eISSN 2938-1487
https://doi.org/10.5565/rev/jhsgl.38

Modern Georgian corporate law in the mirror of European law. General review of the reform

La moderna ley corporativa de Georgia en el espejo del derecho europeo. Revisión general de la reforma

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Reception: 29/09/2023
Acceptance: 01/10/2023

Abstract

One of the obligations under the Georgia-EU Association Agreement was to undertake reforms of Georgian corporate law. Since 1 January 2022, Georgia has had a new corporate law, which is built on a regulatory function. From the point of view of law policy, it is based upon the regime of dispositional arrangement, though regulation of joint-stock companies constitutes an exception. Saturation of modern Georgian corporate law with legislative norms is the best way to overcome corporate impasses. As a result of the recent reform, the new corporate law contributes to the foreseeability and predictability of the corporate-legal relationships, which at once should provide more confidence for both foreign and domestic investors. The norms contained in the present reform are also equipped with a didactic function, which is especially necessary for the post-Soviet corporate economy.

Keywords: Georgian corporate law reform; EU harmonization of corporate regulation; Business judgement rule; Limited and Join-Stock companies

Resumen

Una de las obligaciones del Acuerdo de Asociación entre Georgia y la Unión Europea era llevar a cabo reformas en la ley corporativa de Georgia. Desde el 1 de enero de 2022, Georgia cuenta con una nueva ley corporativa basada en una función regulatoria. Desde la perspectiva de la política legal, se fundamenta en el régimen de disposición, aunque la regulación de las sociedades anónimas constituye una excepción. La saturación de la moderna ley corporativa georgiana con normas legislativas es la mejor manera de superar los obstáculos corporativos. Como resultado de la reciente reforma, la nueva ley corporativa contribuye a la previsibilidad y predictibilidad de las

relaciones corporativas legales, lo que a su vez debería brindar más confianza tanto a inversores extranjeros como nacionales. Las normas contenidas en esta reforma también están dotadas de una función didáctica, lo cual es especialmente necesario para la economía corporativa postsoviética.

Palabras clave: reforma de la ley corporativa de Georgia; armonización de la regulación corporativa con la UE; regla de juicio empresarial; sociedades de responsabilidad limitada; sociedades anónimas

1. Introduction and the paradigm of the policy of law

Since the dissolution of the Soviet Union, Georgian corporate law has undergone numerous amendments. These changes may be roughly divided into three major stages,[1] most notably the period following the signing of the Association Agreement between Georgia and the EU. This agreement significantly altered corporate law in Georgia, with work on it commencing in 2015.[2] One particular section of the Association Agreement is devoted to corporate law and its approximation to the supranational law of the European Union, which was established as one of the political-legal obligations of the agreement. This means that the guiding principles and binding directives shall be necessarily incorporated into national law by virtue of the reform, and national law must comply with them. Several aims are achieved in this manner: (1) The Georgian legal system (in this area) will obtain unified modern European characteristics, based on the major ground that is recognized by EU law, and will approximate thereto; and what is most important politically and legally, it will fulfill obligations deriving from the Association Agreement relating to approximation of the law. It may be assumed that legal "expansion" will be followed by economic growth,[3] because a proper corporate legal system which recognizes European standards and principles of implementation and protection of (internal) rights and duties at the legislative level will attract the interest of European investors to make capital investments in Georgian enterprises; (2) The legal regulation of intra-corporate relations

1. Regarding the (hypothetical) periodical differentiation to date, see: Burduli (2013, 2018) and Burduli et al. (2016).
2. This is when the first draft of the "Law of Georgia on Entrepreneurs" was drawn up by the group of experts (Chanturia, Papuashvili, Jugheli, Burduli). It was worked on by the Ministry of Justice in the following years, improvements were made, and it was finally introduced to the Parliament of Georgia for adoption in 2022.
3. Compare: Burduli (2019a).

will fill a lot of gaps[4] which cannot be categorized as "deliberate errors" (Gschnitzer, 1992) on the part of the legislator and which will provide business entities with an opportunity to avoid possible disputable situations and resolve their problems. This is necessary for the proper functioning and management of enterprises and the effective realization of the rights and duties of their partners. In addition, a well-formed legal system with its dispositional or imperatively defined legal norms will empower judges, which is vitally important in the fair resolution of disputes, especially in the case of a country that does not belong to the common law system but to the continental European law family.

Accordingly, as a result of the reform, emphasis is placed on the model of corporate law regulation, which forms an independent legal matter in this field.[5] This is especially noticeable in joint-stock company law,[6] where the advantage is moving from the so-called "Self-Enforcing Model"[7] – i.e. a self-regulating model – to an essentially regulated one, which, as noted above, is based not only on approximation to the corporate law of the European Union, but also on domestic needs.[8]

2. Systemic breakdown of the law and several issues from the general part of the law

The primary source of corporate law in Georgia is the Law of Georgia on Entrepreneurs (hereafter "Law on Entrepreneurs"), which was adopted in the early 1990s.[9] In order for the law to be able to fulfill its purpose – to be an effective regulation of corporate relationships in the country – it must meet several important criteria, among others: it must be based on the requirements for a well-ordered and reasonable system, it must perform the function of prediction and foreseeability in society, and it must be stable.[10] Legal stability determines the stability of other social spheres. Substantial, unsystematic and frequent changes make the law ineffective, which can be considered a prerequisite for the formation of a nihilistic attitude in society towards certain laws. This aspect is charac-

4. There is also a scientific opinion regarding the need to reform modern Georgian corporate law, which focuses on turning to legal corporate law: Lazarashvili (2013) and Chanturia (2015a).
5. Notably: Burduli (2021).
6. With its narrow meaning.
7. On the self-enforcing model and its advantage see: Chanturia (2009).
8. For example, regarding the didactic function of legislation (law) from this point of view: Chanturia (2015a, 2015b). On the superiority of the regulation model, see: Burduli (2019b).
9. For details on the history of its creation, see: Chanturia (1996).
10 Since its adoption in Georgian private law, the Civil Code has maintained its stability the best, despite a number of essential changes: Zarandia (2019).

teristic in the recent history of the Law on Entrepreneurs.[11] The breakdown of the unified system, the presence of regulatory deficits and the complete corrosion[12] of the separation of organizational-legal forms at the legislative level underlined the need to draft a new law.[13] Accordingly, the main goals of the new edition of the law were to eliminate marginal differences in the typological nature of business entities;[14] to bring the norms into a logical system; to enrich it with normative provisions regulating (internal) corporate relations; and to bring the law into compliance with the relevant directives of the European Union.

3. Predominantly dispositional nature of law and freedom of statutory autonomy

From the point of view of legal policy, the current law refuses the (previously existing) character of full deregulation and lays the ground for a (re-)regulated regime in some cases. With this, statutory corporate law has returned to Georgia,[15] which is undoubtedly welcome. This, of course, does not mean giving up private autonomy and freedom of contract,[16] which are vital to the relationship between partners, to the business entity, and to the management of the enterprise. In its expression of the principle of the freedom of statutory autonomy on the one hand, and regulatory deficit and neutralizing shortcoming regulating the relationship on the other, for the most part the law is based on the so-called default rule, i.e. dispositional regulation.[17] This means that in the absence of the silence of the charter and best practice, the function of the regulator is carried out by legal norm, which will also contribute to the further development of the autonomy of the charter itself.[18]

11. Georgian scientists have expressed a critical opinion on this more than once: Chanturia (2015c, 2016), Lazarashvili (2013), Burduli (2019c). See also Explanatory note of the draft pp. law: <https://matsne.gov.ge/ka/document/view/4962987?fbclid=IwAR3HYFK5dWlF6vpxHx3ZWNIx_FqMzC3nBWAKTBNKTFY-IIgshLNeMm4agqA&publication=0>, 111 and following.
12. For example: Makharoblishvili (2011).
13. In 2015, with the financial support of Germany (GIZ) and the USA (ProLoG), a group of experts was created to develop a new edition of the Law of Georgia on Entrepreneurs. Within a few months, it submitted the initial version of the draft law to the Ministry of Justice of Georgia. After processing, review and discussion in the target groups of society, the law was presented to the Parliament of Georgia in the spring of 2021, and in the fall of the same year it was adopted within three readings. It became effective from January 1, 2022.
14. About the non-existent legislative dichotomy of entrepreneurial entities: Kiria (2011).
15. This implies the regulation of the mentioned field by the laws established by the state.
16. About the statutory autonomy and the objective correlation of legislative regulation, see: Chanturia (2015b).
17. Exceptions are the regulatory norms of the Civil Code (Article 1, paragraph 4 of the Law), due to incorporation with the European directives on the one hand, and to the peculiarities of this legal form itself, on the other.
18 In this regard, Chanturia's position is completely acceptable: Chanturia (2015b: 562 and following).

Therefore, it is necessary to determine a golden mid-point between excessive regulation of the relationship on the one hand, and situations of corporate deadlock caused by disorder on the other. The deregulated regime has its economic effect; however, the economic aspect of the issue cannot be discussed without its relationship with the legal reality. At the time of deregulation, there should be a developed judicial practice, a high level of education of lawyers, and a developed jurisprudence (best practice) in the country. The frequent unsystematic changes in the legislation, which had been generally characteristic of Georgian corporate legislation since the beginning of the 1990s, created many legal dead ends. This created a feeling of nihilism among investors, and a sense of mistrust towards the law.[19]

The mechanism for neutralizing this was to establish a lawful normative regime in post-Soviet Georgia, although it should be taken into account that the regulation of the socio-economic sphere should not be overloaded with "multiple laws" (Zoidze, 2005). As Zoidze notes:

> The abundance of laws (norms) is not the best solution to organize life. Before the legislator develops a law, he must find out whether the legislative regulation is necessary. Maybe other kinds of social norms would deal better with the subject of interest. (Zoidze, 2005: 19-20)

Zoidze concludes that where the customary norms work well, it is possibly excessive to overload it with legislative norms (Zoidze, 2005).

However, the specifics of corporate relations must be taken into account, and their novelty in the Georgian context. The customary norms were nonexistent in this sphere.[20] Neither could judicial best practice function as a regulatory mechanism. Therefore, we should agree with Chanturia's thesis, that in such cases the legislation must take the burden of the "educational" function, establishing normative provisions for regulating corporate relations.[21] Hence, the state's approach must be directed towards the creation of an adjustable regime, which generally means interference of the state in the market structure or the correction of market results. The traditional motivation for this is the realization of economic-political goals based on public interest.[22] However, this does not mean a "usurping" of the regulation of legal rela-

19. A regulatory legal regime may not necessarily stand at the forefront of liberal law. "It is possible to implement liberalization at the same time as regulation." Djibuti (2015).
20. The specificity of the modern business-corporate relationship is discussed, otherwise such norms certainly existed in Georgian commercial law. For an overview see: Burduli (2007).
21. For example: corporate management (enterprise control), which in the modern sense is completely foreign to the old Georgian commercial law. See: Chanturia (2006).
22. Let's say, the regulation of the capital market, which ensures its functioning and the protection of investors at the legal level.

tions and the unjustified restriction of the free area. “Freedom must be preserved even in the reality regulated by the law […]. If there is no necessity, we can refrain from legal intervention there. Society can drown in a sea of unnecessarily excessive laws.” (Zoidze, 2005) Besides, it should be noted that the law is saturated with provisions, which not only (literally) have a regulatory function, but also a clarifying one.[23] This makes the corporate-legal relationship even more clear and predictable, which will certainly make its modest contribution to the development of the corporate economy.

4. The issue of organizational management and the legal transplant of the business judgment rule

Issues relating to the management and representation of enterprises are interestingly formulated in the law. It can be said that in this regard, the law eliminates many problems, which in practice are related to the perception of the governing body of a business entity, its function and tasks, its representative competence in relation to third parties, and no limits/restriction of representative authority (Article 41 and following). More clarity is introduced regarding the scope of actions of an enterprise’s directors and the issue of establishing responsibility. There is an attempt to provide a specific catalog of fiduciary duties, as detailed as possible, and particular components of the duty of care and duty of loyalty are regulated. The general standard of care established by Georgian judicial practice over the last decade[24] is reflected in Article 51 of the law, which is followed by the peculiar legal transplant of the American so-called business judgment rule,[25] which excludes liability of directors towards the company in the event of their unsuccessful activity and damage to the business entity, if the director could reasonably be assumed to have acted on the basis of sufficient and reliable information in favor of the business entity’s interests, independently and without a conflict of interest or without the influence of other persons.

The US prudent man rule standard,[26] as a legal maxim for the actions of a director,[27] is used precisely in Article 52 of the Law of Georgia on Entrepreneurs. As for the duty of loyalty, which is not covered

23. For example, Article 8, first paragraph of Article 9 of the law, etc.
24. See Founding decisions of the Supreme Court of Georgia: Supreme Court of Georgia No. 687-658-2016 of November 6, 2018, No. As-766-766-2018 of June 10, 2019, No. As-112-105-2017, No. -2014, decisions No. As-1158-1104-2014.
25. Regarding the definition of the institution, there is also Georgian language literature: Chanturia (2006); Zurabiani (2020); Maisuradze (2011).
26. See, for example, Hoye v. Meek, 795 F.2d 893 (10th Cir. 1986).
27. For example, the Model Business Corporation Act 2016 Revision, section 8.30.

by the doctrine of business judgment, this is presented in the form of three provisions included in it: prohibition of competition (Article 53), prohibition of misappropriation of business opportunity (Article 54. Business opportunity doctrine), and conflict of interest, which is provided independently only in the legal form of the joint-stock company (Article 208).

These clear provisions established by the law on the one hand encourage directors to make bolder and freer decisions, so that they have a better idea of the scope of their actions and the scope of their responsibility, and, on the other hand, protect them from intra-corporate disputes (derivative) and from lawsuits filed by potential third parties.

5. Law of business corporations

Georgian corporate law underwent the most amendments in 2008, when the total liberal approach towards business entities was developed. It especially affected the most widespread type of business organization in Georgia, the limited liability company (LLC). This type of legal entity was left without any legal regulation.[28] This created legal and economic gaps,[29] due to the fact that 95% of the share of the corporate economy comes from here. The obligation to implement European directives does not apply to LLCs, except for certain exceptions, but based on the analysis of practical problems and legal policy, it was decided to regulate them in detail as much as possible.

The primary task for the working group of the draft law was to outline the distinguishing features between two types of corporation – LLCs and Joint Stock Companies (JSCs) – at the legislative level. The main manifestation of this is the dispositional nature of the majority of norms applicable to LLCs and their complete statutory autonomy. However, it should also be noted that the capital structure of the LLC has approximated to the JSC, which should open the way for it to be financed through the capital market.

It can be said that the LLC is a transitional legal form between a personal type company without a synergistic financing effect and a joint-stock company carrying the function of connecting classical capital. This should produce its economic effect. In this regard, the law provides for a peculiar flexible structure of capital. Unlike JSCs, the so-

28. In the special part of the current law, only five articles are devoted to it, which, it can be said, leaves this organizational form almost without regulation.
29. And this is confirmed by the "evaluation of economic effect the future law" carried out on the draft law. See part of the explanation card of the draft Law on Entrepreneurs: <https://matsne.gov.ge/ka/document/view/4962987?fbclid=IwAR3HYFK5dWlF6vpxHx3ZWNIx_FqMzC3nBWAKTBNKTFY-IIgshLNeMm4agqA&publication=0>.

called "*intangibilité du capital*" system is rejected; however, mandatory norms for the preservation of property, and restrictions on property distribution and dividend issuance are imposed in order not to jeopardize the satisfaction of creditors' demands and the achievement of the company's goal. Simply, unlike JSCs, where issuing dividends to shareholders is tied to the concept of binding net profit, issuing dividends in LLCs will be possible even if the balance of the enterprise is positive and the company still has some assets to distribute as dividends. In addition, dividend distribution, in principle, is possible at any time, in the form of annual or interim distribution.

The law has regulated in detail the cases of concession of the share in both legal forms, more precisely cases of voluntary and forced concession. In this sense, the law is more similar to the regulation of the German LLC law, where a distinction is made between voluntary or forced (mainly known as amortization) surrender of share and so-called caduceus (Article 139). The latter means the exclusion of partners from the company due to non-fulfillment of the contribution or its untimely fulfillment.

However, the disputed proceedings are replaced by non-disputed proceedings, which means that if the internal corporate procedure is followed, expulsion of partners from the company will not require an appeal to the court. The dogmatic reason for this change lies in the violation of the main obligation of the partner based on the share: at this time, due to the non-synallagmatic nature of the contribution agreement between the inferent and the business entity, the requirements related to the non-made contribution remain in force. As for another case, which provides for the exclusion of a partner from a company as a result of causing damage, this will be done through a lawsuit, as the current Georgian court practice shows.

Another important point: amortization means removing a share. In this case, the procedure is directed directly to a certain class of the entity's share, after which it is canceled. In the case of caduceus, the sanction, along with legal liability, bears corporate liability, is directed against the partner himself, which leads to his expulsion from the enterprise. In such a case, unless something else is established by the company charter or a separate decision of the partners, the share is not withdrawn. It will either be distributed to other partners or will be transferred to the ownership of the business entity as a result of its further alienation or withdrawal.

What also makes the LLC different from the JSC is the so-called partnership, that is, the binding of the governing body, or rather, the directors, to the decisions of the partners. The concept of fulfilling the instructions of the partners, depending on the instructions (Article 124,

paragraph 2 of the draft, paragraph 37,[30] although not literally, but as a result of a teleological interpretation) is excluded in the form of JSC, and the basis for this exclusion is Article 203 of the Act, which in this case is paragraph 76 of the German Stock Act. The first paragraph is a legal transplant. The board (*Vorstand*), i.e. the governing body (director), in our understanding, manages the business entity under its own responsibility. The principle of horizontality of bodies is strengthened in the law of the JSC, which excludes the concept of subordination of bodies. LLCs differ from JSCs in this way as well: the control system of the JSC enterprise, i.e. corporate management, is built on the so-called principle of enumerability. This is especially noteworthy in the dualistic system, where the obligations of the general assembly of shareholders (*Hauptversammlung der Aktionäre*) and the supervisory board (*Aufsichtsrat)* are regulated in detail. What is not included in their authority is the prerogative of the activity of the governing body.

6. Conclusion

Since 1 January 2022, Georgia has had a new corporate law, which is built on a regulatory function and formed as an area of statutory law. From the point of view of law policy, it is based on the regime of dispositional arrangement, although the exception is the regulation of the joint-stock company. The latter is based on the spirit of paragraph 23 section 5[31] of the German Stock Act, and is characterized by mandatory reservations. Saturation of modern Georgian corporate law with legislative norms is the best way to overcome corporate impasses. This process fills the vacuum regulating the relationship, although there is a large place given to statutory autonomy.

As a result of the recent reform, the law contributes to the foreseeability and predictability of the corporate-legal relationship, which instills more confidence in the (foreign or domestic) investor towards Georgian business. The containing norms are also equipped with a didactic function, which is especially necessary for the post-Soviet corporate economy. Modern (Western European) norms teach the participants of corporate relations the extent of their behavior and the justification of their actions. Following the reform, Georgian corporate law has been brought into compliance with supranational corporate law of Europe, and in this respect is fully close to it. This is a prerequisite for the fulfillment of the Association Agreement signed with the European Union (in this area).

30. In German law it is called *Weisungsrecht / Weisungsgebundenheit*. On the institution, see among others: Beurskens (2022) and Casper (2021).
31. So called Satzungsstrenge (Statutory stiffness)

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