveys on the effect of female board members on company performance and comes to conclusions, that the effect is rather positive. Among positive implications for company they outlined the following: 1) female directors having better monitoring ability; 2) statistically women are more likely to have a degree in business; 3) improving managerial accountability, such as board meeting attendance and CEO accountability. (Brahma, *et al.*, 2021, p.5705)

In sub-chapter 3.1. we discussed board-level representation of employees and gender diversity on the board.

Among researched jurisdictions, Germany is the one with the highest level of protection of stakeholders due to board-level representation of employees and gender quotas. In the UK and Lithuania not implemented, however the efforts are being made in that direction through provisions of Corporate Governance Code in Lithuania and by FSA in the UK. In Lithuania the workers can protect their interests through participation in work councils.

We agree that employee board-level representation is a powerful instrument for not only protection of employee rights, but for business itself, as such directors provide valuable insights from the employees point of view and strengthen contact and understanding between management and workforce. We understand, however, that implementing employee representation is a complex reform, that should be made gradually, and the best start for it is giving employees opportunities to represent their interests on non-board level, e.g. through work councils, as it is done in Lithuania.

Different studies identify the positive causal relation between appointing women on the board and increase of company's profitability, providing arguments in support. At the same time, we are aware of another side of the medal, when establishing compulsory quotas for women on the board can potentially lead to their appointment just to fill in the place without paying thorough attention to the persons' qualification. In this regard we have two points in

mind: 1) we believe in the necessity to promote of gender diversity in management in order to ensure equality and justice and build contribute to sustainable and socially responsible business; 2) we believe, that this must be done in a way, that will positively impact on company's profits. In our opinion, the best way to achieve that balance, is through complex changes not only in company law, that would lead to equal access of men and women to labor market, to managing positions, equal payment, etc. In terms of company law, we believe, a good example is the approach, used by UK FCA, when target were set for the percentage of women on management positions, and the company is to report annually on the reasons, why the targets were not met. Such reporting on one side helps the company understand, the reason and possible ways to deal with not meeting the targets and as well gives the authorities, reviewing the report the feedback about challenges, that business faces and thus, the chance to adjust the policy to realistic conditions and needs of the business.

CHAPTER 2. PROCEDURE OF APPOINTMENT OF CORPORATE BOARD

Sub-chapter 2.1. Legal framework governing appointment procedure

In the Chapter 1 we have discussed the composition of the board, and now we move to the procedure of appointment of the board members.

According to OECD Principles of Corporate Governance, among the basic shareholders rights are the right to participate and vote in general shareholder meetings and the right to elect and remove members of the board. In order the election process to be effective, shareholders should have the possibility to participate in the nomination of board members and in the vote on individual nominees or on different lists of them. (G20/OECD Principles, 2015) Among the elements, necessary for effective process of board members elections, the OECD Principles outline the right of shareholders to vote in absentia with such a vote being equal to the one given in person, elimination of obstacles to cross-border voting, protection of minority shareholders from abusing their rights by the controlling shareholders, the process of board nomination and election should be transparent and open. (G20/OECD Principles, 2015) We agree that the minority shareholder protection is especially important in the context of board appointment. However, shareholders are far from the only one concerned in board appointment. In companies with large amount of employees, the latter are certainly interested in influencing the management of the company, that among other things can be realized by active participation in appointment of the board. As discussed previously, not all jurisdictions give employees the possibility to be present on the board, which means that they as well have either no or very limited influence towards appointment of directors, as well as other stakeholders. Together with shareholders, directors themselves participate in board nomination and appointment.

In sub-chapter 2.1. we will discuss the procedures of appointment of boards of directors in the UK, Germany and Lithuania.

Germany

German legislation requires the public limited companies to have two-tier boards. The supervisory board is appointed by the founders and the management board is – by resolution of the supervisory board for the maximum period of five years with possible extension for

five more years. The resolution on extension is to be adopted not earlier than one year before the expiry of the member's previous term. In case where several persons are appointed to the management board, the supervisory board can choose one of them as chairman of the management board. (Stock-Corporation Act, 1965)

Members of the supervisory board, representing the shareholders are appointed by the general meeting. The decisions are made by the simple majority vote, and the Corporate Governance Code recommends to appoint by the single votes. (German Corporate Governance Code, 2022) Voting right in German public limited companies is based on the amounts of the shares held by the shareholder. In unlisted companies if the shareholder owns a number of shares, the voting right may be restricted by limiting the number of shares giving the right to vote. (Stock-Corporation Act, 1965) Candidates to supervisory board are made by shareholder representatives in the supervisory board or by shareholders themselves. Corporate Governance Code recommends establishing the Nomination Committee, consisting of shareholder representatives, to nominate candidates to the supervisory board. One-third of the supervisory board may be appointed by specific shareholders if the articles of association allow. In companies subject to co-determination, appointment rights are limited to one-third of the shareholder representatives. (Davies, 2013) Former members of the management board (in the last two years before election) may be elected or appointed as a member of the supervisory board of a listed company only if a quorum of shareholders holding more than 25 % of voting rights propose a former member of the management board. (Stock-Corporation Act, 1965) (Davies, 2013) There's no possibility for the supervisory board itself to appoint members, even in case of emergency. As well no deputies of the members of supervisory board can be appointed. However, it is possible to elect substitute directors where one of the supervisory directors has stepped down. (Stock-Corporation Act, 1965) In some urgent situations the supervisory board may be appointed by the court. This happens when the management board lacks a required member and an interested party addresses to the court with the petition to designate such a member in order to fix the issue urgently arisen. Once the issue is solved the office of the member appointed by the court expires. (Stock-Corporation Act, 1965)

Supervisory board members, representing employees are elected by separate procedure. According to Co-determination Act, the employees supervisory board representatives are

elected either by the delegates (in companies with more than 8000 employees) or directly by employees (in companies with less than 8000 employees). (Co-determination Act, 1976)

In every company one delegate has the right to vote on behalf of 90 employees. If in such a way more than 25 delegates are received, their number is reduced dependent on the amount of delegates, however the amount of votes for each delegate will be increased proportionally to reduction of the candidates number. E.g. if company has more than 25 delegates, their amount will be reduced by half, and each delegate shall receive 2 votes. It is important that all types of employees were represented by the delegates, including those, who were hired for vocational training, persons engaged in home work, civil servants and workers of the public service. (Co-determination Act, 1976)

To choose the delegates employees vote by secret ballot for candidates from the lists. The lists are prepared by the employees and contain names in the amount of at least twice as many candidates as there are delegates to be elected. (Co-determination Act, 1976) Among the employee representatives on the supervisory board must be company's employees and members of trade union. The trade union representatives are elected by the secret vote by the employees' delegates, who elect from the lists of candidates provided by the trade unions represented in the company. The similar procedure applies for election of employees – representatives of the supervisory board. Co-determination Act, 1976)

In order to adhere to legal requirements to gender equality among the employees' representatives, election is void, if one sex represents the majority of the candidates in the respective ballot. (Co-determination Act, 1976)

In companies to which the Law on One-Third Employee Representation in the Supervisory Board applies (i.e. the companies with more than 500 employees except those working in the coal and steel industry), the representatives of employees on the supervisory board are elected by the majority voting in secret ballot. All employees over 18 can vote. The candidates are nominated by the members of the work council and by employees. The lists of candidates must be signed by at least one tenth of those with voting rights or at least 100 persons with voting rights. (Federal Ministry of Labour and Social Affairs, 2019)

As regards German private Limited Liability Companies, the law gives more freedom in terms of director appointment procedure for the articles of association. The appointment is

made by the general meeting of shareholders by the majority vote, provided that each euro of the share has one vote. (Act on Limited Liability Companies, 1892)

UK

When it comes to appointment of directors it is the same situation with the UK Companies Act, as with the issue of board composition – the Act sets a general framework, giving the freedom to establish the whole procedure in the articles of association. (Companies Act, 2006)

Model Articles of Association provide for two ways of appointment of directors for private and public companies: 1) by ordinary resolution (a resolution of members or a class of members, that is passed by simple majority (Companies Act, 2006); 2) by decision of the directors. Usually, the appointment takes place by an ordinary resolution (the absolute majority) of the general meeting, however, it may be as well entrusted to a certain shareholders or even creditors. (Davies, 2013) Whenever the vacancy of director occurs between the annual general meeting of the shareholders, the board is allowed to fill them in themselves. (Companies Act, 2006) It is very usual situation, when shareholders give directors the authority to appoint board. In cases when there is only one director, it can be given the authority to increase the number of directors to the minimum required by statute or by the articles, or to constitute a quorum. (Mortimore, 2017) However, their power is limited with the articles of association and other company policies/codes of conduct, that the company can adopt. E.g., if the members can only appoint persons recommended by the board, this recommendation must be given by a properly constituted board meeting. It will not be sufficient that a majority of the board are present at the general meeting and assent to the appointment then. Members must also comply with any contractual or third party rights limiting their powers of appointment. (Mortimore, 2017)

In rare cases UK companies in their articles of associations can as well authorize the third parties with the right to appoint directors. (Mortimore, 2017) However, at the same time, according to Company Act 2006, Articles of Associations can bind only the company and its members. (Mortimore, 2017) In order to realize the right to appoint directors, the third party must have a separate contractual undertaking with the company. (Mortimore, 2017) At the same time, even if there is such an agreement on the appointment and/ or removal of directors

by the third parties, the shareholders have a statutory right to remove a director by ordinary resolution in accordance with UK Company Act. (Companies Act, 2006)

In general, for private and public companies in the UK the procedure of appointment is more or less the same with some discrepancies mostly in terms of rotation and appointment of alternates. Under general rule, each director of a public company must be appointed by separate resolution, unless there is the unanimous agreement of the general meeting and any resolution, adopted in contravention with this requirement is void. (Mortimore, 2017) Model Articles of Associations require all director of public companies to retire on the annual general meeting, however they can be specifically reappointed. As well model articles require all directors that were not reappointed during two last general meetings to retire. . (Mortimore, 2017) It means, that the director can be reappointed at least every three years.

For the public listed companies there are additional rules, set out in the Corporate Governance Code. Corporate Governance Code stresses that the procedure of appointment must be transparent, and outlines the importance of the maintenance of effective succession plan for board and senior management.

The succession plan should promote diversity of gender, social and ethnic background, as well as personal qualities and professional qualifications. (UK Corporate Governance Code, 2018) Corporate Governance Code requires to establish a nomination committee to coordinate the procedure, prepare description of the role, recommend the candidates on the board, oversee the process of succession. The majority of the nomination committee must consist of independent directors. The resolutions on election of directors must be accompanies by documents, issued by the board, explaining, why each particular candidate should be appointed or stay on the position of director, describing their contribution to company's performance. In order to prepare those documents, the annual board evaluation procedure is necessary. The work of directors and chairman individually, as well as performance of committees should be evaluated, and the Corporate Governance Code recommends considering the possibility of external evaluation. (UK Corporate Governance Code, 2018)

Lithuania

Lithuanian Law on Limited Companies states that election and removal of board members is to be regulated by the articles of association. Board members are elected by the general meeting. (Law of Republic of Lithuania On Limited Companies, 2000) During elections

of the members of the supervisory board, each shareholder has the amount of votes equal to product of the number of shares owned by him and the number of members of the supervisory board to be elected. The shareholder distributes these votes at his discretion – for one or several candidates. Candidates with more votes are elected. If there are more candidates with equal votes than there are vacancies in the supervisory board, the voting is repeated, and during that repeated voting the shareholder can elect only one of the candidates with an even number of votes. (Law of Republic of Lithuania On Limited Companies, 2000) To give more understanding as regards to voting, it should be kept in mind that according to the Law on Limited Companies of Lithuania, if all the company's voting shares have the same nominal value, each share carries one vote at the general meeting of shareholders. If the voting shares have different nominal values, then one share of the lowest nominal value entitles its owner to one vote, and the number of votes granted to other shares is equal to their nominal value divided by the lowest nominal value of the share. (Law of Republic of Lithuania On Limited Companies, 2000)

The supervisory board is elected for not longer than four years. The revocation of the members of supervisory board is possible before expiration of its' term of office. If a member of supervisory board resigns and at the same time the shareholders with 1/10 vote object against its' change, the entire supervisory board looses its' powers Should the individual members of supervisory board be elected instead of those, who resigned, the duration of their powers is the same as of the entire board. (Law of Republic of Lithuania On Limited Companies, 2000)

The similar procedure applies to the election of executive board, where the supervisory board is not established in the company. In cases, where there is a supervisory board in the company, it elects the executive board. (Law of Republic of Lithuania On Limited Companies, 2000)

The Corporate Governance Code recommends to have nomination committee, carrying out functions of selection of candidates to supervisory and management bodies and recommending them for approval. The nomination committee should conduct evaluation of the balance of skills, knowledge and experience in the executive board members, prepare a description of the functions and capabilities required to assume a particular position and assess the time commitment expected. Nomination committee must assess, on a regular basis, the

structure, size and composition of the supervisory and management bodies as well as the skills, knowledge and activity of its members, and provide the collegial body with recommendations on how the required changes should be sought. Succession planning is one more matter, that Corporate Governance Code recommends to the nomination committee to pay attention to. (Corporate Governance Code for the companies listed, 2019)

Sub-Chapter 2.2. Comparative analysis of the procedures board appointment in the UK, Lithuania and Germany

In this sub-chapter, we would like to give our comparative analysis of the procedures of board appointment in the three researched countries, based on the findings, made in sub-chapter 2.1.

When comparing the procedures of board appointment, first that we understand, is that the processes are subject to management models that are inherent for every country. Each of the analyzed jurisdictions' procedures have own advantages.

The term of office of directors varies based on the country. In Germany and Lithuania it is not more than five and four years respectively, while in the UK – maximum three years for private companies and in public companies directors are required to retire on every annual general meeting with the possibility to be reappointed for not more than twice in a row and are subject to evaluation each year.

One more significant provision, that requires UK public listed companies to elect directors separate resolution each. In our understanding, this norm is aimed to contribute to better assessment of qualities of each particular prospective board member. In our opinion, the UKs approach is more flexible, frequent rotation together with annual evaluation allows to effectively identify and quickly react on directors' low performance. On the other hand, German and Lithuanian approach's advantage is in giving board enough time on office to complete middle and long-term project or strategy. The yearly evaluation of boards' performance even though not provided by laws or corporate governance codes, would be appropriate to specify in articles of association.

Recommendation to have nomination committees are present in all three jurisdictions. In our opinion, the most transparent and impartial nomination is in the UK listed companies, due to external evaluation of the Chairman and because independent directors are to compose the nomination committee. We can say that in German companies with board employee representation, process of nomination remarkable by engaging the largest possible number of persons concerned, (e.g. all categories of employees, including those on the vocational trainings). We believe, that for Lithuanian and UK companies with a large amount of employees, seeking more transparent nomination process, that takes into account the interests

of not only shareholders, would be a good option to involve have on the nomination committees not only the shareholders representatives, but at least one person, representing employees. E.g., in the UK this function can be entrusted with the someone among independent directors. The function of an employee representative can, but not necessarily be limited in comparison with those nomination committee members, that are specified in the Corporate Governance Codes.

Speaking of voting procedure, each jurisdiction has its' own peculiarities, e.g., for German companies it is possible to entrust the election of 1/3 of supervisory board to specific group of shareholders and in the UK in particular cases even third parties can be allowed to elect board members. However, the most advantageous from the point of view of protection of minority shareholders is the one, provided by Lithuanian legislation. Lithuanian companies the procedure of so-called cumulative voting. It means, that the shareholders during elections of the board, are given the right to distribute votes on their own discretion, including by giving more than one vote to a particular candidate. Such a provision allows the shareholders with less votes to still influence the elections results by accumulating more votes for the particular candidate and increase his / her chances to be on board. The advantages of such a provision will be in more details discussed in the next subchapter when we move to minority shareholders protection.

To summarize the comparison, we believe, that each of the jurisdictions has its' own strengths. The main advantage of the procedure of board appointment in the UK, is transparency and meticulous scrutiny regarding qualities of each particular candidate. German's jurisdiction main advantage is protection of employees' interests and in Lithuanian companies due to cumulative voting the minority shareholders' interests are effectively and better protected during the board elections.

Sub-chapter 2.3. Minority-shareholder and stake-holder rights in the context of appointment of board

Previously we mentioned two theories of purpose of the firm – shareholder primacy and stakeholder theory. Based on shareholder primacy theory, the primary responsibility of the company profits of its' shareholders and social factors which sacrifice shareholder wealth should not be taken into account. (Luca, Carli,2017) The stakeholder theory is about companies paying more attention to its' impact on environment and society. (Manning *et al.*, 2017)

If we analyze the problems, arising from board appointment, we see affected persons from the point of view of each theory – shareholders and employees. Board election is one of the aspects of a conflict between majority and minority shareholders, where the latter often have limited influence on appointment of company management and as a result – on board decisions. Majority shareholders can expropriate resources from minority ones, including by their capacity to control the board appointment. Minority board representation can ensure minority interests are protected and considered in the management decision process. (Yu-Hsin *et al.,* 2017)

Principle of shareholder equality is one of the fundamental in corporate governance. Though it neither means that each shareholder have equal powers, nor that the quantitative differences between shareholdings must be even. (Pönkä, 2016, p.1) It means that all shares of the company must be treated equally, unless otherwise provided by articles of associations or law. (Pönkä, 2016, p.1)

Thus, there can be no total equality among shareholders and it's a normal situation when some shareholders with larger amount of equity have more influence on company decisions. These principles require an adequate consideration of the minority shareholders' interests.

The first problem can arise when it comes to the issuing of so-called "golden shares"– the shares, sold to the state or a public body, granting among other things, the right to appoint additional directors. In this respect the EU law requires norms allowing golden shares not to restrict the free movement of capital. (Luca, Carli,2017) E.g., in a case EDP – Energias de Portugal (C-543/08) the EUCJ decided that the right of the Portuguese State to appoint a director and several other rights granted by shares in the company, are against the principle of

free movement of capital. (European Commission v. Portuguese Republic, 2010) The similar case was in Germany – EUCJ case C-112/05 *Commission v Germany* (known as Volkswagen case) about golden shares of the company Volkswagen (20% ownership), belonging to State of Lower Saxony. The special law that covered exclusively the automobile company Volkswagen created regime that benefited the State of Lower Saxony by limiting the voting rights for all shareholders to 20% of the total share capital, and at the same time increasing the majority required for approval of resolutions by general meeting from 75% to 80%. Additionally, *the Law allowed Lower Saxony to appoint two directors to the company's supervisory board for as long as it retains any shares in the company, thus granting the authorities with special power to appoint directors.* The Commission recognized such provisions of the law as violating Article 63* of the Treaty on Functioning of the European Union (*Art. 63 prohibits the barriers to free movement of capitals). The Court confirmed that presence in the law of all three provisions – increase of the majority for approval of resolutions of the general meeting, limiting voting rights and allowing *Lower Saxony to appoint two directors to the company's supervisory board* constituted the violation of Art. 63 of the TFEU and to fix the issue, Germany had to amend the law and retain only one from the three provisions. (Free movement of capital, 2014)

If talking generally about minority shareholders rights during board elections, two ways protection can be distinguished – cumulative voting and shareholder agreement.

In cumulative voting each share gives the shareholder to as many votes directors to be elected. A shareholder may cast all votes for one or more candidates. Cumulative voting makes it possible for minority shareholders to elect board members even if the majority of shareholders are against their election. In other words, to make the elections of some board members more likely, the minority shareholders accumulate their votes and give them for some number of directors – fewer than the total number to be elected. (Bhagat, Brickley, 1984, p.339) Even though cumulative voting is not the right of only minority shareholders we can see that it has positive effect specifically on minority shareholders' right to appoint board members. (Bhagat, Brickley, 1984, p.339) Several leading corporate governance indexes identify cumulative voting as a measure that better protects outside investors and consider it to be a sign of "good" corporate governance. (Yu-Hsin et al., 2017)

In Lithuania cumulative voting is provided by the Law "On Limited Companies" for the election of supervisory board. As mentioned earlier, the Law states that when electing the supervisory board, each shareholder has the amount of votes as granted by shares he owns multiplied by the number of members of the supervisory board to be elected. The shareholder is allowed to distribute the votes at his / her own discretion giving them for one or several candidates. Should after such a voting be more candidates with equal amount of votes than there are vacancies in the supervisory board, another vote is held, in which each shareholder can vote for only one of the candidates with an even number of votes. (Law of Republic of Lithuania On Limited Companies, 2000)

In Germany the cumulative voting is not allowed, (Germany Summary of Current Shareowner Rights, 2013) as well as in the UK. (Companies Act, 2006)

Laws of these countries allow another effective way of protection of minority shareholders – shareholders' agreement.

Shareholders' agreement is a binding instrument, concluded between shareholders and sometimes the company, establishing additional rights and obligations, not provided by law and articles of association. The reason for this instrument being popular is its' higher level of confidentiality, as unlike articles of associations, it is not required to be registered at company registry (like in UK), flexibility, as it is easier to change, then the articles association and easier to enforce the right, envisaged in such an agreement. (Seth, 2020, p.45)

In the UK the shareholders agreements are common due to very general provisions of Company Act. Issues of director appointment, board composition and other procedural matters can be specified in the shareholder agreement. (Seth, 2020, p. 48)In UK companies the shareholder agreement could protect the minority rights by either allowing a minority shareholder to appoint and maintain in office the majority (or any amount) of directors or giving them the weighted voting rights. (Owen, Manches, 2018, p.7)

In Germany shareholders agreement may cover issues of board composition as well as minority shareholders' protection, e.g. by granting minority shareholders rights to nominate directors, allow the shareholder personally to be a director of the company without a right of the other shareholders to remove him / her or by granting a veto power against the appointment of any further director and against any instructions from the other shareholders even if they are owning the majority of voting rights. (Gesell, 2018, p.4)

Civil Code of Lithuania allows shareholders to conclude voting agreements, for joint voting at the meeting of participants of legal entity, provided that such agreement is invalid in cases of vote based on instruction of the governing body of the company; or for all proposals of the governing body, or based on the instructions to refrain from voting for reward. (Civil Code of the Republic of Lithuania, 2000)

In our opinion, both cumulative voting and shareholder agreement are effective tools to solve the issue of minority shareholders rights protection and Lithuania, having both these instruments implemented is more advantageous among our researched jurisdictions.

We would like to outline one more problem of board appointment procedure typical for German companies with employee representatives on board and which is potentially possible for other jurisdictions, that implement employee-board-level representation. It relates to territorial applicability of co-determination, that is an important matter for large international companies.

Co-determination legislation is first of all relevant to the companies with the large number of employees, which most often are international companies with main office in Germany and production capacities and subsidiaries abroad. German codetermination laws cannot be applicable outside German borders. Thus, it leads to situation, hen employees of foreign subsidiaries, located in countries without employee board level participation, cannot execute the right to board representation. Usually, foreign employees are as much affected by the decisions of the supervisory boards as those, working in the territory of Germany. Examples of such companies are Deutsche Bank, Siemens or Volkswagen, having more workforce abroad than within Germany. Some scholars even consider such a situation as a discrimination and violation of the treaties on the European Union. To fix this issue and overcome discrimination between employees, a number of German companies have even changed their organizational form and incorporated as a European Companies (SE). The reason is that Statutes of SE are more flexible in this respect and allow representatives of employees and the management of the company to agree on a participation in the election process of employees working outside of Germany. (Sandrock, 2015, p. 137)

Another problem of the German co-determination is rather minor, so we will just quickly stop on it. The matter relates to high cost of election for companies with a large number of employees (e.g. more than ten thousand). The possible solution is to elected employee

representatives indirectly in a two-stages process. The individual employees vote for members of electoral colleges which then, in their turn, elect the delegates. No wonder that for the organization of such procedures much money has to be disbursed. (Sandrock, 2015, p.138)

Independent directors are present in the corporate legislation of all three analysed countries – Germany, Lithuania and UK. We understand, that due to high level pf impartiality of independent directors, their presence on the board strengthens the board and has positive effect on the stakeholder rights, particularly – employees.

A study on role and effectiveness of non-executive directors was conducted in the UK in 2003, during which several recommendations on how to reform the Corporate Governance Code were made. There was one problem identified, that related directly to appointment of independent directors – a high level of informality of the process. According to the authors of the report, almost half of the non-executive directors surveyed for the review were recruited to their role through personal contacts or friendships. As a solution of this problem the report recommends to identify essential and desirable competencies before candidates are approached. (Goldenberg, 2003, p.84) Publishing of advertising of roles is as well considered good practice, often alongside other forms of search. (Higgs, 2003, p. 39)

The next important matter is again connected to shareholders' rights, particularly to voting by institutional investors.

According to studies, in the UK there was an increase of shareholdings by institutional investors and at the same time decrease of private shareholders in public listed companies. (Celik, Isaksson, 2014)

Usually, the ownership parts, belonging to institutional investors are very significant, that provide them with a substantive power to influence the governing of a company. One of the ways for institutional investors to control the company is exercising their power to vote, including at board elections. However, voting on the companies' general meeting is not an obligation, but the right, and since institutional investors have fiduciary obligations towards their customers there is a discussion, whether the vote for them should be an obligation. (Poutianen, 2001, p. 70) In the UK the Cadbury and Hampel Committee agreed that for institutional investors there must be at least an obligation to register voting. (Poutianen, 2001, p. 71)

In our opinion, it is logical and reasonable, when e.g. pension funds or asset managers, who are supposed to protect their investors' interests by being aware of all relevant information and electing management of the company, in which they invest funds.

And the last, but not least issue in respect of board appointment relates to independent directors.

According to study of the UK Corporate Governance Code, made by Briggs, the process of appointing independent directors is highly informal. Almost half of the non-executive directors surveyed for were recruited to their role through personal contacts or friendships. (Higgs, 2003, p. 39) As we can see from the content of the UK Corporate Governance Code, Higgs recommendation: best practice is that essential and desirable competencies are identified before candidates are approached. Advertising of roles is considered good practice, often alongside other forms of search. (Goldenberg, 2003)

As we can see from the analysis of the UK Corporate Governance Code, the reports' recommendations were implemented in terms of requirement for listed companies to establish nomination committees and of succession planning.

To sum up everything stated above, the main issues, arising from the procedure of appointment of boards can be divided into two groups – those, relating to shareholder rights, particularly – minority shareholders, and those, relating to stakeholders rights, in our thesis – we analyze employees in this context.

Lithuania has an effective solution for protection of minority shareholders rights – cumulative voting is prescribed by their legislation, which increases chances of minority shareholders to elect their candidate. Shareholders' agreements are present in all the analyzed jurisdictions and are effective remedies for minority shareholders' protection. Having analyzed the procedures of appointment in Germany and the UK, we don't see the obstacles, that would prevent the possibility of mechanism of cumulative voting in those jurisdictions.

As regards to employees rights protection during appointment, it is understandable, that UK and Lithuania have no such a mechanism of protection, since the absence of institute of codetermination. However, we believe, it doesn't mean that nothing can be changed in this respect. Both, Lithuania and UK have in their legislation the requirement to appoint independent directors for listed public companies Corporate Governance Codes of both countries recommend to have a nomination committees for assistance with the appointment.

In our view, it would be possible and reasonable to include into the representatives of employees on the nomination committees, so they could indirectly influence on appointment to the extent, that either the legislator or the company in its articles of association can determine – e.g. employee representatives can be to both – preparation of qualification requirements and selection of candidates, or only to one of these stages of nomination, or as well to the formulation of succession plan.

CHAPTER 3. ARTIFICIAL INTELLIGENCE AND FORMATION OF CORPORATE BOARD

Sub-chapter 3.1. Role of Artificial Intelligence in Corporate Governance

In sub-chapter 3.1. we will have a closer look at the issue of artificial intelligence and corporate governance. Though there are a lot of technologies that influence company law and corporate governance, in our Thesis we chose to focus on the artificial intelligence, as in our opinion, it is the closest possible technology, that can not only facilitate and improve the corporate governance, but to become directly a participant of the corporate board.

Artificial Intelligence can support different business needs, e.g. as automating business processes, gaining insight through data analysis, and engaging with customers and employees. (Hickman, Petrin,2021)

Nowadays the new role for artificial intelligence is being formulated and anticipated. According to research of the World Economic Forum, by 2025, corporate governance will have be subject to a robotization process to such an extent, that artificial intelligence directors will actually share board seats and, more importantly, decision-making power at the same level as human ones. (Global Agenda Council, 2015)

So artificial intelligence is being viewed as a tool that is capable not only to assist, but to completely replace the human being in the decision-making process, particularly in corporate governance.

There are already cases, where some countries made attempts to grant legal status to the artificial intelligence. E.g., in 2017 during innovative conference Saudi Arabia announced granting citizenship to a robot Sofia (Saudi Arabia grants robot citizenship, 2017); and in 2021 in Japan the resident status was granted to an artificial intelligence Mirai (Artificial Intelligence Has Officially Been Granted, 2017)

Moreover, there were even examples, when companies were trying to involve the artificial intelligence on their boards.

In 2014 the Hong-Kong company Deep Knowledge Venture, a venture fund, that invests in research in the areas of life-science and medicine, appointed an artificial intelligence algorithm called VITAL (Validating Investment Tool for Advancing Life Sciences) as a

member of the board. When making an announcement about that, the company explained, that the AI will be acting as an observer whose advice would, in all likelihood, support the decisions taken by human board members. (Algorithm appointed board director, 2014)

In 2016, the Norwegian IT company TIETO, included an AI-based application called 'Alicia T' in a leadership team. Its role was: to support data-driven decision-making and innovate new data driven ideas with the help of machine intelligence and advanced data analytics. Technically the member is equipped with a conversational interface system so it is possible have a discussion with it and ask questions about anything. In the current shape, the AI is a basic construction that will continue to evolve in both form and data capacity. (Tieto the First Nordic Company to Appoint, 2016)

From these examples we can see, that artificial intelligence, even though appointed as a board member or to the management position, still doesn't act as a completely independent entity that is completely equal to the natural person.

To give deeper understanding on the subject, we would like to better explain what is of artificial intelligence. Artificial intelligence is one of the newest fields in science and is working over building an intelligent entity, which is not a human being. To explain in more details, the artificial intelligence possesses the characteristics that are human and rational. It is supposed to think and act as a human being, which means having an automation of activities, that are normally associated with human thinking, doing things, that require intelligence, when performed by people, as well as to think, i.e. perceive, reason and act and demonstrate the intelligent behavior. The features, that must have the machine to possess the quality of intelligence, as defined by Alan Turing (the Turing test) are the following:

- Natural language processing, i.e. to be able to communicate successfully in English;
- Knowledge representation, i.e. store what it knows or hears;
- Automated reasoning, i.e. use the stored information to answer questions and to draw new conclusions;
- Machine learning, i.e. to adapt to new circumstances and detect and extrapolate patterns. (Russell, Norvig, 2016)

The last characteristic – learning, is a crucial for the understanding of possibility of AI's involvement in boards' activity. Unlike the common computer program, that is developed to fulfil a known set of instructions, the artificial intelligences' algorithms are created in such a

way, that it may continuously and autonomously adapt, refine, and alter its responses and decisions, i.e. – learn. (Mantas, 2019)

The EU Commission defined artificial intelligence as encompassing all those 'systems that display intelligent behavior by analyzing their environment and taking actions – with some degree of autonomy – to achieve specific goals'. Additionally, 'once they perform well, they can help improve and automate decision-making in the same domain'. (Communication from the Commission, 2018)

The idea of application of artificial intelligence in law, particularly in company law and corporate governance is not new and recently, the European Commission published a study on the Study on the relevance and impact of artificial intelligence for company law and corporate governance. The purpose of the study was to contribute to a better understanding of the effects of the use of artificial intelligence by companies, shareholders, creditors, public authorities or other persons in order to perform certain company law and corporate governance tasks. (Directorate-General for Justice and Consumers)

According to the study, with regard to corporate governance, the opportunities, that artificial intelligence gives are supporting directors in fulfilling their fiduciary duties by helping corporate boards in processing and analysis of data more effectively, choosing the most significant information from a large amount of data, and avoiding groupthink and other human biases in assessing situations and making decisions. On the other hand, artificial intelligence can entail potential risks related to compliance with the fiduciary duties of directors in case of its' misuse. Moreover, it can also lead to typical human biases when artificial intelligence is trained on past data with inherent occurrences of unfair treatment and other unethical or undesired examples. The analysis of legislation of the EU Members and some third countries, including the UK, demonstrated that the use of artificial intelligence is neither prohibited, nor its' regulation is explicitly established and is used as support tools. If talking directly about our topic, research on AI use in company law and corporate governance has not found any cases, for example, where AI machines were appointed members of corporate bodies. The study identified two areas, where the developments of artificial intelligence is the most probable and relevant:

- Directors' duties and liability arising either from the use or non-use of artificial intelligence in the boardroom, particularly in respect of artificial intelligence related tools, used by directors in their activities and within the corporate decision-making processes;
- Availability of relevant artificial intelligence -related skills and expertise in the board of directors as the use of tools at the board level increases. (Directorate-General for Justice and Consumers)

In 2017 European Commission proposed general principles on robotics and artificial intelligence, emphasizing the AI's strategic importance in a communication on Digital Single Market Strategy; and the European Council invited the Commission to put forward a European AI approach. In April and December 2018, the European Commission released two documents outlining a broader AI strategy: A communication on 'Artifcial Intelligence for Europe' and a 'Coordinated Plan on Artifcial Intelligence'. Most recently, the Commission also released a white paper on AI as well as a report on the safety and liability implications of AI and other technologies. (Hickman, Petrin, 2021) The Ethic Guidelines for trustworthy artificial intelligence was as well elaborated by the EU Commission and provides that for the safe use of artificial intelligence in different spheres it must be:

- Lawful. Which means that artificial intelligence must be in compliance with all applicable laws and regulations of the respective country; (Ethics Guidelines for Trustworthy AI, 2019)
- Ethical. Which means, that it must adhere to ethical principles; (Ethics Guidelines for Trustworthy AI, 2019)
- Robust, both from a technical and social perspective, in order to avoid unintended adverse impacts (Ethics Guidelines for Trustworthy AI, 2019)

As we can see, among the relevant areas, identified by the Commission, the use of artificial intelligence by the board during decision-making process is the closest to our research topics matters. The study didn't identify neither the issue of appointment of artificial intelligence machine as a board member, nor the direct usage of artificial intelligence in the election of directors.

However, in the doctrine there are a number discussion on the appointment of artificial intelligence as a board member, as well as leaving decision making in corporations to AI and the possible implications of this practice and making decisions by referring to the results of

AI's analysis of the data and utilizing AI to choose directors. AI is used in businesses to accelerate the decision-making process in order to keep up with the pace of commercial life. (Eroğlu, Kaya, 2022)

Christopher Bruner in his article "Distributed Ledgers, Artificial Intelligence and the Purpose of the Corporation", similarly to the EU Commissions' study, agrees that artificial intelligence can make the corporate decision-making process quicker and more efficient. He points out, that currently there is a trend to seek involvement of new technologies in legal spheres as something more effective than human-being activities. However, the author expresses his scepticism on this matter. (Bruner, 2020) Bruner considers the matter in the context of purpose of corporation in the context of publicly traded companies, that is usually typically comes down to the extent, to which governance power shareholders should have and the degree to which boards of directors should be required to focus on shareholders' interests. (Bruner, 2020) Bruner states that companies governed solely and directly by algorithms would prove workable, or attractive to the general investing public, anytime soon, however the impact of new technologies, particularly, artificial intelligence is inevitable, and it will be important to find the perfect balance of traditional corporate governance actors and involvement of those technologies. Moving closer to artificial intelligence involvement in the board of directors, it should be noted that traditionally the board had two major functions – monitoring corporate performance and formulating corporate strategy. The decision-making in these functions can be automated with the use of artificial intelligence. In terms of how it can be engaged with the decision-making artificial intelligences' functions may be divided into such groups:

- Assistance to human decision-makers by performing limited tasks; (Bruner, 2020, p. 443)
- Advising by giving information that would otherwise be unavailable or more difficult and time consuming to obtain; (Bruner, 2020, p. 443)
- Being completely autonomous, which means that the decision is made by the machine itself. (Bruner, 2020, p. 443)

Bruner writes about different views of prospective role of the artificial intelligence in corporate governance – some lawyers and scholars thins that it is inevitable that in the future some functions of board can be replaced by technological solutions. Others are not sure of

that and raises concerns, that replacement of human decision-making by machine raises legal and technical problems. One of the major legal matters is about who should be liable when the machines' algorithm fails and leads to a harmful decision. There are other concerns, such as consumer data protection and impossibility to model truly novel events and circumstances. There is as well an opinion, that use of artificial intelligence can be particularly harmful and used by companies in unlawful purposes. The author of the article himself adheres to the golden mean and agrees that even though the artificial intelligence can be used widely in corporate governance, there are functions, that it simply is incapable to perform, such as complex decision-making processes, while administrative and monitoring functions will be done by the AI. (Bruner, 2020)

In another article "Intelligent Approaches to Al" the author analyses the possibility of involvement of artificial intelligence on the board for solving ethical issues, for improving financial management and audit. The author identifies a number of problems, that can emerge from the use of artificial intelligence, e.g. errors and bias, based on the data used to train them or the individuals who trained them, issues of data protection, considering that AI in the process of learning and afterwards will have to work with data, including personal data. (Mantas, 2019)

Sub-chapter 3.2. Perspectives of Appointment an Artificial Intelligence as a Member of Corporate Board

Previously we mentioned the attempts of companies to delegate the role of directors to the artificial intelligence machines. In this sub-chapter we will discuss whether this question in more details.

Talking about the advantages of artificial intelligence acting as a director the scholars define: 1) absence of conflict of interest, as artificial intelligence does not have any personal interest, and will take the decisions, that will benefit the company in the first place; 2) advantages in terms of work productivity; 3) reduction of litigation by early detection and mitigating the issues via specific algorithms that take the facts of the case as inputs, apply themselves the relevant precedents and applicable laws, predict which direction the case may go, and provide suggestions; 4) ability to make decisions without the influence of other persons. (Rudrakanthwar, 2022)

In the Article "AI and the Board Within Italian Corporate Law: Preliminary Notes" (Mosco, 2020), the author professor of corporate law Gian Mosco, asks, among other questions, whether the artificial intelligence can be appointed as a board member, can the board delegate specific tasks to artificial intelligence and what are the consequences of it. The author of the article states, that, since boards' function nowadays consists mainly in supervising executives, on which directors spent most of their time, technology could free directors from such tasks, allowing them to devote more time to business matters. AI can contribute to this process in several ways, whether by increasing shareholder activism, helping director face the challenges within increasingly complex organizations, or by helping to make decisions access to assessments without influence of executives and major shareholders. The article states on the impossibility to appoint artificial intelligence on the board in Italy, since Italian law requires a director of the company to be a natural person or a legal person, that shall fulfil its' functions through the natural person. Another way to involve artificial intelligence on the board can be the right of directors to delegate their power to another entity, however Italian law doesn't permit such a delegation. The matter of liability is as well mentioned in the article in the context that under Italian law the directors are civilly liable towards the company, shareholders and third persons, provided that liability is not common

for all of the directors, but depends on each directors' actions, and thus there is a question of the possibility of the liability for artificial intelligence, should it be appointed as director and by its' decisions cause damages. (Mosco, 2020)

Similarly, we can analyze from the laws of the countries, we are researching in this Thesis.

If talking about Lithuanian companies, Lithuanian law is quite straightforward in this respect and requires only natural persons to be directors, which makes it practically impossible to appoint as a director some other entity, including artificial intelligence.

German law on Limited Liability Companies, that requires having at least one director, provided that only a natural person can hold that position, as well as based on the Stock Corporation Act, only a natural person can be a member of the management board, or of the supervisory board. (Stock-Corporation Act, 1965)

When it comes to the UK, the Companies Act requires that private companies must have at least one and public companies – at least two directors, provided that at least one of the directors must be a natural person. (Companies Act, 2006)

From the analysis made in the previous chapters we remember, that UK allows legal entities to be board members, however, provided that the individual will be acting on behalf of legal entity director. Neither of the analyzed countries have any regulation, that would allow to admit that the artificial intelligence could be appointed as a board member. In our opinion, it would be safe to say, that for now the involvement of AI on the board in Lithuania, Germany and the UK is possible only as an auxiliary tool, that would help with some parts of directors work and under the supervision of human board members or officers.

The examples of the companies, that have already implemented artificial intelligence into their corporate governance systems illustrate, that in fact it is not a full-fledged board-member, but more an advisory instrument, that complement the board.

In case of our researched jurisdiction the matter is that the artificial intelligence do not have capacity under civil law. Much of this as well comes the impossibility of artificial intelligence to have one of the key characteristics, important for of directors' role, such as directors' liability. E.g., according to German Stock-Corporations Act, the members of the management board and supervisory board, who failed to exercise duties of skill and care are liable to compensate the company for any damage resulting from their actions. In order to be

able to carry out liability, the entity (in our case artificial intelligence) must according to the law be considered as an independent person with legal capacity.

The matter of liability and legal capacity of artificial intelligence is, however, being decided at the moment. Committee on Legal Affairs of the European Parliament prepared the document called "Recommendations to the Commission on Civil Law Rules on Robotics" (Report with recommendations, 2017) with justification and proposals of how to regulate the electronic personality and robot rights, giving definition of artificial intelligence-based robots' rights and responsibilities. The recommendations mention the current trend leans towards developing smart and autonomous machines, with the capacity to be trained and make decisions independently and to perform activities which used to be typically and exclusively human as well as development of certain autonomous and cognitive features, and as a result to make harmful actions, that require elaboration of norms on civil liability. At the same time it is recognized that when there is some harmful effect caused by technologies, the person responsible is found in the human, that is anyway present behind the operation of the technology, including the artificial intelligence. (Report with recommendations, 2017)

For our topic of research, it means that the legal framework necessary for artificial intelligence to be appointed as a board member is being considered and elaborated at the EU level, however in the near future there is unlikely to appear. Even in case if some regime, granting legal capacity appears, it is most likely to be some special status, that is not equal to the one, that has the natural person human being. In our view, the most probable scenario is when the artificial intelligence will be appointed and act on the board as an individual, and the liability for damages will be carried out by the legal entity or natural person, whoever is responsible for technical support or however is agreed with the shareholders.

CONCLUSIONS

The tasks of the present Master Thesis "Formation of Corporate Boards: Comparative Analysis" were set as follows: 1) to analyze the legal framework of formation of corporate governance bodies of three countries – UK, Germany and Lithuania and to do the comparative analysis of legal regimes of formation of corporate boards in those three countries and identify their advantages and disadvantages; 2) to analyze the issue of protection of stakeholders, particularly employees and other concerned persons in the course of formation of corporate board; 3) to identify the place and role of artificial intelligence in the formation of corporate board.

As a result of the above-mentioned comparative analysis and in terms of the tasks set for this Master Thesis, we came to the following conclusions.

1) We have compared the legal framework, governing composition and procedure of appointment of the corporate boards. Following the comparison, we understand, that even though the analyzed jurisdictions have different the management systems, there are several similarities in their approaches to board composition. All three countries recognize the importance of diversity in terms of qualification, experience, gender, social status, etc. among the board members and require to have independent directors, who provide the unbiased objective view in managing the company and play an participate in the nomination of candidates. The researched countries give more freedom to decide on board composition to private and non-listed companies, while more requirements are set for public companies and those, allowed to trade on stock-exchanges, which is done to ensure protection of the investors, who in case of public companies, as a rule have less understanding of company's business and overall situation, then the founders of private companies. The most advantageous jurisdiction in terms of stake-holder rights protection and social responsibility is Germany due to institute of co-determination, that requires companies with big numbers of employees and/or working in certain industries to appoint the employee representatives on the board and to have a definite percentage of women on boards in certain cases. The advantage of UK board formation are minimum requirements to corporate governance model, and in case of listed companies, thorough attention to evaluation of directors, short period of rotation, however, with the possibility to be reappointed, which on the one hand helps to swiftly react on the situation

with performance and the need to change company's strategy and policies. In terms of procedure of voting, the most advantageous is Lithuania, allowing the cumulative voting, which can be the means of protection of interests of minority shareholders.

2) Having analyzed the relevant legal framework and doctrine in respect of our researched countries, we came to conclusion, that the main problems in terms of our research topic are protection of minority shareholders interests and protection of stakeholders interests, particularly employees, and the matter of ensuring diversity on the board. Doctrine identifies as well smaller-scale matters, though, important matters, such as voting of institutional investors on the general meetings, high costs of elections of employee representatives in German companies with high numbers of employees and a certain level of informality in the course of elections of independent directors in the UK. Returning to the major issues, there are two instruments to protect minority shareholders interests: procedure of cumulative voting and shareholders agreements. Lithuania is the most beneficial in this respect, as its' legislation provides both – cumulative voting and voting agreements. Cumulative voting enables shareholders to cumulate votes and on its' own discretion distribute among candidates, with the right to give any amount of votes for some certain candidate. Even though this right is given to all shareholders, it can benefit the minority shareholders in particular, increasing their chances to elect the desirable candidate by accumulating the necessary amount of votes. In the shareholders' agreements, among other things, shareholders can agree on giving particular rights to minority shareholders during the directors' elections, e.g. guarantee the appointment by them certain number of directors, etc. Laws of UK and Germany allow shareholders agreements however the cumulative voting procedure is unavailable option in these countries. Implementation of cumulative voting in company law of these countries would strengthen the position of minority shareholders. As regards, diversity on board, in this Master Thesis we focused on gender equality matters. Among analyzed jurisdictions only German laws establish compulsory percentages of female board members, however, this norm is relevant not for all companies by default, but for those, covered by co-determination legislation. Doctrine finds positive causal connection between the gender equality on the board and increase of firms' performance. In our opinion, the best approach was chosen in UK in the FCA's recommendations for listed companies, setting the target percentage of women on board and requiring the company to explain in the financial reporting the reason why the target was not

met. We believe, that such a reporting mechanism helps to do the system changes by both – company and the authorities. Speaking of protection of employee rights, there are two points in terms of our researched jurisdictions. Firstly, in Germany, where the employee board-level participation is present in the companies subject to co-determination legislation, there are still the problem related to cross-border aspect. Where a large international company has e.g, production capacity in the country without board-level employee representation, employees, working in that country loose their opportunity to participate in board elections, even though their rights are affected by the decision of the management of the company, located in Germany. Some companies resolved this problem by registration as a European Company (SE). Other possible ways to solve the matter at least for Germany and Lithuania could be adoption relevant legal norms, governing employee board-level representation on the EU level or as well the bilateral agreements could be concluded between states, regulating the matter for such groups of companies.

3) In this Master Thesis we chose to discuss the role of artificial intelligence in corporate governance and its possibility to be appointed as member of the board. At the moment appointment of artificial intelligence as a board member in the UK, German or Lithuanian companies is impossible due to absence of legal framework for that. In the world there are precedents, when artificial intelligence was given a place in the boardroom, however a closer look on those examples revealed that the artificial intelligence was not an independent board member, equal to human ones, but performed the auxiliary function, assisting the board in their work. In order for the artificial intelligence to be director, it must have a legal capacity, be able to be liable for possible damages, that it can cause. At the moment this is impossible neither the laws of the researched countries. At the EU level, the legal framework necessary for artificial intelligence to be appointed as a board member is being considered and elaborated, however in the near future there is unlikely to appear. Should the regime, granting legal capacity to artificial intelligence appear, it will most likely be defined as *sui generis* entity, not completely equal in rights and obligations with the natural person. In our view, the most probable scenario is when the artificial intelligence will be appointed and act on the board as an individual, and the liability for damages will be carried out by the legal entity or natural person, whoever is responsible for technical support or however is agreed with the shareholders. In our opinion, for now the best and at the same time the only possible approach

regarding the role of artificial intelligence is for it to remain used by the companies, that wish to do so, however not as the board member, but to perform other functions, helping the board in decision-making process.

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SUMMARY

Formation of Corporate Boards: Comparative Analysis

Nadiia Franko

The aim of the Master Thesis is to make the comparative analysis of the composition and procedure of appointment of boards of directors in three countries – UK, Germany and Lithuania, to determine and discuss possible problems, emerging in the course of appointment of the board with the focus on social responsibility and stakeholders theory of the purpose of the firm and to determine the place, that artificial intelligence can have in the formation of corporate boards of the mentioned countries.

The objective of the Thesis is legal framework, governing the composition and procedure of appointment of board of directors in three jurisdictions – UK, Germany and Lithuania and the role that artificial intelligence can have in the course of formation of corporate boards of those countries.

As a result of the work we analyzed the legal framework of formation of corporate governance bodies of three countries – UK, Germany and Lithuania and did the comparative analysis of legal regimes of formation of corporate boards in those three countries. In the Master Thesis we identified advantages and disadvantages of those jurisdictions, analyzed the issue of protection of stakeholders, particularly employees and other concerned persons in the course of formation of corporate board, considered the problem of protection of minority shareholders and the possibilities of its' solutioni and the issue of gender equality on the board. The last, but not least part of our work was to identify the place and role of artificial intelligence in the formation of corporate board, particularly, the possibility of artificial intelligence being appointed as a board member.