TYPES OF COMPANIES' MANAGEMENT BODIES UNDER LITHUANIAN LAW

Virginijus Bite, Assoc. Prof. Dr.
Gintare Jakuntaviciute, Dr.
Mykolas Romeris University, Lithuania

Abstract

The bankrupts and financial crisis of large-sized companies, which took place in Eastern Asia, USA, Europe and Australia between the middle of XX and beginning of the XXI centuries, stimulated to take a deeper look into the legal status of the members of the companies' management bodies, because one of the main reasons which determined the bankrupts and financial crisis all over the world was bad faith, improper performance of duties and negligence of the members of the companies' management bodies. Unfortunately, neither Lithuanian legal acts, nor case law, nor legal doctrine provide with clear understanding what is and should be attributed to the category of the companies' management bodies. This implies the uncertainty problem regarding the persons to be applied by the liability standard of management body members.

Therefore, the purpose of this study is to determine the types of companies' management bodies under Lithuanian law. This objective will be reached by the analysis of the concept of the management body, presenting the corporate governance systems dominating over the world and identifying the content as well as the nature of management function performed by the management bodies. The research has shown that the management function comprises three functions, i.e. direction, representation and control; therefore, board of directors, supervisory council and the head of a company are deemed to be part of a category of management bodies.

Keywords: Corporate Governance, Management Body, Board, Director, Supervisory Counsel

Introduction

The bankrupts and financial crisis of large-sized companies, which took place in Eastern Asia, USA, Europe and Australia between the middle of XX and beginning of the XXI centuries initiated the reform on the law of companies, which was manifested by the amendments of legislature, its

improvement, especially in the area of the legal status and liability issues of the members of management bodies. At the time, when the world's economy was in the biggest financial crisis since the Great Depression in the USA, the question of legal status and liability of company's management bodies became one of the most relevant, especially taking into considerations that the main reasons of the crisis were named improper governance of companies, evaluation and control of risk, implementation and development of irresponsible borrowing, the impact of the shareholders to the directors to adopt too risky decisions in order to reach bigger incomes by sacrificing long term investments, i.e. stimulating the creation of short term value, and other.

However, valid legal acts regulating specific types of legal persons in Lithuania, considering their number and fluctuation, are not harmonised. Neither in the legal acts, nor in the legal doctrine there is united opinion regarding the definition of the management function; therefore, it is unknown, what is and should be attributed to the category of the management bodies. This implies the uncertainty problem regarding the persons to be applied by the liability standard of management body members. Due to this reason the purpose of this study is to determine the types of companies' management bodies under Lithuanian law. This objective will be reached by the analysis of the concept of the management body, presenting the corporate governance systems dominating over the world and identifying the content as well as the nature of management function performed by the management bodies.

The relevance of this study is also proved by the fact, that the Organization for Economic Co-operation and Development (OECD), after performance of a detailed research on the financial crisis as of 2008, in 2009-2010 as one of the main directions to overcome the crisis distinguished the necessity of the reform of corporate governance of the companies, by clearly defining the legal status of the management bodies, its powers and liability. The same was confirmed in the Green Paper "*The EU corporate governance framework*" issued by the European Commission in 2011, stating that "in each case, it is indispensable to define clearly the roles and the responsibilities of all parties involved in the risk management process: the board, the executive management and all operational staff exercising the risk function". Hence, this study is especially relevant both to the national and international extent, especially at the moment, when the extent of the activities of companies is widen and it includes the territories of few countries.

System of Corporate Governance

Systems of corporate governance[5] differ across various countries around the world. Even within EU States there has not been developed a single system of corporate governance yet. The OECD, when preparing corporate governance principles, also emphasized that there was no single system of corporate governance throughout the world (OECD Principles of Corporate Governance, 2004). Such regulatory differences depend on historical events, distinctions within political and social ideologies (Andenas and Wooldridge, 2009), as well as other national law branches functioning in the same jurisdiction (Antunes *et al.*, 2011).

It is possible to distinguish the following corporate governance systems that can be found in corporate laws of different countries: 1) *one-tier (unitary) system*, characterized by only one management body established within a company (for instance, such system of corporate governance is implemented in England, Ireland, USA, Denmark, Sweden, Spain, Portugal, Belgium, Cyprus, Malta and others); 2) *two-tier (dual) system*, characterized by two separate collegial management bodies established within a company, one of which is responsible for its day-to-day activities (usually composed of executive directors thereof), another – is in charge of implementing supervisory role (composed of non-executive directors) (for instance, such system of corporate governance is used in Germany, Austria, Holland, Poland and others); and 3) *mixed system*, which covers cases where certain state laws, even when granting priority to one system, reserve the choice option regarding another system (for instance, such option is recognized in Lithuania, Finland, Norway, Italy, Luxemburg and others) (Ernst & Young Société d'Avocats, 2009).

There is an opportunity to choose and apply either one-tier or two-tier systems of corporate governance in a majority of EU countries, but there are countries, such as England or Germany, where such option is not provided. If according to the laws of the respective countries the supervisory council may not be established within a company, the supervision function is usually carried out by the shareholders or non-executive directors thereof. But in jurisdictions where a mandatory two-tier system of corporate governance is determined, there does not exist any possibility to transfer the supervision function to any shareholder thereof. However, the requirements of such system usually do not correspond to the needs of family companies[6]

[5] Under the legal doctrine, the companies' management system is additionally called: 1) "*organizational system of company's business activities*" (Greičius, 2007); 2) "*system of management bodies*" (Abramavičius and Mikelėnas, 1999). However, in this study we will use widely known term "*system of corporate governance*" (Baranauskas *et al.*, 2007).

[6] In most countries throughout the world, family business takes over more than 70% of all business activities and makes a significant impact towards the growth of economy or

(Abouzaid, 2008) or single investors, who are themselves concerned, being shareholders of a company, to execute such supervisory role. This system does not also satisfy the interests of corporation group, where the parent company is interested in exercising this supervision function itself. Even though, it can be taken advantage out of establishment of the European Company (SE, fr. *Societas Europaea*), but this form might be also not acceptable due to the large amount of the required authorized share capital.

Although different states establish and apply various systems of corporate governance, but the role of the board[7] therein is usually deemed as crucial. For instance, strong boards of directors within companies are typically involved into the implementation of company's business strategy, ensuring of proper corporate governance, maximization of benefits available for company's shareholders, as well as protection of legitimate interests of any other stakeholders related thereto. However, the boards of directors in developing and emerging market economies, including Lithuania, often fall into one of the following two categories: 1) so called *"rubber stamp" boards*, which typically play only a minor role in the company's management, thus, convening of their meetings and decision making in their nature are more formal procedures, which results that the company is directly governed by the controlling shareholder; or 2) so called *"family boards"*, where members usually are relatives of the controlling shareholder which are appreciated as long-term reliable advisers, who are able to adopt key strategic decisions; such type of a management board can be efficient in defending interest of the respective family controlling such company, although, in many cases these interests may be contradicting to expectations of investors or even long-term goals of a company itself (Robinett, 2003).

In order to disclose the concept of companies' management bodies and system of corporate governance functioning in Lithuania, we will further analyze the following most common models of the corporate governance systems over the world: 1) *Anglo-Saxon*; 2) *Nordic*; and 3) *German*.

establishment of new working places. For instance, in Spain around 75% of all business activities are family business, which makes approx. 75% of its gross national product. As successful examples of family business might be specified such widely known companies as *Salvatore Ferragamo*, *Benetton* and *Fiat Group* in Italy, *L'Oreal*, *LVMH* and *Michelin* in France, *Samsung*, *Hyundai Motor* and *LG Group* in North Korea, *BMW* and *Siemens* in Germany, *Ford Motors Co* and *Walt-Mart Stores* in USA and other (Abouzaid, 2008).

[7] In this case the definition "*board*" includes the board of directors, the supervisory council and the head of a company (author's note: the latter is a separate management body under Lithuanian law).

Anglo-Saxon, Nordic and German Models

Anglo-Saxon Model. In companies of Anglo-Saxon model type, members of management body normally act within one single collegial body – the board of directors and carry out managing, representation and supervisory functions (Davies, 2003). Such board of directors is composed of executive and non-executive directors[8]. Non-executive directors perform both management function (for instance, provision of advises and directions to executive directors regarding the strategy of company's further development and assessment) and also supervisory function (for instance, monitoring whether the company's business activities comply with the legal and ethical standards) (Lederer, 2006), and this supervisory function *inter alia* covers supervision of actions of the company's executive directors (Davies, 2003). Furthermore, duties of the board of directors are divided into two main groups: decision making and supervision (Forlow, 2009). Decision making function determines a duty of directors to adopt decisions that are important for the company's business development, while supervisory function – a duty to monitor, how managers of lower level and employees implement these decisions and duties foreseen by the respective laws.

Nordic Model. In companies of the Nordic model, management body members are also acting within a single collegial body – the board of directors, which is only in charge of implementing the supervisory function. The board of directors is flexible and efficient since only in such case can be ensured independence of the board members from the administration officers in charge of management and representation functions, including the head of a company, who is not considered to be a separate management body.

German Model. The corporate governance system in companies of German model comprises of two management bodies: supervisory council (ger. *Aufsichtsrat),* performing supervisory and at times representation function and board of directors (ger. *Vorstand),* performing direction and representation functions. The board of directors is responsible for execution of the company's day-to-day activities and the supervisory council – for the supervision of the board's actions. Thus, the supervisory council controls the board of directors as well as compliance of actions thereof to the statutory norms, articles of association of the company and respective business strategies that are being implemented (Hopt and Leyens, 2005). Moreover, the supervisory council is entitled to act on behalf of the company against the board of directors, for instant, when initiating legal proceedings for

[8] In UK it is wider used term "*non-executive directors*", and in USA – "*outside directors*". As these are identical definitions based on their content, herein we will use the term "*non-executive directors*".

compensation of incurred losses (Art. 112 of the Law on Companies of the Federal Republic of Germany).

Hence, in companies of Anglo-Saxon model, management body members performing direction, representation and supervisory functions act within a single collegial management body – the board of directors. In companies of Nordic type – at one single collegial management body (the board of directors) are functioning members that are only in charge of supervisory function. The management structure of German model companies comprises the supervisory council performing supervisory and at times representation functions and the board of directors performing representation functions.

Corporate Governance System in Lithuania: Which Model is Being Applied?

There is no exact tradition regarding single structure of a company's management in Lithuania, i.e. which model of corporate governance system should be chosen – Anglo-Saxon, Nordic or German.

Article 2.82(2) of the Civil Code of the Republic of Lithuania (2000) (the "Civil Code") provides that each legal entity shall have sole or collegial management body and general meeting of shareholders, unless incorporation documents or statutory acts that regulate activities thereof stipulate different management structure. Laws establishing separate organizational forms of legal entities may determine that management body and general meeting of shareholders can be the sole management body of such legal entity, for instance, owner and manager of an individual entity can be the same person; if a small partnership does not foresee the sole management body, the general meeting of small partnership members is also considered as a management body thereof (Law on Small Partnership of the Republic of Lithuania, 2012). In such case the general meeting is also given respective competencies assigned to the management body and each member is considered as a member of such management body (Bakanas *et al*., 2002). In reference to stated above, the structure of legal entity's management body can be simple or complex. In Article 18(1) of the Law on Companies of the Republic of Lithuania applicable in the year 1990 was provided that the general meeting of shareholders is the supreme management body of a company. The same provision remained in the wording of this law applicable as of the year 1994 and also in the new wording of this law as of the year 2000. However, as of the year 2004, the general meeting of shareholders is not anymore assigned to the management bodies of a company. The Supreme Court of Lithuania noted that the general meeting of shareholders is still considered to be the supreme body of a company, adopting decisions in respect to composition of management bodies, amendment of incorporation

documents, liquidation of a company and other matters that are not related to company's daily operational affairs and (or) that are not related to any change of entire or significant portion of company's assets (for instance, increase or decrease of a company's share capital) (Resolution adopted in civil case No. 3K-3-329/2009, 2009). However, shareholders are not entitled to give directions to management bodies in any way if these management bodies are granted certain particular competencies (Bakanas *et al*., 2002). Therefore, such management is also called management by ownership (Kiršienė, 2002), resulting in separation of activities of general meeting of shareholders from actions of company's management bodies connected to administration of regular business matters thereof.

According to the Article 19(1) of the currently applicable Law on Companies of the Republic of Lithuania (the "Law on Companies") each company shall have *a general meeting of shareholders* and *a sole management body* – the head of a company. The Article 19(2) of the Law on Companies provides that a company might also have a *collegial supervisory body* – the supervisory council and a *collegial management body* – the board of directors. Thus, in Lithuania there is no statutory obligation to establish collegial management body – such as the board of directors, and the head of a company will be recognized as a separate management body. As previously noted, in either Anglo-Saxon, Nordic and German type companies the head of a company is not considered to be a separate management body, since such head of a company is usually a member of the board of directors (or it can be employee of a company), with whom management or similar agreement is concluded regarding assignment to the company's manager position. While in Lithuania the head of a company is a separate management body, which in the event the board is not established, is entitled to decide on majority of matters that are initially assigned to the competency of the board of directors (Article 37(10) of the Law on Companies). Otherwise, if no supervisory council is established in the company, functions attributed to the competency thereof cannot be assigned or transferred to the other bodies of the company (Article 32(2) of the Law on Companies). Therefore, the current structure of company's bodies does not actually correspond to either one-tier or two-tier corporate governance systems, since the head of a company is distinguished as a separate management body, and in such way the board of directors, being a management body, is deprived of its exclusive authority to represent the company before the third parties and in most cases the board of directors remains only as a supervisory and control body but not as an executive body of a company. Accordingly, it does not comply with the current case practice, where the board of directors has been clearly recognized as a collegial *executive* management body of the company (Resolution adopted in civil case No. 3K-7-124, 2014).

Additionally, this does not also comply to the nature of provision stipulated in Article 2.82(2) of the Civil Code, where it is stated that each legal entity must have the sole *or* collegial management body, allowing to conclude that the legislator did consider sole and collegial management bodies as alternatives and, therefore, functions thereof cannot be separated because just their respective competences might differ, when company's incorporation documents provides for the establishment of both such bodies.

Currently there is a draft Law on the Amendment to the Law on Companies of the Republic of Lithuania submitted to the consideration of the Parliament (Seimas) of the Republic of Lithuania, which provides the following proposals: (1) to impose an obligation solely in respect to public limited liability companies (not including private limited liability companies) regarding a mandatory requirement to form at least one collegial management body – board of directors or supervisory council; and (2) to entitle the companies, where a supervisory council is not formed, to foresee under their articles of association that the board of directors is entitled to conduct the following supervisory functions: (i) to supervise the activities of the head of a company and submit its comments and proposals in respect thereof to the general meeting of shareholders; (ii) to consider whether the head of a company is qualified to remain in this post when the company continues to incur losses; (iii) to submit its proposals to the head of a company regarding revocation of decisions thereof which contradicts to the laws and any other applicable legal acts, articles of association of the company, the respective decisions of the general meeting of shareholders or the board of directors; (iv) to address any other issues assigned within the board of directors powers by the articles of association of the company as well as by the decisions of the general meeting of shareholders thereof regarding the supervision of the company's and its manager's actions (Law on amendments to Articles 19, 20, 24, 25, 30, 31, 33, 34, 35, 37, 44, 54, 59, 60^1, 63, 67, 69, 72 of the Law on Companies, addition with new Article 45^2 and amendment and supplement to the Appendix thereof, 2013). However, these proposals still do not solve the aforementioned problem with regard to ensuring a possibility for all types of companies to have an option to constitute either sole or collegial managing body within its management structure.

In Lithuania it might be distinguished the following four possible alternative corporate governance structures (Kononovič, 2001): 1) *four-tier* (general meeting of shareholders, supervisory council, board of directors and head of a company); 2) *three-tier* with the supervisory council (general meeting of shareholders, supervisory council and head of a company); 3) *three-tier* with the board of directors (general meeting of shareholder, board of directors and head of a company); and 4) *two-tier* (general meeting of

shareholder and head of a company). Since competencies of a supervisory council cannot be assigned to other bodies, then, in theory, Lithuanian corporate governance system moves towards the German model with it clear separation of functions of direction, representation and supervision. However, in practice completely different situation is noticeable, which can be seen in Table 1 below, where models of corporate governance system of three biggest Lithuanian companies listed on a stock exchange are compared.

Table 1. Samples of models of corporate governance system within companies listed on a stock exchange

Name of a company	Management bodies and structure thereof	Model
Private limited liability company Lietuvos energija	✓ General Manager ✓ Board (5 members): • 1 executive director (general manager) • 4 non-executive directors	Anglo-Saxon
Public limited liability company "GRIGIŠKĖS"	✓ Director ✓ Board (5 executive directors, including director, chief financial officer and others) ✓ Supervisory council (5 non-executive directors)	German
Public limited liability company TEO LT	✓ General Manager ✓ Board (6 non-executive directors, performing supervisory and control functions)	Nordic

In Lithuania the head of a company is not restricted to be appointed as a board member. In such case the board is composed of executive and non-executive directors (Anglo-Saxon model). When the head of a company is not appointed as a board member, the board is usually composed of non-executive members (Nordic model). In rare cases Lithuanian companies selects German model as usually no supervisory council is established therein.

Hence, it can be summarized that still there has not been developed any Lithuanian tradition regarding selection and implementation of single corporate governance system within companies. In Lithuania we can find companies, applying all three – Anglo-Saxon, German and Nordic – models of corporate governance systems. This perception will be significant in further parts of this study, when providing possible solutions in respect to conceptual issues of the management bodies' definition.

Types of Management Bodies

Conceptual Issues Regarding Definition of Management Bodies

Neither in appropriate laws of Lithuania, nor in the legal doctrine or court practice we may find any united opinion regarding the issue, what can be assigned to the category of company's management body. Accordingly, this results in certain conceptual issues, with respect to persons on which

shall be applied relevant fiduciary duties or civil liability standard that are normally imposed on or undertaken by management body members.

After systematic study of regulatory framework, it might be distinguished several issues in determination of management bodies' definition. Firstly, there are two terms of different meaning that are used in respective legal framework – "*management body*" and "*manager*". In certain laws, for instance, the Law on Credit Unions of the Republic of Lithuania (1995) (the "Law on Credit Unions"), the Civil Code are found both terms, in others – only one of them, such as the Law on Controlling Investment Companies of the Republic of Lithuania (2003) (the "Law on Controlling Investment Companies"). The Article 21(2) of the Law on Credit Unions stipulates that *management bodies* of the credit union are the board of directors and the *head of administration*, however, in Article 30(1) thereof the head of credit union is defined by determining that such category includes: 1) members of supervisory council; 2) board members; 3) head of administration; 4) head of internal audit council; 5) chairman of loan committee; 6) chairman of inspection commission (inspector). It shall be noted that according to the Article 2(50) of the Law on Collective Investment Institutions of the Republic of Lithuania (2003) *managers* can not only be natural persons (head of depository administration, board of directors and supervisory council members) but also legal persons (management and investment companies). In such laws, respective definitions of "*management body*" and "*manager*" are deemed to be in relationship of subordination, i.e. term "*manager*" includes term "*management body*". However, under the Civil Code these definitions are separated, i.e. by indication that these are different terms (for instance, Article 6.67(1), items 2 and 3). The Law on Controlling Investment Companies does not contain any *management body* definition and only companies' *managers* are determined by defining that they are members of supervisory council or board of directors, head of administration or deputies thereof, chief accountant (Article 2(8) thereof). Such legal regulation does not provide clear answer, what is the legal status of company's *managers* and how it differs from the legal status of *management body members*, what are responsibilities thereof; and if the respective liability standard applicable on *management body members* shall be applied thereupon. In particular, Enterprise Bankruptcy Law of the Republic of Lithuania (2001) (the "Enterprise Bankruptcy Law") specifies term "*manager*" and namely it stipulates obligation thereupon regarding compensation of losses, incurred by creditors due to delay of a company to submit application before the court regarding initiation of the bankruptcy proceedings (Article 8(4) thereof). Thus, if these uncertainties within legal regulations are not removed, even particular credit union employees that are considered as credit union's managers, might incur such liability to

compensate respective losses due to default in respect to obligations imposed by the Enterprise Bankruptcy Law, that indeed is not considered to be reasonable and does not correspond to the real regulatory purposes associated with such legal provision.

Another issue is that the laws too widely define who are deemed to be *members of a management body*. For instance, according to the Article 23 of the Law on Agriculture Companies of the Republic of Lithuania (1991) (the "Law on Agriculture Companies") the management bodies thereof are the *board of directors* or *administration*, but it is not provided, which persons, excluding the head of administration, are assigned to this category of administration officers. There are certain opinions in a law doctrine that all persons holding management position within the company shall be attributed to a category of *management body members* (Rimas, 2009). Such wide interpretation and regulation of management body members might result in difficulties with regard to determination of persons, who shall be imposed respective fiduciary duties and civil liability that are normally imposed thereupon.

Finally, one of key problems remains to be determination of supervisory council legal status. In certain laws supervisory council is attributed to the category of management bodies, for instance Article 18(1) of the Law on Financial Institutions of the Republic of Lithuania (2002) anticipates that *collegial management bodies* of the financial institutions are the supervisory council and the board of directors. However, in other laws supervisory council is not attributed to the category of management bodies, explicitly stating that members of supervisory council, not performing or failing to duly perform duties stipulated in the respective legal acts, shall be liable in the same manner as members of management bodies, for instance, such provisions is set forth in Article 27(5) of the Law on Credit Unions. Certain other laws generally do not stipulate any civil liability principles applied in respect to supervisory council members, and only stipulate that the supervisory council is not attributed to the category of management bodies, for instance, such legal regulation is found in the Law on Companies and the Law on Cooperative Societies of the Republic of Lithuania (2002). There is no unanimous opinion regarding the aforementioned issue neither in legal doctrine, nor in court practice or company laws of any foreign states. For instance, in *Czech Republic*, *Estonia*, *Hungary*, *Slovakia*, *Cyprus*, *France* and *Norway* supervisory council members are not considered to be members of company's management body (Ernst & Young Société d'Avocats, 2009). In laws of *Belgium*, *Denmark*, *Netherlands* (Pereira *at al*., 2006) is stipulated that equal civil liability standards shall be applied to all directors (both, executive and non-executive, i.e. members of both, supervisory council and boards of directors). In *Germany*, even if supervisory council is considered

as management body, the actual function of a company's management remains in hands of the board of directors, but not supervisory council (Art. 76(1) of the Law on Companies of the Federal Republic of Germany). The supervisory council is entitled to use the veto right on the respective transactions, but differently than in *USA*, *England* or *France*, it does not have any authority to give direction to the company's board of directors (Kraakman *et al*., 2009). The German supervisory council can be compared to the respective audit and compensation committees established within boards of directors of *U.S.* companies. In common law countries it is acknowledged that regardless of differences between roles of executive and non-executive directors, duties thereof are considered the same, therefore, their liabilities should also not be differentiated (Smerdon, 2004). Although under OECD standards, when determining responsibilities of company's management bodies it is stipulated that "<...> Principles are intended to be sufficiently general to apply to whatever board structure (authors note: one-tier or two-tier) is charged with the functions of governing the enterprise and monitoring management" (OECD Principles of Corporate Governance, 2004), allowing to conclude that a supervisory council is also deemed to be included into the category of management bodies. This principle is indirectly included into EU legal framework, regulating separate forms of legal entities (for instance, EU Council Regulation as of 8 October 2001, No. 2157/2001 regarding statute of European Company (SE) [2004] OL L 294/1, etc.), considering various corporate governance systems of a company that exist in different EU member states, but at the same time indicating that one-tier board (called administrative body) is equal to two-tiers board (both supervisory and management body), that implies that an supervisory body should be deemed to be management body, which members should be applied same duties and civil liability standard that are imposed on management body members.

The legal doctrine from the beginning of XX century stated that management bodies at all do not exercise any management function, because they are solely assigned to perform just supervisory function (Hornstein, 1950). However, eventually this approach has been criticized by scientists, stating that a management body is mainly in charge of management but not supervision function (Eisenberg, 2006). Currently, some scientists consider that supervisory council shall be attributed to the category of management bodies (Kavalnė and Norkus, 2011) as management bodies *inter alia* exercise supervisory function (Douglas, 1934). Other scientists on the contrary remain to the opinion that supervisory council is not and cannot be deemed to be a management body, because it does not exercise any management function (Rimas, 2009). R. Greičius can also be attributed to the latter group of authors, but according to this author, members of supervisory

council, same as members of management body, have fiduciary duties set forth in Article 2.87 of the Civil Code, that allows to come to conclusion that they can also be imposed civil liability standard applicable to management body members (Greičius, 2007). However, legal doctrine also contains opposite views – A. Bosaitė and S. Butov states that members of supervisory council are not and cannot be assigned duties foreseen in Article 2.87 of the Civil Code as such body does not perform any management functions (Bosaitė and Butov, 2009).

The Supreme Court of Lithuania stays at the opinion that supervisory council is a management body (Resolution adopted in civil case No. 3K-3-19/2012, 2012), thus, liability of members thereof shall be determined upon applying analogical provisions, anticipating civil liability as regards to the board members (Resolution adopted in civil case No. 3K-3-214/2011, 2011). The Court has identified the board of directors as an *executive management body* in charge of company's management, implementation of company's goals, proper commercial business activities, as well as company's management practice and supervision thereof, while the supervisory council has been identified as an *supervisory management body*, in charge of controlling board of directors activities, company's financial status, use of funds, accounting as well as compliance of other company's documents to the legal requirements (Resolution adopted in civil case No. 3K-7-226/2006, 2006). However, the Supreme Court did not provide any detailed reasoning, justifying such perception. The Supreme Court only emphasized, that the supervisory council was also a management body, regardless of its differences in status, particularities of actions, as well as mandate and competencies thereof (Resolution adopted in civil case No. 3K-3-139/2009, 2009). It should be noted that the Supreme Court practice does not state that a supervisory council does not exercise management function. Moreover, attention is mainly drawn towards existing differences in mandates and competencies of supervisory council and board of directors. As will be further identified in this study, terms "*function*" and "*competence*" in terms of content remain to be considered different terms. Therefore, respective misunderstandings regarding management body performed functions imply that aforementioned issues in respect to management body definition appear.

Functions and Competence of Management Bodies

As of XX century, management function was recognized as a separate function, not connected to any risk capital contributions into the company (Davies, 2002). Management function remains solely assigned to the discretion of management bodies. However, the scope of such function depends on the size of a company, allocation of shares, as well it may vary

based on implementation of regulations of an ordinary dominant shareholder or supervision of senior employees responsible for fulfilment certain managerial tasks in the company, remaining actually in charge of adopting and implementing strategic goals (Davies, 2002). It is quite common that in public type companies the management function is being carried out by the board of directors and (or) the head of a company, while in closed type companies – to the shareholders, who are either directors *de jure* or *de facto* assigned these duties, when formally thereof should be carried out by another body (Tikniūtė, 2006). J. Kiršienė and A. Tikniūtė state that in order for one or another body within a company to be deemed as a management body, it shall be granted certain controlling powers or any key portion thereof (Kiršienė and Tikniūtė, 2004). In the event no controlling powers are delegated thereto, then shareholders are in charge of implementing such management function, for instance in one-member companies, where shareholders *de facto* are also normally holding position of a manager, establishment of any other management bodies are pointless, because company's interests and intentions fully meet interests of its shareholders (Kiršienė, 2003). However, even when in public type companies the general meeting of shareholders carries out management function, in terms of scope thereof it is completely different from actual management functions exercised by management bodies. In Supreme Court practice, management of shareholders is referred as a strategic management, being understood as finding solutions regarding any crucial, extraordinary long-term business strategy related matters (Resolution adopted in civil case No. 3K-3-168/2009, 2009).

In Lithuanian legal system terms "*function*" and "*competency*" are quite frequently confused, as there is no clear distinction in between these terms, although in substance they are very different. The Supreme Court of Lithuania indicates that "key functions of a company's manager are organization of company's day-to-day activities, hiring and dismissing of employees, conclusions and termination of employment contracts, as well as promotion of employees or initiating disciplinary actions in respect thereto" (Resolution adopted in civil case No. 3K-7-444/2009), however, these activities shall be understood as a capacity of a company's manager itemizing its performance of functions having managerial nature. However, in other resolution the Supreme Court of Lithuania states that "when comparing competences of the board of directors and the head of a company as assigned under the Law on Companies of the Republic of Lithuania, it is noticeable, that the duties of the board of directors are basically related to the *control* of the company's manager's actions, execution of certain managerial functions having more general nature and rather passive participation within the day-to-day activities of the company, for which the responsibility lies

with the company's manager" (Resolution adopted in civil case No. 3K-7-124, 2014). The Civil Code distinguishes but does not determine the respective definitions (for instance, Article 2.82(1) thereof). However, in a legal doctrine these *functions* of company's bodies are determined as follows: 1) *developing* and representing intentions (will) of a company; 2) *managing* legal company's activities; 3) *acting on behalf of a company* without being granted separate authorizations (Baranauskas *et al.*, 2007). As it was previously noted, the first function is assigned to the general meeting of shareholders. This means that the other two functions – *management* and *representation* are assigned to the management bodies.

In dictionary of international words, term "*function*" (in Latin *functio* – performance, action) is determined as "*duty, mandate, scope of actions*", while "*competency*" (in Latin *competentia* – dependency (at law)) – as entirety of *rights and obligations* of certain institutional body or agency, set by the statute or internal regulations thereof (Vaitkevičiūtė, 1999).

In terms of this study it is important to define functions of directors as management body members and the respective competencies thereof. In dictionary of international words, term "*director*" is determined as a person, to whom shareholders entrusted the entire *control* and *direction* of a company (Gove, 1993). In legal dictionary, term "*director*" is defined as a person, who is assigned or appointed to the board of directors, which *manages* company's affairs by exercising *control* over lower level officers (Garner, 1999). Therefore, directors are assigned the *direction* and *control* functions. Hence, upon summarizing views under a legal doctrine and defining respective terms, we can state that management bodies are assigned the following functions: 1) *direction*; 2) *representation*; and 3) *control*. Such functions are understood as comprising scope and content of entire management function.

This perception is based not only under EU regulations, but also under the legal doctrine and provisions found in the company laws of foreign states. For instance, Article 2(1) of the EU Parliament and Council Directive as of 16 September 2009 No. 2009/101/EB regarding coordination of security measures, which are imposed by EU Member States against companies, specified in Article 48(2) of the Agreement, seeking to protect their own or third party's legitimate interests, aiming to unify application thereof [2009] OL L 258/11, provides a clear distinction between *direction (administration), representation* and *control* functions, assigning them to respective members of management bodies, based on applicable corporate governance system. In German company law it is clearly defined two functions exercised by board members: *direction* (ger. *Geschäftsführung*) and *representation* (ger. *Vertretung*). *Direction* function has an internal character and it is related to respective rights and obligations used for

company's management, while *representation* function has an external character and it is related with rights and obligations during representation of the company before the third parties (Dornseifer *et. al*., 2005). The supervisory council performs *supervision* of board actions (Art. 111(1) of the Law on Companies of the Federal Republic of Germany) and, therefore, it cannot implement functions assigned to the board of directors. The same approach is found in Italian company law (Dornseifer *et. al*., 2005). Hence, management function is exercised by both, board of directors and supervisory council, but such bodies carry out management functions different in their nature – direction, representation and (or) control functions.

Direction function is usually assigned to the board of directors and the head of a company, for instance, Article 23 of the Law on Agriculture Companies anticipates that the board of directors is in charge of *managing* of the company's activities (Article 24(1) thereof). The scope of such function might be defined by reference to the mandate of organization of company's day-to-day activities. Under opinion of R. Greičius, a key function of head of a company's is such organization of company's regular daily activities, while functions of the board of directors are connected to respective organizational issues of company's daily affairs management (Greičius, 2007). The same position is found in court practice, specifying that management of daily business activities is *inter alia* assigned to management bodies of a company (Resolution adopted in civil case No. 3K-3-19/2012, 2012).

Representation function under legal entity doctrine is understood as an external function (Bakanas *et al*., 2002), where actions of respective company's body are equivalent to actions of a company itself (Baranauskas *et al.*, 2007). Furthermore, management bodies of a company are entitled to exercise such representation function *ex officio,* i.e. without obtaining any additional authorizations. Such representation cannot be compared to standard legal representation relations, stipulated under Article 2.132-2.185 of the Civil Code. In general, such function is related to management body actions on behalf of a company in its relations with the third persons. Such right under Lithuanian legal system is exclusively assigned to the sole management body of a company – head of a company (Article 37(10) of the Law on Companies), unless the incorporation documents thereof stipulates the rule of quantitative representation. But this contradicts to equality principle in respect to management bodies as anticipated in Article 2.86 of the Civil Code, under which the right to represent a company in its relations with the third persons, shall be equally granted to all management body members thereof (Bakanas *et al*., 2002). We do believe that such rights shall be granted to those members of management bodies, who *inter alia* exercise company's direction function, such as the head of the company or the board of directors. In such a manner the equality principle would be respected in a

functional level, at the same time ensuring the efficiency and productivity of the board of directors, as currently board of directors in Lithuania are established and acting only on a formal basis, mainly exercising just supervision function. Thus, such principle of representation would become more acceptable and understandable to the foreign investors and would not result in concentration of representation powers in hands of single person, i.e. the head of a company.

The scope of **control function** is as well not homogenous. Such function might be understood as a control of company's developments and assumed risks exercised by the general meeting of shareholders (for instance, by appointing members of management bodies, sale of shares, supervising implementation of higher risk business strategies) (Blair and Stout, 1999). In particular currently, when it is noticeable a tendency of increase in market share held by institutional investors, that is considered to be a normal outcome of extension and modernization of financial markets, the control level exercised by shareholders-institutional investors is also growing, as individual shareholders usually are subscribing shares seeking to receive dividends, while institutional investors – aiming to exercise control over a legal entity (Bainbridge, 2010). In legal doctrine three main control areas exercised by shareholders are being distinguished: (i) control of a content of company's incorporation documents; (ii) control of company's management; and (iii) control of company's additional economical value (Davies, 2002). This issue of company's management gains higher importance in companies, where management is centralized, i.e. in companies, where shareholders assigned management functions to management bodies, instead of keeping it in their hands. Control of company's shareholders might be exercised in two ways: (i) by appointing and dismissing members of management bodies or by determining order of their decision making; for instance, by obligating the head of a company to obtain prior approval of shareholders in respect to implemented transaction. Another control forms are the control of company's activities exercised by the supervisory council (Article 31(1) of the Law on Companies) or control of actions of a company's manager as is exercised by the board of directors or control of company's day-to-day activities as is exercised by the head of a company (Summers, 1991), etc. However, all these controlling options are considered to be different as some of them are attributed to managerial function but others – are not. For instance, the general meeting of shareholders is not entitled to exercise functions attributed to management bodies, including control function (Article 20(2) of the Law on Companies), as this body is only in charge of controlling company's management. Furthermore, control function assigned to supervisory council cannot be assigned to any other bodies of a company (Article 19(3) of the Law on Companies).

Management functions, i.e. components and content thereof are specified under the competencies attributed to company's bodies, which in legal doctrine are most frequently determined as an entirety of all rights and obligations, stipulated under the laws and incorporation documents of a company (Abramavičius and Mikelėnas, 1999), or as the essential requirements for the respective entity regarding performance of or refraining from certain actions (Greičius, 2007). The competencies of company's bodies are determined not only in the Civil Code (for instance, Article 2.82(3) thereof), or respective laws (for instance, Article 20 of the Law on Companies stipulates competencies of the general meeting of shareholders, Article 32 thereof – the supervisory board, Article 34 – the board of directors, and Article 37 – the head of a company), but also might be defined in respective provisions of incorporation documents. Competencies play a significant role as based thereupon it is possible to determine a scope of functions exercised by company's bodies, such as scope of control or direction functions.

Considering the foregoing study, it is possible to conclude that the management function comprises three functions distinguishing in terms of their content – i.e. direction, representation and control. In reference to the aforementioned perception, the following company's bodies are deemed to be part of a category of management bodies: collegial management bodies, i.e. executive and supervisory body (board of directors and supervisory council), and also a sole management body, i.e. the head of a company.

Conclusion

The analysis herein has shown that still there has not been developed any Lithuanian tradition regarding selection and implementation of single corporate governance system within companies. In Lithuania we can find companies, applying all three – Anglo-Saxon, German and Nordic – models of corporate governance systems.

The authors also note that the management bodies are assigned the following functions: 1) *direction*; 2) *representation*; and 3) *control*. Such functions are understood as comprising scope and content of entire management function.

Accordingly, the authors make a conclusion that the following company's bodies are deemed to be part of a category of management bodies in Lithuania: 1) *collegial management bodies*, i.e. board of directors and supervisory council; and 2) *sole management body*, i.e. the head of a company.

References:

Abouzaid, S. (2008), "IFC Family Business Governance Handbook", available at: http://www-wds.worldbank.org/external/default/WDSContent Server/WDSP/IB/2008/08/21/000333038_20080821023525/Rendered/PDF/ 450770WP0ENGLI1siness1200801PUBLIC1.pdf (accessed 21 April 2014)

Abramavičius, A., Mikelėnas, V. (1999), *Įmonių vadovų teisinė atsakomybė* [Liability of Enterprises' Directors], VĮ Teisinės informacijos centras, Vilnius.

Aktiengesetz [Law on Companies of the Federal Republic of Germany] (1965), available at: http://www.gesetze-im-internet.de/aktg/ (accessed 27 April 2014).

Andenas, M., Wooldridge, F. (2009), *European Comparative Company Law*, Cambridge University Press, Cambridge.

Antunes, E. J., et al. (2011), "European Commission Internal market and Services Report of the Reflection Group On the Future of EU Company Law", available at: http://ec.europa.eu/internal_market/company/docs/ modern/ reflectiongroup_report_en.pdf (accessed 16 April 2014).

Bainbridge, S. M. (2010), *Shareholder Activism in the Obama Era. Perspectives on Corporate Governance*, Cambridge University Press, New York.

Bakanas, A., *et al*. (2002), *Lietuvos Respublikos civilinio kodekso komentaras. Antroji knyga. Asmenys* [Commentary to the Lithuanian Civil Code .Second book. Persons], Justitia, Vilnius.

Baranauskas, E., *et al.* (2007), *Civilinė teisė. Bendroji dalis* [Civil Law. General Part], Mykolas Romeris University, Vilnius.

Blair, M. M.; Stout, L. A. (1999), "A Team Production Theory of Corporate Law", *Virginia Law Review*, Vol. 85 No. 2, pp. 248-328.

Bosaitė, A; Butov, S. (2009), "Legal Entities as Civil Law Institutions", in Mizaras, V. (Ed.), *Civilinė teisė. Bendroji dalis. Vadovėlis* [Civil Law. General Part. Textbook], Justitia, Vilnius.

Davies, L. P. (2002), *Introduction to Company Law*, Oxford University Press, New York.

Davies, L. P. (2003), *Gower and Davies' Principles of Modern Company Law*, Sweet & Maxwell Ltd, London.

Dornseifer, F., *et. al*. (2005), *Corporate Business Forms in Europe*, European Law Publishers GmbH, München.

Douglas, O. W. (1934), "Directors Who Do Not Direct", *Harvard Law Review*, Vol. 8 No. 47, pp. 1305-1334.

Eisenberg, A. M. (2006), *The Structure of the Corporation: A Legal Analysis*, Beard Books, Washington.

Ernst & Young Société d'Avocats (2009), "Study on the Operation and the Impacts of the Statute for a European Company (SE) – 2008/S 144-192482",

available at: http://ec.europa.eu/internal_market/consultations/docs/2010/se/study_SE_9122009_en.pdf (accessed 21 April 2014).
Furlow, C. W. (2009), "Good Faith, Fiduciary Duties, and the Business Judgement Rule in Delaware", *Utah Law Review*, pp. 1061-1095.
Garner, B. A. (1999), *Black's Law Dictionary. Ninth Edition*, West Group, Sent Paul Minnessota.
Gove, P. B. (1993), *Webster's Third New International Dictionary of the English Language Unabridged. A Merriam-Webster*. Merriam-Webster, Springfield.
Greičius, R. (2007), *Privataus juridinio asmens vadovo fiduciarinės pareigos* [Fiduciary duties of the head of a private legal entity], VĮ Teisinės informacijos centras, Vilnius.
Hopt, K. J.; Leyens, P. C. (2005), "Board Models in Europe. Recent Developments of Internal Corporate Governance Structures in German, the United Kingdom, France, and Italy", *Company & Securities Law Review*, Vol. 1, pp. 217-245.
Hornstein, D. G. (1950), "Stockholders' Agreements in the Closely Held Corporation", *The Yale Law Journal*, Vol. 6 No. 59, 1040-1056.
Kavalnė, S.; Norkus, R. (2011), *Bankroto teisė. Antroji dalis. Vadovėlis* [Bankruptcy Law. Second Part. Textbook], Justitia, Vilnius.
Kiršienė, J. (2002), "Akcininko nuosavybės teisės įgyvendinimo problemos [Issues of Implementation of Shareholder's Ownership Rights]", *Jurisprudencija*, Vol. 28 No. 20, pp. 87-95.
Kiršienė, J. (2003), "Finansinio turto problema nuosavybės teisės doktrinoje ir teisinėje praktikoje [Financial Assets Issues under the Ownership Legal Doctrine and Court Practice]", *Doctoral Thesis*, Lithuanian law university, Vilnius.
Kiršienė, J.; Tikniūtė, A. (2004), "Juridinio asmens civilinių teisių įgyvendinimas bendrovėje: kam priklauso valdymo funkcija? [Implementation of legal entity's civil rights in a company: who is in charge of management function?]", *Jurisprudencija*, Vol. 55 No. 47, pp. 32-39.
Kononovič, A. (2001), *Bendrovių valdymas, akcininkų susirinkimai, vertybiniai popieriai* [Corporate Governance, Meetings of Shareholders, Securities], Vilniaus universiteto spaustuvė, Vilnius.
Kraakman, R. R., *et al*. (2009), *The Anatomy of Corporate Law. A Comparative and Functional Approach*, Oxford University Press, Oxford.
Lederer, P. (2006), "A Comparative Analysis of the Liability of Non-executive Directors in the UK and of Members of the Supervisory Board in Germany", *European Business Law Review*, Vol. 17 No. 6, pp. 1575-1614.
Lietuvos Respublikos akcinių bendrovių įstatymas [Law on Companies of the Republic of Lithuania] (2000), *Valstybės žinios*, No. 64-1914.

Lietuvos Respublikos akcinių bendrovių įstatymo 19, 20, 24, 25, 30, 31, 33, 34, 35, 37, 44, 54, 59, 60^1, 63, 67, 69, 72 straipsnių pakeitimo, įstatymo papildymo 45^2 straipsniu ir įstatymo priedo pakeitimo ir papildymo įstatymo projektas [Draft Law on amendments to Articles 19, 20, 24, 25, 30, 31, 33, 34, 35, 37, 44, 54, 59, 60^1, 63, 67, 69, 72 of the Law on Companies, addition with new Article 45^2 and amendment and supplement to the Appendix thereof] (2013), available at: http://www3.lrs.lt/pls/inter3/dokpaieska. showdoc _l?p _id=462269&p_tr2=2 (accessed 30 April 2014).

Lietuvos Respublikos civilinis kodeksas [Civil Code of the Republic of Lithuania] (2000), *Valstybės žinios*, No. 74-2262.

Lietuvos Respublikos finansų įstaigų įstatymas [Law on Financial Institutions of the Republic of Lithuania] (2002), *Valstybės žinios*, No. 91-3891.

Lietuvos Respublikos įmonių bankroto įstatymas [Enterprise Bankruptcy Law of the Republic of Lithuania] (2001), *Valstybės žinios*, No. 31-1010.

Lietuvos Respublikos kolektyvinio investavimo subjektų įstatymas [Law on Collective Investment Institutions of the Republic of Lithuania] (2003), *Valstybės žinios*, No. 74-3424.

Lietuvos Respublikos kontroliuojančiųjų investicinių bendrovių įstatymas [Law on Controlling Investment Companies of the Republic of Lithuania] (2003), *Valstybės žinios*, No. 74-3425.

Lietuvos Respublikos kooperatinių bendrovių įstatymas [Law on Cooperative Societies of the Republic of Lithuania] (2002), *Valstybės žinios*, No. 57-2296.

Lietuvos Respublikos kredito unijų įstatymas [Law on Credit Unions of the Republic of Lithuania] (1995), *Valstybės žinios*, No. 26-578.

Lietuvos Respublikos mažųjų bendrijų įstatymas [Law on Small Partnership of the Republic of Lithuania] (2012), *Valstybės žinios*, No. 83-4333.

Lietuvos Respublikos žemės ūkio bendrovių įstatymas [Law on Agriculture Companies of the Republic of Lithuania] (1991), *Valstybės žinios*, No. 13-328.

OECD Principles of Corporate Governance (2004), available at: http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf (accessed 17 April, 2014).

Pereira, A. M., *et al*. (2006), *Directors' Liability: A Worldwide Review*, International Bar Association, Netherlands.

Resolution of the Supreme Court of Lithuania as of 25 May 2006 adopted in civil case *K. J. J. v. J. B. and V. K.* (case No. 3K-7-226/2006).

Resolution of the Supreme Court of Lithuania as of 20 March, 2009 adopted in civil case *V. V. v. UAB "Senasis lokys"* (case No. 3K-3-139/2009).

Resolution of the Supreme Court of Lithuania as of 5 May 2009 adopted in civil case *V. G. v. R. G.* (case No. 3K-3-168/2009).

Resolution of the Supreme Court of Lithuania as of 9 July 2009 adopted in civil case *BUAB "Alveronas" v. I. S., R. P., A. P., G. M., G. B. and D. C.* (case No. 3K-3-329/2009).
Resolution of the Supreme Court of Lithuania as of 20 November, 2009 adopted in civil case *BUAB "Optimalūs finansai" v. G. P.* (case No. 3K-7-444/2009).
Resolution of the Supreme Court of Lithuania as of 29 April 2011 adopted in the civil case *Vilnius District Chief Prosecutor and UAB "Vilniaus vandenys" v. A. J. V. M. and B. J. B.* (case No. 3K-3-214/2011).
Resolution of the Supreme Court of Lithuania as of 1 February 2012 adopted in civil case *UAB "Panevėžio spaustuvė" v. R. S., A. B. and A. G.* (case No. 3K-3-19/2012).
Resolution of the Supreme Court of Lithuania as of 9 January 2014 adopted in civil case *UAB "Mitnija" and "MG Baltic Investment" v. V. G. and E. R.* (case No. 3K-7-124/2014).
Rimas, J. (2009), "Akcijų opcionai kaip privataus kapitalo investuotojo ir bendrovės vadovų interesų derinimo priemonė [Call-Options as a Measure for Coordinating Mutual Interest of a Private Investor and Company's Manager]", *Teisė*, Vol. 73, pp. 124-125.
Robinett, D., et al. (2003), "Experiences from the Regional Corporate Governance Roundtables", available at: http://www.oecd.org/dataoecd/19/26/23742340.pdf (accessed 17 April, 2014).
Smerdon, R. (2004), *A Practical Guide to Corporate Governance. Second Edition*, Sweet & Maxwell, London.
Summers, E. L. (1991), *Accounting information systems. Second Edition*, Houghton Mifflin Company, Boston.
Tikniūtė, A. (2006), "*Juridinio asmens ribotos atsakomybės problema: teisiniai aspektai* [Problem of Legal Entity's Limites Liability: Legal Aspects]", *Doctoral Thesis*, Mykolas Romeris University, Vilnius.
Vaitkevičiūtė, V. (1999), *Tarptautinių žodžių žodynas. A-K.* [Dictionary of International Words. A-K.], Žodynas, Vilnius.
Vaitkevičiūtė, V. (2000), *Tarptautinių žodžių žodynas. L-Ž.* [Dictionary of International Words. L-Ž], Žodynas, Vilnius.