



FIDUCIARY DUTIES IN THE MANAGEMENT OF THE CORPORATION AND THEIR APPLICATION IN UZBEKISTAN

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Annotation

At present, comprehensive reforms are being implemented to improve civil law in our country. This can also be seen in the rules of corporate law. In particular, one of the reforms is related to the fiduciary duties of the managers of the legal entity. In corporate law, the fiduciary duties of the governing body of a legal entity are one of central issues. Proper and effective management of a legal entity is largely determined by the extent to which the fiduciary duties of the governing bodies are regulated and adhered to. Failure to comply with fiduciary duties is also the basis for liability of the governing body to the legal entity. Anglo-American corporate law states that the fiduciary duties of the managers of a corporation consist of duty of due care, duty of loyalty, and duty of good faith. The corporate law of the Russian Federation provides that the governing bodies of a legal entity must act in good faith and reasonably in the interests of the legal entity, and violation of these fiduciary duties is the basis of their responsibility to the legal entity. This paper analyzes the fiduciary duties of the management bodies of legal entities based on the legislation and judicial practice of the United States and the Russian Federation and discusses the prospects for applying and improving these duties in the corporate law of the Republic of Uzbekistan.

Key words: fiduciary duties, duty of loyalty, duty of due care, duty of good faith, interests of a legal entity, rationality and good faith

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Introduction.

Our country is currently undergoing comprehensive reforms to improve the civil law. In particular, the draft Civil Code of the Republic of Uzbekistan [1], which seeks to establish appropriate rules for renewed social relations, provides for significant changes. This can also be seen in the rules of corporate law. In particular, according to the draft Code, corporate legal relations are recognized as separate civil legal relations with specific features provided for news by content and types of legal entities. Another change, relating to the operation of a legal entity, belongs to the fiduciary duties of the directors of a legal entity

and we discuss its substance and prospects for practical application below.

Analysis and results of the study materials. The term "fiduciary" originated in ancient Rome and refers to an act of trust: the transfer of property to another person under the guise of a sale with a right of recourse. "Fiduciaries are typically decision-makers; their specialized function is that of . . . making decisions of a discretionary nature about the management or investment of the property of others.

In a general sense, a fiduciary relationship is an ethical and legal relationship based on trust that arises between two or more persons in



connection with the management of money or other property. By the nature of the fiduciary relationship, one person (the fiduciary) acts on behalf of another person (the principal) in his interest and the fiduciary has discretionary power when making decisions about the property in question”.

It is noted that all types of fiduciary duties have the following characteristics: fidelity to the principal; acting honestly; not using the work entrusted to the principal for personal gain without the consent of the principal and not using his powers for the benefit of third parties; and avoiding conflicts of interest.

In ancient Roman law, the fiduciary relationship was reflected in agreements such as the contract of assignment (*mandatum*), the contract of partnership (*societas*), the loan (*commadatum*) and the pledge (*depositum*).

Fiduciary duties are established in trusts in relation to trustees, in representations in relation to agents and in corporate relations in relation to persons managing a corporation [6, p. 2]. Below we consider in more detail the fiduciary duties of the latter mentioned persons.

Anglo-American corporate law states that the fiduciary duties of a corporate director usually consist of: a duty of due diligence, a duty of loyalty and a duty of good faith.

The US Corporate Governance Principles establish two fiduciary duties of the principal. In other words, a director must perform his or her duties in such cases from the perspective of a reasonable person looking out for the interests of the company in the most appropriate way (*duty of due care*). The duty of loyalty to the company requires the director to give priority to the company's interests in his own interest or the interests of third parties when entering into a contract with the company and to notify the company of a transaction in which he is involved.

American Jurisprudence (Second) Corporations presents the fiduciary duties of a

director as duties of care, duty of loyalty and duty of good faith.

The duty of care is defined as a duty of due care and diligence as well as "ordinary skill" and even "reasonable intelligence". In addition, a director must ensure that he or she is aware of the affairs of the corporation. For example, in 3006 arguing that he exercised due diligence in making a business decision, a director can point to the fact that he obtained all necessary statistics and other data from subordinates and sought the advice of expert economists or other specialists.

The literature describes the actions of a company director to ensure the duty of care. In particular, a director should be aware of decisions made in relation to the company's operations so as to exercise due diligence in the interests of the company; take an active part in the management of the company, following the progress of the company; establish committees in cases where special expertise or great effort is required, with the committees being the subject of the director's assistance with management matters, while responsibility for these matters remains with the director; ensure that minutes of the directors meeting are kept accurate and proper; be aware of

In the event of a dispute over the duty of care, the business judgment rule is taken into account, which relieves the director of liability. According to this rule, although the decisions made in the company's interest, in the face of normal unpredictable commercial risk, did not produce the expected results, the obligation to compensate the director is excluded.

The director's duty of loyalty is to act in the interests of the company, putting his own interests above those of the company. The most frequent breach of this obligation is reflected in the conclusion of a contract in which the director has a personal interest on behalf of the company.

One of the court precedents for this fiduciary duty was *Guth v. Loft inc.* which was heard by the Delaware High Court. [9]



According to him, Charles Guth is the caramel and soft drink manufacturer of Loft Inc. He founded Pepsi-Cola and became Loft Inc. The company will use its assets, such as plant, materials, financial resources, employees, to develop its company, and the syrups produced by Loft Inc. sells to the company.

Loft Inc – the company is suing Charles Guth in this case. As part of the case, the Delaware Supreme Court made several rulings on the company's loyalty pledge. In particular, the loyalty pledge means that a company director must use his or her authority only in the interests of the company and not in his or her personal interests.

Loyalty obligations can be in the form of assets and liabilities: a director's actions in the interest of the company imply his obligations on assets to avoid conflicts of interest with the company (i.e. transactions on behalf of the company, personal benefit from transactions), company property, and intangible assets not to use assets (trade secret, trademark, goodwill) for purposes other than those of the company, not to compete with the company constitute the director's passive obligations.

In US corporate law, there has been controversy over whether the duty of good faith is an independent fiduciary duty. In particular, the Delaware High Court held that *Stone v. Ritter* also focuses on his commitment to honesty in his work and interprets it as an element of his commitment to loyalty. According to him, a commitment to honesty does not constitute a separate obligation, such as standards of loyalty and care. Honesty serves as a guarantee that this loyalty commitment is fulfilled. If a director deliberately fails to fulfill his or her duties, it can be considered a breach of the obligation of integrity if he or she deliberately neglects his or her duties.

German corporate law does not allow other legal persons to participate in the management bodies without the consent of the supervisory board, to prevent competition with the company, i.e. not to act independently in

the business sector or to represent others without the consent of the supervisory board, and the confidentiality of information on the company's activities, which must remain confidential. [10]

English corporate law also provides for a director's duty to be an independent manager 3007 who takes an active position in litigation, free from the influence of third parties. [11]

Looking at the views developed in corporate law in developed countries, national law also reflects to some extent the provisions on fiduciary duties of directors of legal entities. In particular, in order to prevent conflicts of interest in the management of the company in accordance with the Laws "On Limited and Additional Liability Companies" [12] and "On Joint Stock Companies and Protection of Shareholder Rights"[13] and a separate procedure for entering into contracts with them.

The same procedure applies in the case of major transactions of the company. The activities of the company, including financial and economic activities, are reflected in the accounts of the company. According to Article 11 of the Law on Accounting [14], the head of a company is responsible for the organization and maintenance of accounting and reporting in companies.

In addition, Article 81 of the Law on Joint Stock Companies and the Protection of Shareholder Rights provides for the responsibilities of management bodies with liability risks only for legal entities in the form of joint stock companies.

According to him, the authorities knowingly provided misleading or false information; breached the procedure for providing information set out in this Act; is liable to the company for offering to enter into major transactions that caused damage to the company and/or transactions in which it is involved, including offers to enter into transactions with the company for profit (income) by themselves or their affiliates.



Pursuant to Articles 42 and 81 of the Limited Liability Companies and Additional Liability Companies and Protection of Stockholders' Rights Act, respectively, the management bodies of the company shall act in good faith and with prudence in their matters.

According to Article 45 of the Civil Code [15], under the law or the constituent documents of a legal person, a person acting on behalf of a legal person must act fairly and reasonably in the interests of the state. The legal person he/she represents.

These rules provide for the requirements to "act in the interests of a legal person", "honesty" and "reasonableness" as fiduciary duties of persons managing and acting on behalf of a legal person. The law does not disclose the content of legal persons in terms of interest, honesty and reasonableness.

These categories are concepts to be assessed and their legal content must be determined by the court, depending on the actual circumstances of the relationship between the parties to the civil transaction.

The content of these concepts is discussed in the literature. In particular, when referring to the interests of a legal entity, I.A. Turbina understands that the legal entity systematically benefits and the interests of the participants/shareholders are respected, but also takes into account aspects such as strengthening relationships with counterparties, the interests of employees, the impact of the company on society and the environment, and the business reputation of the company. According to E.A. Sukhanov, rationality means understanding the situation, rationality and purposefulness of behavior.

Integrity is a subjective state of the individual, which manifests itself in the fact that the individual does not know and may not know that he or she is acting in violation of a right given to him or her. A person acts in the sense that they are exercising the right given to them in accordance with their objectives. The

category of honesty is based on the principle of "bona fides" - "good faith" in Roman law.

Thus, the rules that constitute the essence of fiduciary duties in the management of a legal person in national law are provided for in various pieces of legislation. Nevertheless, there are a number of fiduciary duties 3008 enshrined in developed legal systems, including acting independently without external interference, gathering necessary and sufficient information on which to base decisions and making decisions on their basis, information that must remain confidential within the legal entity (e.g. trade secrets), not using the business capacity of the legal entity for its own benefit (e.g. not directing tangible and intangible company assets for its own needs, personal business).

In this regard, referring to Russian corporate law, Articles 53 and 53.1 of the Civil Code [17], Article 44 of the Limited Liability Companies Act [18] and Article 71 of the Company Law on Joint Stock Companies "[19] establish that the management bodies of a legal entity must act fairly and prudently in the interests of the legal entity, and the violation of these fiduciary duties is reinforced as grounds for their liability to the legal entity.

The Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation "On Certain Issues of Compensation for Losses Caused by Members of Legal Entities" [20] lists the circumstances that determine compliance with the standards of fairness and reasonableness. In particular, according to paragraph 2 of this Ruling, the following cases are considered violations of the fairness standard:

act in the event of a conflict of interest between the director (his affiliates) and the legal entity, including entering into transactions in which he has a practical (de facto) interest, notifying the supervisory bodies of the legal entity in a timely manner and obtaining consent in accordance with the established procedure;



withholding or misrepresenting information about the transactions concluded from the participants/shareholders of the legal entity (including failure to include such information in the relevant reports on the activities of the legal entity);

entering into transactions that require consent in accordance with the articles of association and the law of the legal person, without such consent;

refuse to retain and produce documents related to circumstances that may entail further adverse consequences for the legal entity after its termination;

if in the course of the relevant act (omission) he knew or should have known that it was contrary to the interests of the legal entity, e.g. if he concluded contracts that were unfavorable to the legal entity or could not be performed by the counterparty ("fly-by-night company").

The following cases of acts (or omissions) of a director are deemed not to meet the standard of reasonableness:

failure to take steps to obtain the necessary and sufficient information required by procedural practice in similar cases when making decisions;

making decisions without regard to the information known to him or her that is relevant to the case;

making decisions without following the procedure normally required for similar transactions or set out in the legal entity's internal documents (e.g. without consulting the legal department or accountant).

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As noted in the introduction to this article, along with ongoing civil law reforms, efforts are being made to incorporate fiduciary duties into corporate relationships. In particular, in accordance with the Presidential

Decree "On measures to improve the civil legislation of the Republic of Uzbekistan"[21], the task which is determining the institute of fiduciary obligations of the head of a legal entity in the national legislation, was included in Decree.

In pursuance of this objective, the new 3009 draft Civil Code reflects a special rule providing for the fiduciary responsibility of bodies and officials of legal entities. According to the content of this norm, a person acting on behalf of a legal entity in accordance with the law or the constituent documents of the legal entity must act honestly and reasonably in the interests of the legal entity they represent. This obligation is imposed not only legally but also in fact on the persons managing the legal entity. Persons acting on behalf of a legal person are liable to the legal person for losses caused by the collective bodies of the legal person and the actual managers. The liability of these persons for damages caused to the legal person is joint and several. Where a decision is taken collegially, the liability of persons who voted against the decision that caused the damage to the legal person or who did not vote in good faith shall be excluded.

In our view, the importance of the rules set out in above-mentioned decree manifests itself primarily in expanding the range of entities with fiduciary duties to a legal entity. It also regulates the grounds and procedure for the liability of these persons. However, there has been no change in the definition of the direct content of fiduciary obligations. Fiduciary obligations of the governing bodies of a legal entity are usually expressed in terms of the standards of "acting in the interest of the legal entity", "good faith" and "reasonableness".

In Russian corporate law, these obligations are usually underpinned by the need to act fairly and prudently in the interests of the company, and the cases determining their content are governed by the Plenum of the Supreme Arbitration Court.



The establishment of fiduciary duties in corporate law serves to balance the interests of the company and its managers, to protect the capital invested in the company by investors (members/shareholders), its good governance, and the powers of the company.

In our view, in order to improve the fiduciary obligations of the governing bodies of legal entities, to bring them closer to the corporate law of developed countries, and to increase their opportunities for implementation, it is advisable for the legal entity or the Plenum of the Supreme Court to systematize the fiduciary obligations of governing bodies, to reflect circumstances that give direction in interpreting the content of common concepts.

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