



**COMPARATIVE ANALYSIS OF CORPORATE GOVERNANCE RULES
IN GERMANY AND GEORGIA**

Appointment, Functions and Revocation of Management

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Abstract

Georgia is one of the countries with transition economies that was born after collapse of Soviet Union in the beginning of 1990s. For transition economies to overcome problems related to stable economy, foreign investment and generally development is crucial the existence of conformable legislation basis. One of the parts of this legislation is corporate governance rules and company law which plays big role in ensuring formation of transparent and attractive environment for investing foreign capital. In this thesis I will try to answer some questions regarding attractiveness of company law and corporate governance rules in Georgian Joint Stock Companies and Limited Liability Companies. More attention will be paid on detailed analysis of rules regarding appointment, functions and revocation of management board. In the end recommendations for perfection of the legislation will be provided, which in my opinion is important and will contribute to development of corporate governance rules in compliance with instructions of international financial organizations and legislations of developed countries.

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INTRODUCTION

The term “Corporate Governance” that did not exist nearly twenty years ago, has become one of the favorite topics for analysis since 1990s in the field of company law.¹ There are lots of definitions of “corporate governance”, but these definitions are not mandatory and strict. The most universal and comprehensive definition in my opinion is provided by Organization for Economic Co-operation and Development according to which:

Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.²

After collapse of Soviet Union, extensive privatization began in former Soviet Union states. One of them was Georgia. The development of company law was led in different ways comparing to western countries, because of the lack of proper legislative background and financial institutions. According to OECD research in the field of corporate governance of Eurasia is explained that main reason of the failure of the economic system of the countries with transition economies was lack of good corporate governance rules.³ Managers and Directors of the companies did not recognize themselves as the representatives and accountables of shareholders which led to misuse of the financial resources of business enterprises.⁴ In the beginning of 1990s shifting from Soviet Union based planned economy to market economy was important goal for newly created independent state. Georgian legislation was for the first time introduced with different styles of property rights, financial reporting requirements, bankruptcy law, mergers and acquisitions and other major features of

¹ K. Keasey, S. Thompson and M. Wright (Edited by), *Corporate Governance: Accountability, Enterprise and International Comparison*,. 2005, John Wiley & Sons Ltd. ISBN 0-470-87030-3, p. 1

² OECD Principles of Corporate Governance. OECD, 2004, Preamble, page 11

³ Corporate Governance in Eurasia: A Comparative Overview. OECD. 2004. p. 16

⁴ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law), Tbilisi, “Samartali”, 2006, p. 52

company law. The Law of Georgia on Entrepreneurs was adopted in 1995 to introduce modern principles and terms of Company Law. Newly adopted law was not ideal, because of the fact that it did not satisfy the requirements of the existing reality and needed perfection that led to several amendments. Perfection of the legislation is dynamic process which continues even nowadays.⁵ That is why the Law of Georgia on Entrepreneurs since adoption was amended several times with the last amendment in March, 2008.

Business enterprises play major role in developing market economy and contributing to increase profitability and cash flow in private sector. Main goals and objectives of the companies are well described in International Financial Corporation (IFC) Georgia Corporate Governance Project Overview which defines profitability as the main idea and goal of the business enterprise. Well modified corporate governance rules are important tools for the protection of shareholders' rights.⁶ To be more precise and accurate in definition of the importance of corporate governance practices I would like to quote International Financial Corporation (IFC) Georgia Corporate Governance Project Overview according to which:

The absence of good corporate governance, even if a corporation that is performing well, may indicate vulnerability for stockholders because the corporation is not in a position to deal with financial or management challenges that may arise. The substance of good corporate governance is more important than its form, that is: adoption of a set of rules or principals or of any particular practice or policy is not a substitute for and does not itself assure good corporate governance.⁷

This description explains and follows that good corporate environment can lead to investments that have crucial importance for countries with transition economies. That is the

⁵ Sophio Chachava, Book review “*Corporate Governance and the Managers' Responsibility in Company Law, Lado Chanturia 2006, ISBN 99940-807-7-6*”, [http://www.geplac.org/newfiles/glr/2007/chachava\(eng\).pdf](http://www.geplac.org/newfiles/glr/2007/chachava(eng).pdf), last visited on 03.12.2008

⁶ International Financial Corporation (IFC) Georgia Corporate Governance Project Overview <http://www.ifc.org/ifcext/georgia.nsf/Content/CG>, last viewed on 03.03.2009

⁷ Ibid

reason why I decided to make research in this field of law and to contribute development of all-embracing legal sources vis-à-vis company law.

Importance of corporate governance rules is well defined in a comparative overview of corporate governance in Eurasia, made by OECD, according to which high-quality corporate governance is achieved only when all responsible personnel of the company, including members of supervisory board, management board, shareholders and also all other people interested in profitability and success know and execute their duties properly..⁸ In this thesis I would like to compare corporate governance rules of Georgia and Germany regarding appointment, functions and revocation of management. My main goal in choosing Germany as the example to compare with Georgia was given rise by the fact that basic principles and features of Georgian company law are quite similar to German legal system. Aim of this study is to find the loopholes of Georgian company law, in particular regarding management board of Limited Liability Companies and Joint Stock Companies and by making research of German legislation to form recommendations for future perfection of company law in Georgia.

According to the title of the topic my thesis work will be comparative analysis, so I will need literature about both Georgian and German company law and corporate governance. As there is no lack of both printed and internet based scholar literature about German business law, in particular company law and business enterprises, I would like to pay attention and review two most important sources I have chosen regarding Georgian commercial legal entities and corporate governance rules.

⁸ Corporate Governance in Eurasia: A Comparative Overview. OECD 2004, p. 16

The first source I would like to admit is “Comments on the Law on Entrepreneurs” by Lado Chanturia and Tedo Ninidze.⁹ The book deals with all aspects regarding Georgian Limited Liability Companies and Joint Stock Companies. It is divided in two parts: general and material parts. In general part there are discussed topics of the general character for all types of companies: registration; requirements for registration; principles and requirements of redomiciliation of the companies; procura and power of attorney; accounting and audit of the companies, mergers and acquisitions and all other subjects that regulate general functioning principles. Material part is more concentrated on actual terms regarding structure of the companies; appointment, functions and revocation issue concerning both supervisory board and management board; rights and functions of shareholders; issues regarding shareholders meeting and annual reporting and all other subjects of the specific character for LLC and JSC, which are closely related and useful for my research.

Second main source for review will be “Corporate Governance and Liability of Directors in Corporation Law” by Lado Chanturia.¹⁰ This book can be regarded as the first step to introduce to the reader comparative research of the corporate governance rules in the US, Germany, Georgia, Russia and Kazakhstan. It is particularly important for the developing and refining of the provisions regulating the managers’ responsibility and for the correct implementation of these provisions in practice. The author outlines the essence of the problem and stresses the importance of the responsibility of top managers in Company Law and offers comparative analysis of the legal regulation of the managers’ responsibility within the legal systems of the US, Germany and the post-Soviet states which are particularly interesting.

⁹ Lado Chanturia, Tedo Ninidze, *Metsarmeta shesaxe kanonis komentari, mesame gamocema* (Comments on the Law on Entrepreneurs, third edition) Samartali, Tbilisi, 2002

¹⁰ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law), Tbilisi, “Samartali”, 2006

Chapter 1 - Legal background and sources of law regarding corporations in Germany and Georgia

To better understand in details principles of management organization in German and Georgian business enterprises, it is useful to make small review about companies and legal sources regulating company law and corporate governance rules generally.

1.1 GmbHG

German law provides two principal types of business organizations. These are: *Gesellschaft mit beschränkter Haftung (GmbH)*¹¹, or Limited Liability Company and the *Aktiengesellschaft (AG)*¹², or corporation (Joint Stock Company). Formation, liquidation, organization and all other issues relating to functioning of GmbH are stated in German Limited Liability Companies Act¹³ – *GmbHG* (1892) which was adopted after realizing that AG could not satisfy businessmen' requirements and there was big interest from the part of small and medium business owners in limiting liability.¹⁴ Success of the *GmbHG* can be seen by the fact that not only German business community, but also other countries adopted laws that were leaned upon German Limited Liability Companies Act and shared similar basic models and ideas.¹⁵ *GmbHG* regulates issues regarding organization and functioning of *GmbH*. Besides the fact that there have been made only several amendments (the most important amendments were: 1980 *GmbHG* Amendment, 1985 Balance Sheet Directive Act,

¹¹ *Gesellschaft mit beschränkter Haftung (GmbH)* – Limited Liability Company

¹² *Aktiengesellschaft (AG)* – Stock Corporation (Joint Stock Company)

¹³ Larry Cata Backer, *Comparative Corporate Law – United States, European Union, China and Japan: Cases and Materials*, Carolina Academic Press, Durham, North Carolina, USA, 2002, ISBN: 0-89089-526-0, page 212.

¹⁴ Gregor Bachmann, *Introductory Editorial: Renovating the German Private Limited Company - Special Issue on the Reform of the GmbH*, GERMAN LAW JOURNAL, Vol. 09, No. 09, 2008, p. 1064

¹⁵ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 23, p. 13-15

1991 Act Implementing the 12th EEC Company Law Directive, 1993 Act Implementing the 11th EEC Company Law Directive and 1994 Introductory Law to the Insolvency Code) to the statute, it can be regarded as steady.¹⁶

GmbH originated in Germany and then by influence of German law spread across whole world.¹⁷ Comparing to Georgian Limited Liability Company, *GmbH* can be formed not only to gain profit¹⁸, but also for non-commercial reasons (e.g. pension funds, trade unions, different professional associations and etc.).¹⁹ According to *GmbHG* limited liability companies can be formed by one or more persons.²⁰ Comparing with *AG*, *GmbH* is divided into quotas and not shares.²¹ Main feature of German Limited Liability Company is the “exclusion of its members’ personal liability for the debts of the company in exchange for a minimum nominal capital of €25.000.”²²

After establishment of the limited liability company and registering it in commercial registry, company acquires “its own rights and incur its own obligations and it may sue and be sued in court.”²³ This form of business enterprise is very convenient, because of the fact that it can be used both for small business activities to huge multinational corporations with several subsidiaries. But there are several restrictions in German law, according to which not all industries can be formed as *GmbH*. Exceptions include insurance companies, commercial

¹⁶ See *Supra* note 15

¹⁷ Lado Chanturia, *Shesavali saqartvelos samokalako samartlis zogad natsilshi*, (Introduction to General Part of the Georgian Civil Law) “Samartali”, Tbilisi, 1997, p.295-296

¹⁸ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law) Tbilisi, “Samartali”, 2006, p.86

¹⁹ Henry P. De Vries and Friedrich K. Juenger, *Limited Liability Contract: The GmbH*, Columbia Law Review, Vol.64, No. 5, May 1964, p. 868

²⁰ *GmbHG* (Act on German Limited Liability Companies), § 1.

²¹ See *Supra* note 16, p. 870

²² Patrick C. Leyens, *German Company Law: Recent Developments and Future Challenges*, GERMAN LAW JOURNAL, Vol. 06, No. 10, 2005, p. 1409

²³ Dieter Beinert, *Corporate Acquisitions and Mergers in Germany*, Kluwer Law International, The Hague, 2000, p. 8-9

banks, drug stores and etc.²⁴ Main distinguishing feature from AG is that, shareholders of the company can not trade with shares on stock market. Besides this fact German Limited Liability Companies are very popular in Germany not only for local businessmen, but also for foreign investors.²⁵ Classification of *GmbHs* is possible by different criteria. For example, according to type of business, they can be commercial and non-commercial limited liability companies, or according to number of shareholders, they can be one person *GmbH*²⁶ and multi shareholders *GmbH*²⁷.

1.2 AktG

Next legal source regarding German company law I would like to pay attention is German Stock Corporation Act (*AktG*)²⁸ which was adopted in 1965. It is considered to be “one of the outstanding examples of enterprise law for public stock corporations in world corporate legal systems.”²⁹ The statute provides detailed analysis of the foundation and operation of the Stock Corporations. It is usually used for large enterprises.³⁰ AG can be considered as the classical model of capital enterprises, because it has guarantee capital defined by the articles of incorporation, which is divided into shares. These shares are expressed as stocks and bonds in stock markets for trade purposes. There is a big competition on the international stock market, where German Stock Corporations play big role as one of the adopted and dexterous form of business enterprise.³¹

²⁴ See *Supra* note 15

²⁵ See *Supra* note 20

²⁶ Einpersonengesellschaft

²⁷ Mehrpersonengesellschaft

²⁸ Aktiengesetz

²⁹ Phillip I. Blumberg, *The Multinational Challenge to Corporation law, The Search for a New Corporate Personality*, Oxford University Press, New York, 1993, p.161

³⁰ Dieter Beinert, *Corporate Acquisitions and Mergers in Germany*, Kluwer Law International, The Hague, 2000, p. 10

³¹ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law) Tbilisi, “Samartali”, 2006, p.83

According to German law, there are different types of stock corporations. These are: Public Stock Corporation³², which can be considered as the first-born among modern Stock Corporations. By the trade of the shares is achieved attraction of additional investment and by the same time is secured flow of the shares. Besides the fact that in modern reality, the majority of shares of public stock corporations are owned by so called “parent companies” and institutional investors, like Commercial Banks, Investment Companies and etc. this type of stock corporations best conform to the requirements of the stock market. Legal model of German Stock Corporation are created on the example of the Public Stock Corporation; all other types of AGs are just exceptions.³³

Another type of stock corporations is “Small Stock Corporation”.³⁴ They have small number of shareholders and are opposite of Public Stock Corporations. German Stock Corporation Act foresees simplified rules for Small Stock Corporations rather than Public AGs.³⁵ For example, in the case invitations for general meeting of shareholders³⁶ and during foundation of the company³⁷, the term “small” is used to denote that this type of Stock Corporation has small number of shareholders and it does not trade its shares on the stock market, but in reality these enterprises can be owners and parents of the biggest corporations.³⁸

Other types of stock corporations include Family Stock Corporations³⁹, where generally majority of the shares are gathered under the ownership of family. Usually articles of incorporation of the Family Stock Corporation contain provisions that restrict purchase of the

³² Die Publikums-AG

³³ *See Supra* note 31

³⁴ Die Kleine AG

³⁵ *Ibid*

³⁶ §§ 121, 124 AktG.

³⁷ § 2 AktG

³⁸ Karsten Schmidt, *Gesellschaftsrecht*, (Company Law), 4. Aufl, Heymanns, Köln, 2002, p. 772

³⁹ Die Familien-AG

shares from unknown persons. This is strengthened by Stock Corporation Act, according to which, there is possibility to issue vinculated shares in the name of the subscribing stockholder (registered shares);⁴⁰ also there are One Person Stock Corporation⁴¹, which is rare in Germany and as usually is created in case when founder is state or other legal entity.⁴²

Several steps should be made in order to establish Stock Corporation. These steps are formation of minutes and articles of incorporation in notarial form⁴³, subscribing contributions, which should be also in notarial form and registration to Commercial Register.⁴⁴ Before registration it is so-called “pre-company which does not constitute a juridical entity.”⁴⁵ According to § 41 of the AktG, anyone who acts in the name of company before registration in the Commercial Register will be personally liable.⁴⁶

1.3 German Co-Determination Act of 1976

The concept of co-determination confers to basic principle regarding employee participation at the level of management. These two principles are: “co-determination at establishment level by the works council ... and co-determination above establishment level, on the supervisory board of companies”.⁴⁷ Idea of co-determination dates back to 1920s when Works Councils Act⁴⁸ was adopted, which was followed by “Act on the Co-determination of Employees in the Supervisory & Management Boards of Companies in the Coal, Iron & Steel

⁴⁰ § 68 AktG

⁴¹ Die Einperson-AG

⁴² See *Supra* note 38, p. 773

⁴³ §§ 2, 23 AktG

⁴⁴ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 25

⁴⁵ Ibid

⁴⁶ § 41 AktG

⁴⁷ *Co-determination*, European Foundation for the Improvement of Living and Working Conditions, <http://www.eurofound.europa.eu/emire/GERMANY/CODETERMINATION-DE.htm>, last visited on March, 07 2009.

⁴⁸ Betriebsrätegesetz

Industry”⁴⁹ in 1951⁵⁰, which provided establishment of co-determination in supervisory boards in the industry of coal, iron and steel and also that “Decision to appoint of Labour Director cannot go against wishes of employee representatives on supervisory board”.⁵¹ Co-determination in companies with other type of business comparing coal, iron and steel industry is regulated by Works Constitution Act of 1952,⁵² according to which “employee representatives occupy only one third of seats on the supervisory board”.⁵³ All other forms of business enterprises are subject to Co-determination act of 1976. Co-determination Act applies to companies which employ more than 2000 employees⁵⁴, have legal form of “a joint stock company, a partnership limited by shares, a limited liability partnership or a trade and industrial cooperative”.⁵⁵

1.4 Law on Control and Transparency

In 1st of May, 1998 a new law was adopted about Control and Transparency (KonTraG)⁵⁶, which amended Stock Corporation Act. The reason for adoption of this statute was to improve corporate governance in companies regarding liabilities of management and supervisory board. According to KonTraG, management of the company has to create system of the risk management, according to which: “The management board shall take suitable measures, in particular surveillance measures, to ensure that developments threatening the continuation of the company are detected early”.⁵⁷ Obligation to create insider control

⁴⁹ Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten & Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie (Montan-Mitbestimmungsgesetz)

⁵⁰ Rebecca Page, *Co-determination in Germany - A Beginner's Guide*, 3. überarbeitete Auflage. Reihe: Arbeitspapier, Nr. 33. Düsseldorf 2006, p. 7

⁵¹ Ibid

⁵² Betriebsverfassungsgesetz

⁵³ See *Supra* note 47

⁵⁴ Act on Co-determination of Employees (Co-determination Act), May 4, 1976, Part 1, Article 1.1

⁵⁵ Ibid

⁵⁶ Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), Law on Control and Transparency of, April 27th, 1998, BGBI. I 1998, p. 786

⁵⁷ § 91 (2), AktG

mechanisms which has to be publicly accessible can be deemed as the main achievement of the KonTraG. Another important amendment provided to Stock Corporation Act by KonTraG was that “it extended the ability of a stock corporation to acquire its won shares up to an amount of 10 percent of its stated capital.”⁵⁸

1.5 Transparency and Disclosure Act

In order to introduce German company law with modern and perfect corporate governance rules, amendments made to Stock Corporation Act was not enough and there was need for something new. Due to this fact was adopted Transparency and Disclosure Act (TransPug)⁵⁹ which is one of the amendments of Stock Corporation Act. Main goal of the Act was to raise the level of competition in German stock market by implementing more transparency rules in the governance of the company. The main feature of the act is publishing annual corporate governance report, whether it coincides with German Corporate Governance Code or not. As stated by §161 of the Stock Corporation Act:

The management board and supervisory board of the listed company shall declare annually the recommendations of the “Government Commission German Corporate Governance Codex” published by the Federal Ministry of Justice in the official part of the electronic Federal Gazette has been and will be complied with or which recommendations have not been or will not be applied. The declaration shall be made permanently available to the shareholders.⁶⁰

This information periodically should be accessible to shareholders. In practice it means that the information should be published on the internet website and also it should be presented to shareholders as a report. Another achievement of the TransPuG is that broadcasting of the

⁵⁸ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 9

⁵⁹ *Gesetz zur weiteren Reform des Aktien-und Bilanzrechts, zu Transparenz und Publizität*, (Act for the purpose of further reform of stock corporation and accounting law, of transparency and disclosure), July 19th, 2002, German Bundesgesetzblatt (BGB1), part I, p. 2681

⁶⁰ § 161, AktG

shareholders meeting can be made by “audio-visual transmission”⁶¹. These amendments increased duty of care obligations from the side of management and supervisory board, but according to Patrick C. Leyens, “the underlying comply-or-explain approach is an important step ahead and leads towards higher levels of transparency and governance standards that can be tailored to the individual needs of each single company”.⁶²

1.6 Corporate Governance Code

Adoption of German Corporate Governance Code⁶³ is another step for the improvement of Stock Corporation Act, which was adopted by Government Commission of Corporate Governance. The Code is “guideline to both German and international investors.... The key objective of the Code is thus to boost confidence in the management of German companies.”⁶⁴ The Code itself is not a law; it does not contain any imperative provisions. It provides only recommendations which are enforced voluntarily especially by the companies trading on stock market. The basic features offered by the Code are connected with annual declarations made by management and supervisory board, whether their activities meet the terms of the code or not; and if not then which recommendations are not enforced.

Every year Government Commission updates information regarding compliance of the Corporate Governance Code with newly adopted laws or requirements of the stock market. There were several amendments made to the Code, with the last time amended on June 6th 2008. In order to clarify main goal of the Corporate Governance Code, I would like to show examples of Declarations of Conformity provided by Volkswagen Group (Volkswagen AG)

⁶¹ § 118 (2), AktG

⁶² *German Company Law: Recent Developments and Future Challenges*, Patrick C. Leyens, GERMAN LAW JOURNAL, Vol. 06, No. 10, 2005, p. 1412

⁶³ German Corporate Governance Code, February 26th 2002

⁶⁴ *Corporate Governance in Germany and Corporate Governance Code*, Gerhard Cromme, Corporate Governance, Vol. 13, No. 3, 2005, p. 364

and BMW Group (Bayerische Motoren Werke AG) vis-à-vis recommendations of the Corporate Governance Code in accordance with §161 of the German Stock Corporation Act. According to the Declaration of Conformity provided by Volkswagen Group in 2008, supervisory board and management board announced that recommendations of the Corporate Governance Code were complied with, except “for sections 4.2.2 para. 1 (Supervisory Board resolution regarding the compensation system for the Board of Management), 4.2.3 para. 4 and 5 (severance payment cap) and 5.3.3 (formation of a Nomination Committee).”⁶⁵ Annual Report 2007 of the BMW group contains provisions regarding conformity with Corporate Governance Code, which provides one disagreement with recommendations; in particular, annual report states that company complies with all recommendations except one, regarding “the discussion and regular review of the structure of the compensation system of the Board of Management is performed by the Personnel Committee and not, additionally, by the Supervisory Board (section 4.2.2 paragraph 1 GCGC).”⁶⁶

1.7 Georgian Law on Entrepreneurs

In 28th of October, 1994, after hard debates and discussions was adopted Georgian Law on Entrepreneurs.⁶⁷ During the history of Georgia this is the first statute in private law, which corresponds to experience of the countries with modern market economy. After adoption the statute was regarded to be German, but in reality it is not. One can not find such united act in Germany and also in other European countries. This is “Georgian Law” adopted by way of

⁶⁵ Volkswagen AG, Declaration of Conformity, http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/corporate_governance/declaration_of_conformity.html, last visited on March 12th 2009.

⁶⁶ “Declaration of the Board of Management and of the Supervisory Board of Bayerische Motoren Werke Aktiengesellschaft with respect to the recommendations of the “Government Commission of the German Corporate Governance Code” pursuant to § 161 German Stock Corporation Act”; Annual Report 2007, BMW Group, www.bmwgroup.com, p. 147

⁶⁷ Saqartvelos Kanoni Metsarmeta Shesaxeb, (Georgian Law on Entrepreneurs), October 28th 1994.

strong cooperation with German scholars which is based on the continental European traditions and legal principles.⁶⁸

Georgian Law on Entrepreneurs is divided into general and material parts. General part regulates the issues which are similar for all types of Entrepreneurs and should be working in the same way. In particular, general part standardizes questions related to establishment, registration and name of company, management and representation, accounting and reporting requirements, issues related to reorganization and liquidation of the companies; redomiciliation; procura and power of attorney and etc.

Material part of the law contains provisions related to the seven main types of entrepreneurships. These commercial private enterprises are: Sole Proprietorship, commercial partnership Partnership, Limited Partnership, Limited Liability Company, Joint Stock Company and Cooperative. For this thesis I would like pay attention only to capital enterprises: Limited Liability Company (LLC) and Joint Stock Company (JSC).

The reason for the popularity of Limited Liability Companies in Georgia is the same as in other countries: simplicity and small amount of minimum registered capital. According to 2007 report provided by Department of Statistics under Ministry of Economic Development of Georgia, the number of Limited Liability Companies in 2006 was 46280, which was 28.8% of whole number of enterprises.⁶⁹ The definition of the Limited Liability Company is provided in the Law on Entrepreneurs, according to which Limited Liability Company is a commercial enterprise and it means that LLC can not be established for non-commercial

⁶⁸ Lado Chanturia, Tedo Ninidze, *Metsarmeta Shesaxe Kanonis Komentari – Mesame Gamotsema*, (Comments of the Law on Entrepreneurs – Third Edition), publishers' house "Samartali", Tbilisi, 2002, p. VIII

⁶⁹ Metsarmeoba Sakartveloshi (Entrepreneurship in Georgia), statistical publication, Ministry of Economic Development of Georgia, Department of Statistics, Tbilisi, 2007, p. 27, <http://www.statistics.ge/main.php?plang=1&pform=96> last visited 14.03.2009

reasons.⁷⁰ As with all capital enterprises, one of the conditions for establishment of LLC is minimum capital requirement, which after amendment of the law in 14th of March, 2008 is now symbolical and minimum registered capital can be any sum.⁷¹ Foundation of the Limited Liability Company is possible by one person and there are no restrictions regarding this matter in the law.

Joint Stock Company (JSC) is only enterprise that can issue and trade securities. Like Limited Liability Company it can be established only for commercial reasons. The definition of Joint Stock Company is provided in Article 51.1 of Law on Entrepreneurs, according to which Joint Stock Company is an enterprise whose capital is divided into shares according to defined class and quantity that is provided by the articles of incorporation.⁷² Georgian Company Law distinguishes two types of Joint Stock Companies. The first one, JSC, which has less than 50 shareholders, has to make and update registry of the shareholders by itself or by independent registrar. This kind of Joint Stock Company can be called Closed Joint Stock Company. Second type of JSC, which has more than 50 shareholders, is obliged to keep the registry by independent registrar. This sort of JSC can be called Public Joint Stock Company. This division is conditional and is important only during the trading with shares.⁷³ In particular, the transfer of the shares of JSC, whose registry is kept by independent registrar, is enforced according to rules determined by the Georgian Law on Securities Market. In other cases, transfer of shares is performed by amendment of the registry and it should be certified by the person responsible for keeping the registry.⁷⁴ This is only type of classification which

⁷⁰ Article 28 Georgian Civil Code, 26th of June, 1997

⁷¹ Article 45 Georgian Law on Entrepreneurs

⁷² See *Supra* note 71, article 51.1

⁷³ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law) Tbilisi, "Samartali", 2006, p.104

⁷⁴ See *Supra* note 71, article 51.4

is familiar with Joint Stock Company. Even, when the state is the shareholder of the JSC, it has no privileges and different or special status.

1.8 Law of Georgia on Securities Market

Notwithstanding the fact that activities of the Georgian enterprises are regulated by Law on Entrepreneurs, some of the topics related to company law and corporate governance rules are also regulated by Georgian Law on Securities Market. European Bank of Reconstruction and Development (EBRD) performed categorization on the legislation of the corporate governance and securities markets. Assessment was executed for the conformity of legislations with the OECD Principles of Corporate Governance. 27 countries were divided into five categories: “Very high compliance”, “high compliance”, “medium compliance”, “low compliance” and “very low compliance”.⁷⁵ According to this report, for corporate governance legislation Georgia was rated “low compliance”, which means that legislation regarding the issue is not in compliance and needs reforms; and for securities market legislation was rated “medium compliance”, meaning that, only some terms need to be improved.⁷⁶

Law of Georgia on Securities Market was adopted on 24th of December, 1998 and is thought to be more Anglo-American model.⁷⁷ Main goal of this law is to contribute development of the Georgian securities market, protection of investors, “to ensure the transparency of issuers information during the securities offering and public trading in securities as well as to

⁷⁵ Gian Piero Cigna, *Assessing Corporate Governance and Securities Market Legislation in Early Transition Countries*, EBRD, Law in Transition, London 2006, p. 40 <http://www.ebrd.com/country/sector/law/articles/> last visited on 15th March 2009.

⁷⁶ See *Supra* note 76, p. 44

⁷⁷ Ibid

establish fair and transparent public trading in securities and free competition.”⁷⁸ Main feature of this Law regarding corporate governance rules and company law is introduction to the reporting requirements. Article 9 of the Law regulates reporting companies, according to which reporting enterprise is company established under the Law on Entrepreneurs and which is trading issued securities on stock market or by the way of public offer.⁷⁹ As I have mentioned above only enterprise that can issue securities and trade is Joint Stock Company. So, this Law is concerned to Georgian Joint Stock Companies. By reporting feature Law of Georgia on Securities Market in some aspects can be compared to German Corporate Governance Code, which also provides reporting recommendations for companies trading on securities market. Difference is that Corporate Governance Code is not a statute and is not obligatory to apply, while Law of Georgia on Securities Market is mandatory applicable.

According to Article 11, all reporting companies should prepare annual, semi-annual and current reports. Semi-annual report should be prepared in every six months, while current reports should be prepared for some special occasions. All these reports should be certified by the signatures of responsible persons for the representation and by the Head of the Supervisory Board of the reporting company.⁸⁰ The Law also regulates issues related with the confidentiality of the reporting company, obligations of the management board of the reporting company and other subjects concerning functions of the management board.

Because of the above mentioned terms provided by the Law of Georgia on Securities Market, it can be useful source for my thesis paper in combination with other statutes or regulations.

⁷⁸ Law of Georgia on Securities Market, December 28th 1998, preamble

⁷⁹ Law of Georgia on Securities Market, December 28th 1998, Article 9.1

⁸⁰ Law of Georgia on Securities Market, December 28th 1998, Article 11

Chapter 2 - Composition and system of the management

Management system and competencies of the modern corporations are main topics for international discussions about corporate governance. According to organization of the management two types of systems have been created during the history, the Anglo-Saxon one-tier system and Continental European two-tier system.⁸¹ Main difference in these two models is in the composition of the management board. In one-tier management system there are two governing bodies, shareholders meeting and board of directors, while two-tier system consists of three managing organs, general meeting of shareholders, supervisory board and board of directors. The first one is strengthened by American company law, whereas the second is supported by German company law. In some countries like Germany, Austria and Switzerland two-tier management system is compulsory, while in other countries like France, the Netherlands, Portugal and Finland; they can choose the type of model they want to apply.⁸²

2.1 *Aktiengesellschaft (GERMANY)*

Main dignity of German based two-tier composition system of management is sharply divided functions of management and control among governing bodies. Interesting point is that there is no hierarchical subordination of governing bodies, in particular, supervisory board and board of directors.

⁸¹ Joze Bajuk, *One-tier or two-tier governance: which is better?* Socius Consulting Network, 19th August 2005, available at www.socius.si/media/uploads/file/article_4132.pdf, last visited 16th March 2009, p. 1

⁸² Diane K. Denis, John T. McConnell, *International Corporate Governance*, The Journal of Financial and Quantitative Analysis, published by University of Washington School of Business Administration, Vol. 38, No. 1, 2003, p. 6

Stock Corporation has a two-tier (dual board) structure which strictly separates the roles of management and supervision. Management board is responsible for the directing the enterprise, whereas the supervisory board appoints, supervises and advises the members of the management board.⁸³

Board of Directors (Der Vorstand) is the managing body of the German Stock Corporation, which deals with the day-to-day business of the company under its direct responsibility.⁸⁴ Besides leading corporations' everyday business, Management Board has full and unlimited power to represent company toward third parties⁸⁵, makes strategic decisions and implements them into company's industry.⁸⁶ To lead corporation under its direct responsibility means that management board is not dependent on the instructions of the shareholders. The fact that supervisory board represents the controlling organ for the management board does not change the situation of board of directors.

The Board of Directors of the German Stock Corporation may be comprised of one or more members. In companies, having registered capital more than 3 million Euros, the board of directors shall compose not less than two persons, except the occasion when the articles of incorporation provides that the management board consists of only one member.⁸⁷

Main distinctive point familiar to management board of the Stock Corporation is that it is collegiate organ. This status is important not only for relations with supervisory board or shareholders, but also among members of management board. When Board of Directors

⁸³ Christine A. Mallin (edited by), *Handbook on International Corporate Governance: Country Analysis*, printed in Great Britain by MPG Books Ltd, Bodmin, Cornwall, page 31

⁸⁴ § 76 (1) AktG.

⁸⁵ § 78 AktG.

⁸⁶ Dieter Beinert, *Corporate Acquisitions and Mergers in Germany*, Kluwer Law International, The Hague, 2000, p. 10

⁸⁷ § 76 (2) AktG

consist of several members, supervisory board has right to elect the Head of the Board. Member of the Management Board shall be only natural person with full legal capacity.⁸⁸ Relation between members of Board of Directors and Stock Corporation itself is two-type: Corporate Relation and Contract Relation. Appointment of board member is a corporate legal action, while making agreement with the member of the Board is contract law act.⁸⁹

Next tier I would like to review is the supervisory board (Der Aufsichtsrat) of the German Stock Corporation. Supervisory board is formed by the representatives of the shareholders and employees.⁹⁰ Representation of the employees is regulated by German Co-determination Act, which provides possibility for workers of the company to be elected in the supervisory board. Number of the employ representation depends on the total number of workers in the company, for example supervisory board of the company “normally employing not more than 10,000 employees shall consist of six shareholders’ members and six employees’ members”.⁹¹ If there are six employees representatives in the supervisory board, four of them should be employees of the company and two should be representatives of the trade union.⁹²

Members of the supervisory board appointed by the shareholders are elected on the shareholders meeting or selected by the individual shareholders, but only if this option is provided by the articles of association. Very often, members of the supervisory boards are representatives of commercial banks, qualified executives or generally the outsiders.⁹³

⁸⁸ § 76 (3) AktG

⁸⁹ Lado Chanturia, *Korporatsiuli martva da xelmdzgvanelta pasukhismgebloba sakorporatsio samartalshi*, (Corporate Governance and Liability of Directors in Corporation Law), Tbilisi, “Samartali”, 2006, p. 52

⁹⁰ Julian Franks and Colin Mayer, *Ownership and Control of German Corporations*, The Review of Financial Studies, Oxford University Press, Vol. 14, No. 4, 2001, p. 952

⁹¹ Act on Co-determination of Employees (Co-determination Act), May 4, 1976, Part 2, Article 7.1.1

⁹² Act on Co-determination of Employees (Co-determination Act), May 4, 1976, Part 2, Article 7.2.1

⁹³ Dieter Beinert, *Corporate Acquisitions and Mergers in Germany*, Kluwer Law International, The Hague, 2000, p. 11

Members of the supervisory board have no right to be also members of the management board.⁹⁴

Main function of the supervisory board is the appointment and revocation of the management board together with supervising the management of the company.⁹⁵ Important issue is that supervisory board monitors and supervises only the activities of management and not Stock Corporation itself. It can not give direct instructions to the management board to be performed, but management board makes permanent reports and also requires consent from supervisory board for some special tasks.⁹⁶ Besides management duty to report supervisory board, the later can request information of its interest from management to be provided.⁹⁷ Another important role of the supervisory board is connected to the Annual Report of the company. Supervisory board members instruct auditors for annual and consolidated financial statements and after making final report it should provide written statement about arrangement of the company's' profits.⁹⁸

Competence of the shareholders' meeting (Die Hauptversammlung) is comprehensibly defined by German Stock Corporation Act; in particular it is defined by articles of association. Shareholders' meeting is not constant body of the company. It can be assembled upon call of management or supervisory board.

⁹⁴ § 105 (1) AktG

⁹⁵ § 111 (1) AktG

⁹⁶ Reinhard Schmidt H., *Corporate Governance in Germany: An Economic Perspective*, Center For Financial Studies, CFS Working Paper No. 2003/36, Frankfurt am Main, 2003, p. 8

⁹⁷ Rebecca Page, *Co-determination in Germany - A Beginner's Guide*, 3. überarbeitete Auflage. Reihe: Arbeitspapier, Nr. 33. Düsseldorf 2006, p. 20

⁹⁸ Ibid

The functions of the shareholders' meeting are defined only by articles of association which means that no other authority can be given by other bodies.⁹⁹ Rights of the shareholders' meeting can be classified by its type. According to Bernhard V. Falkenhausen and Ernst C. Steefel there are three types of rights:

1. The right to participate in the administration of a company, i.e., the right to influence the appointment of the principal managers of the corporation and its economic development;
2. Proprietary rights, i.e., the right to participate in the earnings and future growth of the company as well as in the proceeds of its liquidation; further, the right to dispose of shares, the right to have one's investment protected against dilution and "freeze out";
3. Remedies to enforce the rights under 1. and 2., i.e. rights to information and inspection and resort to the courts.¹⁰⁰

Tasks of the shareholders' meeting include appointment and removal of members of the supervisory board which are shareholders' representatives.¹⁰¹ Distribution of the annual profit is another main function of the shareholders' meeting. According to §174 of the German Stock Corporation Act, after approval of annual financial statements, shareholders' meeting "shall resolve on the appropriation of distributable profits", ¹⁰² according to which is determined the amount distributable to shareholders, or transferable to profit reserves, or any other miscellaneous expenses.¹⁰³ Further exclusive rights of the shareholders' meeting include amendment of articles of association. It is very important function, because it can affect the principle issues of the corporation. Amendment may be made to all the terms of the articles of incorporation.¹⁰⁴ Other functions of the shareholders' meeting include appointment

⁹⁹ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 113

¹⁰⁰ Bernhard V. Falkenhausen and Ernst C. Steefel, *Shareholders' Rights in German Corporations (AG and GmbH)*, The American Journal of Comparative Law, Vol. 10, No. 4, published by American Society of Comparative Law, 1961, p. 409

¹⁰¹ In German Stock Corporations 1/3 members of the supervisory board are appointed by employees pursuant to German Co-Determination Act and §101 of the AktG.

¹⁰² § 174 (1) AktG

¹⁰³ § 174 (2) AktG

¹⁰⁴ See *Supra* note 100, p. 414-415

of auditors,¹⁰⁵ approval of annual financial statements,¹⁰⁶ capital increases and decreases¹⁰⁷ and etc.

2.2 GmbH (GERMANY)

For German Liability Companies mandatory governing authorities are shareholders (Gesellschafter) and management (Geschäftsführer). GmbH is very pliable entity; shareholders have almost unlimited options in forming structure of the enterprise. Shareholders have possibility to create supervisory board.¹⁰⁸ GmbH being subject to employ co-determination in case of having more than 500 employees is obliged to form supervisory board, also represented by employees.¹⁰⁹ Mandatory supervisory board is established in case of investment companies as well. According to German Investment Act, supervisory board is also formed when investment company operates in the form of GmbH.¹¹⁰ In case of supervisory boards' existence, terms regulating supervisory board and its rights in German Stock Corporations shall be applied.

In GmbH shareholders' meeting has highest authority. It can appoint and revoke managing directors, can make amendments to the articles of association and decide financial issues like capital increase and decrease.¹¹¹ Competence of shareholders is prescribed in GmbHG, according to which, shareholders decide on: "the annual financial statements and the appropriation of the profits;" approval of group accounts, publication of individual accounts

¹⁰⁵ § 119 (1) AktG

¹⁰⁶ § 270 (2) AktG

¹⁰⁷ § 192 (1) AktG

¹⁰⁸ Michael Beurskens and Ulrich Noack, *The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century*, GMBH – SPECIAL ISSUE, German Law Journal, Vol. 09 No. 09, 2008, p. 1077

¹⁰⁹ Dieter Beinert, *Corporate Acquisitions and Mergers in Germany*, Kluwer Law International, The Hague, 2000, p. 9

¹¹⁰ § 6 (2) InvG (Investmentgesetz, German Investment Act)

¹¹¹ See *Supra* note 109, p. 8

according to International Accounting Standards (IAS) which is provided in German Commercial Code (Handelsgesetzbuch)¹¹². Commercial Code describes terms related to management report and consolidated management report, which is mandatory for GmbHs.¹¹³

GmbH must have one or several managing directors. Director can be only natural person. If there is supervisory board established in German Liability Company, member of supervisory board can not be appointed at the same time on the position of managing director. Besides the fact, that director is the manager of the company representing company's interests to third parties, comparing to Stock Corporation, he/she has no supreme independence. In particular, for managing directors it is mandatory to execute instructions given by shareholders, which is not familiar with German Stock Corporation. It can be drawn up that the subjects of liability in GmbH are directors and in case of the existence of supervisory board, members of the board.

2.3 Joint Stock Company (GEORGIA)

System of the corporate governance in Georgia is based on German corporate governance model. Some of the shortcomings of the German corporate governance system were not taken into consideration. An example is mandatory employee co-determination on the level of supervisory boards in German Stock Corporations and Limited Liability Companies which is not familiar to Georgian company law. For Georgian corporate governance system is typical sharp distinction of power between separate governing bodies.

¹¹² § 46 GmbHG

¹¹³ § 289, 315 (2) HG, (Handelsgesetzbuch – German Commercial Code)

Georgian model of the Joint Stock Company is elective two-tier. Along with shareholders' meeting establishment of supervisory board and management board is not mandatory like in German Stock Corporations. Competence of the shareholders' meeting is exhaustively described in the Law on Entrepreneurs, according to which shareholders' meeting has right to amend articles of association, to make decision regarding reorganization and liquidation of the entity, to elect and remove the members of the supervisory board, to approve reports provided by management board and/or supervisory board, to elect an auditor, mergers and acquisitions and etc.¹¹⁴ Shareholders' meeting has authority for acquisition and alienation of the company's property, if the value of the property exceeds one half of the total assets. Functions of the shareholders' meeting are limited by the Law. On other issues not listed as the authority of shareholders' meeting, decision is made either by management board or supervisory board.

There are two types of shareholders' meetings: general and external meetings. General meeting should be appointed during two months after submission of the annual and/or consolidated report. In case of shareholders' external meeting, the initiators may be Director (Chief Executive Officer) of the company, supervisory board and shareholders owning at least 5% of the shares.¹¹⁵ Georgian legislation provides two categories of shares. Definition and division of the shares by classes is important while discussing powers and obligations of the shareholders.¹¹⁶ These are ordinary and privileged shares. In case of ordinary shares, the

¹¹⁴ Article 54.6 Law on Entrepreneurs of Georgia

¹¹⁵ Irakli Gvaladze, *General Meeting of shareholders*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project <http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 6, December-January-February 2004-2005, p. 4-6

¹¹⁶ Irakli Gvaladze, Irina Gordeladze, *Rights and Responsibilities of shareholders*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project <http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 3, March-April-May 2004, p. 4-7

principle of one share - one vote is used, while owners of the privileged shares have no right to vote. They get dividends according to special rates defined in the articles of association.¹¹⁷

As I have mentioned above, one of the functions of the shareholders' meeting is election and removal of members of supervisory board. Supervisory board shall consist of at least 3 and maximum 21 members. In Joint Stock Companies where state owns more than 50% of the shares supervisory board shall consist not more than 7 members. In my opinion the reason of this restriction is saving state financial resources. There is different situation regarding commercial banks, where number of the supervisory board members should be odd number.¹¹⁸ Functions of the supervisory board, like shareholders' meeting, are also prescribed in the Law on Entrepreneurs precisely. But additionally supervisory board has authority to make decisions on the topics not performed by shareholders' meeting and management board.

Together with other roles of the supervisory board, one of the main points is appointing, removal and control over the business of management board. To perform the power of control and monitoring, supervisory board can request report concerning activities of the company. In case when usage of the company sources is under doubt, supervisory board is obliged to request information and non-performance of this obligation can lead to liability of supervisory board members.¹¹⁹ Power of control and monitoring of management boards' activity is also strengthened by the fact that supervisory board shall present to shareholders' meeting information on the level of the control and what amendments were made to the

¹¹⁷ Article 52.1 Law on Entrepreneurs of Georgia

¹¹⁸ Article 13 Law of Georgia on Activities of Commercial Banks, February, 23 1996

¹¹⁹ Avto Svanidze, *Supervisory Board – Serving Public Interest*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project
<http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 4, June-July-August 2004, p. 4-7

annual and consolidated report.¹²⁰ Other important functions of supervisory board include defining politics and future strategy of the enterprise. It is truth that supervisory board does not participate in day-to-day activities of the company, but it should contribute in making annual budget and the project plan for investments together with management board.

Like German Stock Corporation, in Georgian Joint Stock Companies management function is carried out by directors or board of directors in case if entity has more than one director. They are entitled to represent company's interests to third parties.¹²¹ The instructions given by supervisory board and shareholders' meeting are not mandatory for management board. Hence it follows that management board is not executive body of the enterprise. Executive function of the board of directors is exercised only while implementing decisions made by shareholders' meeting or supervisory board. Management board is obliged to perform his duties honestly, because in case of loss, it will be responsible fully with their whole assets.

Management board is independent body of the enterprise, whose functions can not be transferred to other body. It is impossible to request from board of directors to control activities of whole entity, especially in big companies. Deciding minor issues should be transferred to lower management. So, it is important to know, whether how far can director rely on information provided by employees of the entity.¹²² The answer for this problem is partially solved by Law on Securities Market, according to which management board or managing director can rely on information and/or reports, if provided by:

- a) one of more officers or employees of the company whom such member reasonably believes to be reliable and competent in the matters

¹²⁰ See *Supra* note 120

¹²¹ Article 56 Law on Entrepreneurs of Georgia

¹²² Avto Svanidze, *Director as a Profession – a Privilege or a Burden*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project <http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 2, December-January-February 2003-2004, p. 4-8

presented; or
b) legal counsel, auditors or other persons as to matters such member reasonably believes are within the person's professional or expert competence.¹²³

So, appointment right of management board is an important feature of supervisory board, because it can lead company either to profitability or insolvency.

2.4 Limited Liability Company

Comparing to Joint Stock Company, the structure of the Limited Liability Company is simpler. It has only two bodies – general meeting of shareholders' and director.¹²⁴ Establishment of supervisory board is also optional and depends on the decision of shareholders' meeting.

Shareholders' meeting has wide range of authorities. It appoints and removes directors.¹²⁵ But, in case of supervisory board existence, appointment and removal power is transferred to supervisory board. Shareholders have also authority to acquire, sell or mortgage property.¹²⁶ They make amendments to articles of association and define rights and obligations of management board.

¹²³ Article 16.4 Law of Georgia on Securities Market

¹²⁴ If a limited liability company has more than one managing director with power of representation, than it has board of directors.

¹²⁵ Article 47.3 Law on Entrepreneurs

¹²⁶ Article 45.3 Law on Entrepreneurs

Chapter 3 - Appointment, functions and revocation of management board according to German and Georgian legislation

3.1 Germany

3.1.1 Aktiengesellschaft

According to AktG, management board has sole responsibility to manage the company.¹²⁷

Management board may consist of one or more persons, but German Stock Corporation Act makes exception and underlines that if company's registered capital is more than 3 million Euros, the management board must comprise at least two persons if opposite is not clearly provided by articles of association¹²⁸. German Corporate Governance Code recommends stock corporations to have management board comprised by several persons and to have chairman or spokesman.¹²⁹

There are restrictions regarding persons who can be appointed in the management board. German Stock Corporation Act allows being member of board only to natural persons with full legal capacity, which means that other companies can not be members of the management board.¹³⁰ There is another limitation regarding members of supervisory board, according to which members of supervisory board can not be appointed in the management board at the same time.¹³¹ Exception is that member of supervisory board can be appointed in the management board but for not more than one year, which can be renewed if there is vacancy in the board of directors, but in this case they will not have right to exercise their

¹²⁷ § 76 (1) AktG

¹²⁸ § 76 (2) AktG

¹²⁹ § 4.2.1 German Corporate Governance Code

¹³⁰ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 47

¹³¹ Ibid

supervisory board powers.¹³² While serving as members of management board, they are deemed to be deputy members of the board.¹³³

Appointment of management board is done by the supervisory board. Term of appointment for the member of board is five years, which can be subject for renewal, but each of renewal shall not exceed five years term.¹³⁴ There is no minimum term for members of management board provided by the German Stock Corporation Act, but supervisory board can not be forced to appoint directors for the second term. So, employment contract shall not include any obligations to appoint member of the board for above the term of limited period.¹³⁵ If company's management board is comprised with more than one person, supervisory board shall appoint chairman of the board¹³⁶ and deputy chairman. Appointment of the chairperson shall be registered in the Commercial Register.

For companies which are not the subject of co-determination, only simple majority decision is required to appoint members of management board.¹³⁷ If company is subject to the Co-determination Act, then it requires resolutions with more than simple majority. In particular, "The members of the body responsible for the legal representation of the company shall be appointed by the supervisory board by a majority of at least two-thirds of the votes cast by its members."¹³⁸ If the two-thirds majority is not achieved, then committee established under Co-determination Act¹³⁹ will offer candidate for appointment. The resolution is made by simple majority of the supervisory board. But, if the votes are equal, then another election is

¹³² § 105 (2) AktG

¹³³ Ibid

¹³⁴ § 84 (1) AktG

¹³⁵ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 48

¹³⁶ § 84 (2) AktG

¹³⁷ § 108, 84 (4) AktG

¹³⁸ § 31 (2) Co-determination Act

¹³⁹ § 27 (3) Co-determination Act

made, where chairman of the supervisory board will have two votes in case there is tied vote again.¹⁴⁰

During appointment of the member of management board, supervisory board shall decide the issue regarding representation of the company to third parties, whether one can represent company alone or together with other members of board. Appointment of the board member with representation power shall be registered in the Commercial Register. They also must provide their signatures¹⁴¹ which have to be certified by public notary. Power of representation means that members have right to represent company in all commercial transactions. As usually, representation issue is regulated by articles of association. For example, according to articles of association of Deutsche Bank AG, “The Company shall be legally represented by two members of the Management Board or by one member jointly with a holder of procuration (Prokurist),”¹⁴² or according to articles of association of Volkswagen AG, “The company will be represented by two members of the Board of Management or by one such member and one authorized signatory.”¹⁴³

Besides power of representation, members of management board have rights provided by by-laws. These internal rules are established by management board itself if otherwise is not stated in articles of association.¹⁴⁴ Usually by-laws contain provisions regulating place and time of board meeting, presiding person of the meeting, also who will maintain the Minutes

¹⁴⁰ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 50

¹⁴¹ § 81 AktG

¹⁴² § 7 (1) Articles of Association of Deutsche Bank AG in conformity with the resolution of the Chairman's Committee of the Supervisory Board on February 23, 2009;

http://www.db.com/ir/en/content/articles_of_association.htm last visited March 22, 2009.

¹⁴³ § 7 Articles of Association of Volkswagen AG, current version as at March 2009;

http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/corporate_governance/satzung.html last visited March 22, 2009.

¹⁴⁴ § 77 (2) AktG

of the meeting and so on.¹⁴⁵ AktG provides that all resolutions should be made by unanimous vote, because in case of several members of board, they have to manage company jointly, unless there is majority vote exception made by articles of association or by-laws.¹⁴⁶

Management board is independent body, but articles of association can determine some issues of the company's activities to be carried out only by consent of supervisory board. In case if supervisory board rejects the proposal of the management board, then management board can request approval from shareholders' meeting. The decision should be made with majority voting, of not less than three-fourths of the cast.¹⁴⁷ German Stock Corporation does not provide detailed list of activities and decisions to be approved by consent of supervisory board. Usually these decisions are offered by articles of association. For example, according to articles of association of Volkswagen AG, prior consent of the supervisory board is required for:

1. Establishment and closure of branches
2. Establishment and relocation of production facilities
3. Formation and dissolution of other enterprises or acquisition and disposal of holdings in other enterprises
4. Investments within the scope of investment programmes which are to be submitted on a regular basis and investments such as are outside the scope of such investment programmes insofar as the costs in any individual case exceed a limit to be laid down by the Supervisory Board
5. Raising of loans or credits which exceed the scope of routine business
6. Assumption of guarantees and similar commitments as well as granting of credits insofar as such measures exceed the scope of routine business
7. Acquisition, disposal and encumbering of real property and equivalent rights
8. Appointment of authorized signatories and fully authorized representatives¹⁴⁸

¹⁴⁵ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 53

¹⁴⁶ § 77 (1) AktG

¹⁴⁷ § 111 (4) AktG

¹⁴⁸ § 9 (1) Articles of Association of Volkswagen AG, current version as at March 2009;

http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/corporate_governance/satzung.html
last visited March 22, 2009.

Apart from the consent of supervisory board, certain management decisions should be approved also by shareholders' meeting. Stock Corporation Act provides clause according to which shareholders' meeting shall give approval to the management board's matters only if it is required by the board.¹⁴⁹ Requested matter should be approved during first eight months of the fiscal year.¹⁵⁰ Articles of association of Deutsche Bank AG provide that "The General Meeting called to adopt the resolutions concerning the ratification of acts of management of the Management Board and the Supervisory Board ... shall be held within the first eight months of each financial year."¹⁵¹

Management board has responsibility to report to the supervisory board on some matters. Corporate Governance Code provides that supervisory board shall indicate to the management board about reporting duties in details.¹⁵² The report should be in written including electronic form. German Stock Corporation Act offers detailed list of matters that should be reported to supervisory board. Management board shall provide report about future business policy of the company,¹⁵³ statement regarding financial matters of the company, profitability and annual financial report,¹⁵⁴ general conditions of the company¹⁵⁵ and about activities that can affect company's profitability and liquidity¹⁵⁶. Supervisory board has also right to request information from management board at any time regarding relationship with partner enterprises which should meet the terms of reporting requirements.¹⁵⁷

¹⁴⁹ § 119 (2) AktG

¹⁵⁰ § 120 (1) AktG

¹⁵¹ § 15 Articles of Association of Deutsche Bank AG in conformity with the resolution of the Chairman's Committee of the Supervisory Board on February 23, 2009;
http://www.db.com/ir/en/content/articles_of_association.htm last visited March 22, 2009.

¹⁵² § 3.4 Corporate Governance Code

¹⁵³ § 90 (1) No. 1 AktG

¹⁵⁴ § 90 (1) No. 2 AktG

¹⁵⁵ § 90 (1) No. 3 AktG

¹⁵⁶ § 90 (1) No. 4 AktG

¹⁵⁷ § 90 (3), (4) AktG

Together with power to manage, management board has also duty to manage a company. Responsibility of the management board can not be transferred to supervisory board.¹⁵⁸ Duty of care and performance evaluation is very important issue for determining management boards' liability. For this reason Generally Accepted Management Principles (GAMP) are provided to give standards for supervisory board and shareholders' meeting to evaluate the work of the board.¹⁵⁹ These principles are divided into General and Special Principles. General principles include principles of "legal permissibility", "economic usefulness" and principle of "social and ethical conduciveness", while Special principles regulate matters like "task principles" - strategy, decision control, planning; "organizing principles" – collegiality, division of labor; "personnel principles" – like qualification principle and etc.¹⁶⁰ These principles are not mandatory to be implemented into companies profile, but by comparing they will be useful tool to evaluate performance of the management board.

In case of material cause, supervisory board has right to revoke the appointment of the member of management board.¹⁶¹ German Stock Corporation Act defines "material cause" which is described as "gross breach of duties, inability to manage the company properly, or a vote of no confidence by the shareholders' meeting".¹⁶² Member of the board can dispute his discharge by suing at the court. But revocation will be enforceable unless otherwise decided by the court.¹⁶³ However, revocation of appointment has no direct effect on the employment contract with board member. Employment contract should be terminated with instant effect in order to finalize the employment of the management board member. As usually this two

¹⁵⁸ § 111 (4) AktG

¹⁵⁹ Axel v. Werder and Jens Grundei, *Generally Accepted Management Principles (GAMP) - functions, first proposals, and acceptance among German top managers*, Corporate Governance, Blackwell Publishers, Oxford, UK, Vol. 9 No. 2, 2001, p. 102

¹⁶⁰ See *Supra* note 160, p. 103

¹⁶¹ Melvin Aron Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, California Law Review, published by California Law Review Inc., Vol. 63, No. 2 (Mar., 1975), p. 410

¹⁶² § 84 (3) AktG

¹⁶³ Ibid

actions, revocation of appointment and termination of employment contract are conducted together to have immediate outcome.¹⁶⁴ Employment contract itself will stop having effect, if the term of the contract has expired, or terminated by one of the parties and by mutual termination of the parties.¹⁶⁵ There are some occasions, when revocation can not directly effect termination of the employment contract. For example, when there is a mistrust of the shareholders' meeting to management board, revocation does not automatically terminate the contract, if not otherwise is stated in the contract itself. In this case employment agreement will be valid until the end of the term of the contract.¹⁶⁶

3.1.2 GmbH

Management of the German Limited Liability Company can be enforced by one or more managing directors who have to be natural persons. Abovementioned is defined in GmbHG, which provides that "The company is represented by the managing directors in and out of court."¹⁶⁷ Existence of supervisory board depends on the decision of shareholders which should be represented in the articles of association. Managing directors shall be appointed by articles of association or by shareholders' resolution prior to incorporation.¹⁶⁸

German Limited Liability Company's Act does not provide requirement about number of managing directors, it can vary according to shareholders' decision. There is one limitation, according to which at least two directors shall be appointed (one labor director) if company has co-determination of employees. According to Co-determination Act, labor director shall

¹⁶⁴ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 24, p. 51

¹⁶⁵ See *Supra* note 165, p. 65

¹⁶⁶ Ibid

¹⁶⁷ § 35 GmbHG

¹⁶⁸ § 7, 8 (2) GmbHG

be a full member of the body responsible for the legal representation of the company.”¹⁶⁹ Labor director, like other directors shall have power to represent company and to bear responsibility.¹⁷⁰ Directors of the company shall be only natural persons with “unlimited legal capacity”¹⁷¹. There is no restriction regarding shareholders, which means that even shareholders may be appointed as managing directors.¹⁷² German company law does not provide necessity for managing directors to be resided in Germany. They can live outside the country, but there is one limitation, that in case directors live outside the Germany, company domiciled in Germany should have corporate officers who are living in Germany, in other case they may be regretted to register the company.¹⁷³

During registration and establishment of the limited liability company, shareholders can determine the extent of power for directors. If company has only one managing director, then he will be only representative of the company, but if GmbH has more than one managing director, in this case they will represent company with third parties mutually.¹⁷⁴ On the other hand, shareholders can determine the individual power of representation in case of several managing directors. The individual grant of power can be “to represent the company acting solely; to represent the company acting jointly with one or several other managing directors; or to represent the company acting jointly with one or several managing directors or holders of a Prokura.”¹⁷⁵ Any extension of power shall be defined by articles of association or shareholders’ resolution.

¹⁶⁹ § 33 (1) Co-determination Act

¹⁷⁰ § 33 (2) Co-determination Act

¹⁷¹ § 6 (2) GmbHG

¹⁷² § 6 (3) GmbHG

¹⁷³ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 23, p. 27

¹⁷⁴ § 35 (2) GmbHG

¹⁷⁵ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 23, p. 29

Appointment of managing directors is action governed by company, while concluding employment agreement with them is subject of contract law. Appointment is carried out by shareholders' meeting resolution with simple "majority of the votes cast",¹⁷⁶ if otherwise provided by articles of association or by co-determination act. If company has mandatory supervisory board,¹⁷⁷ the latter will have the right to appoint managing directors.

The managing director of German Limited Liability Company has significant range of powers and duties, but these powers and duties are not prescribed in details. GmbHG only underlines the power of legal representation. Actually, general functions and responsibilities of management are provided in articles of association or in shareholders' resolution.¹⁷⁸ From big list of management boards' duties I would like to underline several of them.

GmbHG provides that "the managing directors shall employ the diligence of an orderly businessman in the matters of the company,"¹⁷⁹ which means that directors shall make their best endeavors to support the purpose of the entity, in particular to contribute company's profitability, not to disclose confidential information about company's business activities and etc. Another important obligation is to preserve company's share capital during registration of the company and in case of share capital increase. According to Limited Liability Company's Act in case of false statements during formation of company, managers and shareholders will be jointly and severally liable to the company to either contribute the capital that is missing, to reimburse compensation or to pay the damages that were caused by submission of incorrect statements.¹⁸⁰

¹⁷⁶ § 46 (5), 47 (1) GmbHG

¹⁷⁷ § 31 Co-determination Act

¹⁷⁸ Henry P. De Vries and Friedrich K. Juenger, *Limited Liability Contract: The GmbH*, Columbia Law Review, Vol.64, No. 5, May 1964, p. 880-881

¹⁷⁹ § 43 (1) GmbHG

¹⁸⁰ § 9a (1) GmbHG

Managers duties include to call shareholders' meeting when annual or other short-term balance sheet shows that company has loss of one half or more of its share capital.¹⁸¹ The managers who fail to perform this duty negligently are also jointly and severally liable for incurred damages.¹⁸² Directors have huge responsibilities in case of company's overindebtedness. When company becomes insolvent, managing director has duty to file a petition "for the institution of bankruptcy proceedings or for the institution of judicial composition proceedings."¹⁸³ Directors who will avoid performing this duty will be liable for damages to the company.¹⁸⁴ Managing directors also will be liable to any new creditor for their losses, if "director continues to conduct business even though there is either an excess of debts over assets or the company is unable to pay its debts (i.e. is "insolvent")."¹⁸⁵

According to German Limited Liability Companies Act, "the appointment if the managing directors may be revoked at any time, notwithstanding the claims for compensation arising from existing contracts."¹⁸⁶ Like in German Stock Corporations, revocation of appointment includes removal or resignation of director, which is governed by company law and termination of employment agreement which is governed by contract law.

Removal of managing director is done by shareholders resolution, which is passed by simple majority vote cast if not otherwise stated in articles of association.¹⁸⁷ Articles of association may provide different procedure for removal of managing directors, like increase of size of

¹⁸¹ § 49 (3) GmbHG

¹⁸² § 43 (2) GmbHG

¹⁸³ § 64 (1) GmbHG

¹⁸⁴ Matthew Bender, *Business Transactions in Germany*, Looseleaf, New York, First published 1983, chapter 23, p. 96

¹⁸⁵ Michael Beurskens and Ulrich Noack, *The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century*, GMBH – SPECIAL ISSUE, German Law Journal, Vol. 09 No. 09, 2008, p. 1082

¹⁸⁶ § 38 (1) GmbHG

¹⁸⁷ § 46 (5), 47 (1), 45 (2) GmbHG

majority, or provisions regarding removal of managing director by supervisory board, by specific shareholder and etc. On the other hand, articles of association may limit “dismissal to cases in which important reasons require it.”¹⁸⁸ Definition of “important reasons” or “cause” varies and is not provided by GmbHG. However statute provides examples of “cause” which are “a gross violation of duties or incapacity of proper management”.¹⁸⁹ Other types of “important reasons” include, but are not limited to bribery, misuse of company’s property, inappropriate keeping of accounting books and so on.

Removal of managing director should be registered in commercial register.¹⁹⁰ Registration of removal has crucial importance, because removal without registration will not be effective with third parties who were not aware about removal of the managing director. German Commercial Code provides explanation for this argument, according to which:

Solange eine in das Handelsregister einzutragende Tatsache nicht eingetragen und bekanntgemacht ist, kann sie von demjenigen, in dessen Angelegenheiten sie einzutragen war, einem Dritten nicht entgegengesetzt werden, es sei denn, daß sie diesem bekannt war.¹⁹¹

(As long as a matter which is required to be entered in the Commercial Register is not registered and made public, it cannot be invoked by the person in respect of whose affairs it ought to have been entered against a third party, unless the latter had knowledge thereof).¹⁹²

According to the terms provided by German Commercial Code, company will be liable toward third parties if removal of the director is not registered properly. Like removal, resignation of the managing director should also be registered in the Commercial Register. Resignation is governed by the rules governing removal of managing director.

¹⁸⁸ Henry P. De Vries and Friedrich K. Juenger, *Limited Liability Contract: The GmbH*, Columbia Law Review, Vol.64, No. 5, May 1964, p. 881

¹⁸⁹ § 38 (2) GmbHG

¹⁹⁰ § 39 (1), (2) GmbHG

¹⁹¹ § 15 (1) HGB

¹⁹² Simon L. Goren (translated with an introduction), *The German Commercial Code, Second Edition*, Littleton, Colorado, Published by Wm. S. Hein Publishing, 1998, p. 14

3.2 Georgia

3.2.1 Joint Stock Company and Limited Liability Company

As I have mentioned in previous chapters, Georgian company law is regulated differently comparing to German. Terms of German AGs (Stock Corporation) and GmbHs (Limited Liability Company) are provided in two separate acts (AktG and GmbHG), while Georgian corporation law is standardized in one statute (Law on Entrepreneurs). Because of this reason, regulation of management board activities, appointment and revocation are shared, except small details that I will discuss below.

According to Law on Entrepreneurs, management of the Georgian Joint Stock Companies and Limited liability companies¹⁹³ is delegated to directors.¹⁹⁴ If the main duties of supervisory board include definition of general strategies and overall monitoring of the activities of the company, management board is leading day-to-day activities of the company and they have to achieve company's high concurrency and profitability. Directors should have responsibility and duty of care and loyalty.

Members of management board are appointed by supervisory board¹⁹⁵ and shareholders' general meeting in case of Limited Liability Companies.¹⁹⁶ Director should be an adult person, with full legal capacity and with experience in executive experience. Law on Entrepreneurs does not define the moment when member of management board is deemed to be appointed on the position. There are examples when directors conduct their activities as the members of management board, but they are not registered to Commercial Register. So, it is considered that director has liabilities even before the registration, which is expressed in

¹⁹³ Article 9 (1) Law on Entrepreneurs

¹⁹⁴ Article 56 (1) Law on Entrepreneurs

¹⁹⁵ Article 55 (7) Law on Entrepreneurs

¹⁹⁶ Article 9¹ (6) Law on Entrepreneurs

preparing legal documents for registration and arranging contributions to be made by shareholders. After registering member of management board in Commercial Register, he/she is acquires full power of director defined by Law on Entrepreneurs.¹⁹⁷ As I have mentioned member of the management board should be adult person, but Georgian legislation does not provide maximum permissible age. In Germany, this issue is regulated by recommendations given by Corporate Governance Code, according to which “An age limit for members of the Management Board shall be specified,”¹⁹⁸ meaning that enterprise should provide in the annual report information regarding age limit for the members of management board. In my opinion it will be useful tool if this practice will be considered also by Georgian Joint Stock Companies and corporations.

Directors are empowered with exclusive rights to represent company with third parties. If only one director is registered in Commercial Register, there is need of only one signature to conduct company’s transactions. In case of several members of management board registered in Commercial Register, they will have only joint of power of representation, unless otherwise provided by articles of association or by-laws.¹⁹⁹ Supervisory board should define rights of management board by employment contract. If such rights are not prescribed, then general principles of Law on Entrepreneurs will be applied.²⁰⁰ Generally management board is not subject to Labor Law. According to Labor Code of Georgia, director is employer, not employee,²⁰¹ which means that he/she has big variety of functions including recruiting personnel and can not be subject of Labor Law. In my opinion it is positive to have

¹⁹⁷ Irakli Gvaladze and Avto Svanidze, *Employment Agreements - Directors' Rights Also Need To Be Protected*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project <http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 5, September-October-November 2004, p. 18-20

¹⁹⁸ § 5.1.2 German Corporate Governance Code

¹⁹⁹ Article 56 (3) Law on Entrepreneurs

²⁰⁰ Article 9¹ (6), 56 (2) Law on Entrepreneurs

²⁰¹ Article 3 Labor Code of Georgia

employment contract concluded, but in practice Georgian corporations and Limited Liability Companies ignore this option and regulate functions of management board only by articles and by Law on Entrepreneurs.

Powers of management board are not regulated by Law on Entrepreneurs in details. Major part of the functions, are defined by company's articles of association. As an example, I will review the management board functions in JSC ProcreditBank Georgia. Articles of association provide that main function of board of directors is to maintain the solvency and liquidity and to enforce all actions in order to achieve this goal.²⁰² After this general explanation of the function, articles provide more detailed list of director's rights, in particular, management board has to make monthly report about company's activities to supervisory board and revision commission,²⁰³ to appoint employees and determine their compensation,²⁰⁴ to prepare annual consolidated and financial reports²⁰⁵ for presenting them to supervisory board and shareholders' general meeting, to prepare proposals for amendment of articles of association and by-laws of the company.²⁰⁶

Law on Entrepreneurs also provide several duties for management board, like requirement for making reports about financial activities of the company and about distribution of profits to be presented to supervisory board.²⁰⁷ Georgian legislation has foreseen terms of German Stock Corporation Act about activities which can be enforced only by consent of supervisory

²⁰² Article 39 Articles of Association of JSC ProcreditBank Georgia, updated on April 10th 2008, http://www.procreditbank.ge/index.php?lang_id=GEO&sec_id=99 last visited 26.03.2009

²⁰³ Article 39.1 Articles of Association of JSC ProcreditBank Georgia, updated on April 10th 2008, http://www.procreditbank.ge/index.php?lang_id=GEO&sec_id=99 last visited 26.03.2009

²⁰⁴ Article 39.3 Articles of Association of JSC ProcreditBank Georgia, updated on April 10th 2008, http://www.procreditbank.ge/index.php?lang_id=GEO&sec_id=99 last visited 26.03.2009

²⁰⁵ Article 39.5 Articles of Association of JSC ProcreditBank Georgia, updated on April 10th 2008, http://www.procreditbank.ge/index.php?lang_id=GEO&sec_id=99 last visited 26.03.2009

²⁰⁶ Article 39.11 Articles of Association of JSC ProcreditBank Georgia, updated on April 10th 2008, http://www.procreditbank.ge/index.php?lang_id=GEO&sec_id=99 last visited 26.03.2009

²⁰⁷ Article 57 (1) Law on Entrepreneurs

board. These activities include purchase and sale of the shares of more than 50%, beginning of new business activity, appointment and removal of prokurists, making decision about permission to trade with securities on stock exchange and etc.²⁰⁸

Not only appointment, but revocation of appointment is also made by supervisory board²⁰⁹ and shareholders' general meeting in case of Limited Liability Companies.²¹⁰ Comparing to German Stock Corporation Act and Corporate Governance Code, Georgian legislation is not familiar with the term of service for directors. Corporate Governance Code even gives recommendation not to exceed term for the first appointment to five years.²¹¹ Result of this loophole is that directors of Georgian Joint Stock Companies are appointed without term of service which is not good practice in my opinion, because directors can claim repayment of remained compensation. Like appointment, removal of the member of management board should also be registered in Commercial Register.

²⁰⁸ Article 55 (8) Law on Entrepreneurs

²⁰⁹ Article 7 Law on Entrepreneurs

²¹⁰ Article 9¹ (6) Law on Entrepreneurs

²¹¹ § 5.1.2 German Corporate Governance Code

Chapter 4 - Perspectives and recommendations for perfection of Corporate Governance rules in Georgia

Georgian company law has been developing since collapse of Soviet Union. The first step was adoption of Law on Entrepreneurs which was first statute regulating formation and activities of private enterprises. Besides several amendments, the statute is far from being perfect and needs some changes. Research of German corporate governance rules led me to formulate recommendations for perfection of corporate governance rules and generally company law.

The first recommendation is general and concerns adoption of Georgian Corporate Governance Code. For better investment environment in my opinion it is necessary to adopt Corporate Governance Code as it exists in Germany and other EU member countries. Corporate Governance Code is not mandatory statute, it only regulates internal procedures and governance rules in Stock Corporations. Implementation of Corporate Governance Codes in companies will contribute to develop more transparent business environment and help investors to distinguish “good” companies from “bad”.²¹²

As I have mentioned in previous chapter, Georgian legislation is not familiar with terms regarding maximum age for members of management board. In Germany it is recommended by Corporate Governance Code to define age limit. So, I think on the first stage, Law on Entrepreneurs should be amended and added provision regulating age limit for directors of

²¹² Irina Gordeladze, *Georgian Business needs effective legislation*, Quarterly Bulletin on Corporate Governance, International Financial Corporation (IFC), Georgia Corporate Governance Project <http://www.ifc.org/ifcext/gcgp.nsf/Content/ProjectMaterialsPublications> Vol. 1, September-October-November 2003, p. 10

the enterprises. But after adoption of Corporate Governance Code, this issue should be regulated by Corporate Governance Code by means of recommendations.

According to Law on Entrepreneurs appointment and revocation of appointment of management board is made by supervisory board. It also regulates powers of directors by adopting by-laws. But in Georgian reality, adoption of by-laws is ignored and directors apply to general principles provided by statute.²¹³ Another provision related to this problem is that directors are not subject of Labor Code of Georgia, so in my opinion detailed regulation of their rights and duties should be provided in written form by applying Article 56 (2) of Law on Entrepreneurs.

The last loophole I would like to pay attention regards term of the employment contract with members of management board. Georgian legislation does not contain any provision concerning term of employment contract, which very often leads to conclusion of permanent contracts. This is also in the interest of big companies not to have “dictators” instead of directors. In Germany this issue is regulated by Corporate Governance Code which gives recommendation that director who is appointed for first time to have appointment term less than 5 years.²¹⁴ Implementation of provisions like German will help supervisory boards to maintain actual control over management board, in order to monitor their activities.

So, in my opinion these abovementioned changes will be useful for future development of corporate governance rules and generally company law, which in itself will bring attention of potential investors.

²¹³ Article 56 (2) Law on Entrepreneurs

²¹⁴ § 5.1.2 Corporate Governance Code

Conclusion

Nowadays, corporate governance is very actual topic for Georgia, as far as it is connected with improvement of investment environment. For existing Joint Stock Companies and Limited Liability Companies one of the important problems is lack of financial resources. In developed countries this problem is solved simply by means of foreign investments, but in our case investors decide to invest money with less faith, because of the non-compliance of company law and corporate governance rules with laws of well developed countries and instructions provided by international financial organizations. To get confidence of investors', company law and corporate governance rules of Georgia need to be changed according to international practice.

Compliance with corporate governance rules of well developed countries led me to choose Germany as the example for comparison. Activities of German Stock Corporations and Limited Liability Companies are regulated by Stock Corporation Act (AktG) and by Act on Limited Liability Companies (GmbHG) and also supplemental laws regulating concrete issues of business, like Law on Control and Transparency (KonTraG), Act on Co-determination of Employees of 1976, German Corporate Governance Code, Transparency and Disclosure Act (TransPuG) and etc. whereas Georgian company law is standardized only by Law on Entrepreneurs and Law on Securities Market.

The lack of regulations for corporate governance rules led me to discover loopholes in Georgian legislation by comparing them with German analog. Absence of Corporate Governance Code is the first big shortcoming of Georgian legislation. By adopting Corporate Governance Code, activities of Joint Stock Companies will become more reliable and

transparent and will give opportunity to foreign investors to make right choice in case of their decision to invest money in Georgia.

Other recommendations are based on detailed research of provisions regarding management board of the Stock Corporations and Limited Liability Companies. Proposals include amendment of Law on Entrepreneurs on issues regarding term of the directors' employment contract, age limit for members of management board and paying more attention to powers and duties of management board that in my opinion should be regulated in written form and which is ignored by majority of existing companies and corporations.

Finally, detailed research of corporate governance rules in Germany and Georgia led to conclusion that they have essential value for developing more transparent environment for investment and contributing to development of states' stable and profitable economical and financial system.

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