Minority Shareholder Protection in Georgia and Germany

A Comparative Analysis

by

Tamar Kvintradze

LL.M. SHORT THESIS
COURSE: Legal Aspects of Corporate Governance
PROFESSOR: Stefan Messmann
Central European University
1051 Budapest, Nador utca 9.
Hungary

Abstract

The thesis observes main aspects of minority shareholder protection in Georgia and Germany. The comparative overview provides analysis of the topic from corporate governance perspective and underlines essential regulatory framework of two jurisdictions. The thesis starts with the general overview of the main rationale beyond the existence of different interest groups within the company, focusing on the underling social and economic reasons for protection of minority shareholders and then turns to the specific legal rules in Georgia and Germany. The goals of the thesis are first to evaluate the relevance of protection Georgian jurisdiction offers to minority shareholders in comparison to German jurisdiction, revealing existing gaps there and second to find the solutions for the problems that Georgia faces regarding the protection of the minority shareholders rights.

Table of Contents

Introduction

Minority shareholder protection is a theme that can be discussed from different aspects and in several dimensions. The topic has become central for analysis not only for lawyers but also for economists. Indeed, one of the most important processes that the corporate law tries to control is conflict between the shareholders, to be more precise conflict between minorities on the one hand and the majority shareholders and managers on the other hand, that is termed agency problem. This problem "arises whenever the welfare of one party, termed "the principal", depends upon actions taken by another party, termed the "agent". The problem lies in motivating the agent to act in the principal's interest rather than simply in the agent's own interest."[1]

However, the thesis covers legal aspects of this specific subject matter only from the perspective of Georgian and German jurisdictions, with country specific solutions of existing problems regarding minority shareholder protection. To be more precise, the aim of my thesis is to reveal the problem areas in protection of minority shareholder rights in Georgia and suggest the applicable solutions. In order to achieve the goal the first thing to do is to understand the legal system of Georgia and secondly compare it with the country which has the strong legal tradition. Germany is the country which "has always had a prominent place in the international corporate governance debate. The country is among the largest and richest

1 R. Kraakman, P. Davies, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, E. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, Oxford University Press, 2004, p.21.

industrial economies, and many German companies are world leaders in their fields."[2] That is why Germany would be good example for Georgia to follow.

Why did the topic become so important to discuss in Georgia? Because of the fact, that protection of the minority shareholders is momentous in the emerging market countries, like Georgia, where the government is constantly trying to create the attractive atmosphere for local and foreign investors. That is why, incorporation of good Corporate Governance principles is very important for Georgia at this stage of development. This will help the country to strengthen private sector and create attractive atmosphere for investors for achievement of significant economical growth in the country.[3]

Still, some work has been already done in Georgia regarding the implementation of corporate governance principles. Changing economic environment and new legal relations have given birth to new normative acts, introducing essential modern standards in Commercial Law of Georgia. Starting from 1990 Georgia began to move slowly from planned towards market economy, and therefore, had great challenges to face. In 1995 the Law of Georgia on Entrepreneurs was adopted in order to introduce and establish modern legal aspects of Company Law. Today International Financial Corporation and Organization for Economic Co-operation and Development assist Georgia in development of sound corporate governance regulations, implementing several projects. Main goal to achieve is to match the needs of

[2] Fabrizio Barca and Marco Becht (editors), *The Control of Corporate Europe*, Oxford University Press, 2003, p. 128.

[3] OECD, *Corporate Governance in Eurasia: A Comparative Overview*, 2004, p.9.

modern world with the regulations of corporate law and to improve legal framework in Georgia, as "with the common aim of improving market credibility, the choice and ultimate design of different provisions to protect minority shareholders necessarily depends on the overall regulatory framework and the national legal system." [4] Georgia has made significant steps forward in legal and institutional reforms including corporate governance policy, but still it has to face more challenges in the future.[5] Among those challenges should be mentioned the need for a corporate governance code.

As for Germany, the efforts to implement superior corporate governance practice were achieved only from the beginning of 1995. German government appreciated the importance of better corporate governance in order for German companies to be competitive on international market only after the Holzmann corporate crisis in 1999. Soon after that, the leading experts started to work on the first Corporate Governance Code in Germany, which was published in 2002. The Code was influenced by the OECD Corporate Governance Principles.[6] Today Germany is among the leading industrial economies and is considered as the country which has successfully implemented good corporate governance principles.

As the issue of my research is vast, it will be impossible to cover everything. That is why I will focus only on the core problems existing in Georgian law in comparison with German

[4] OECD Principles of Corporate Governance, p.43.

[5] OECD, *Corporate Governance in Eurasia: A Comparative Overview*, 2004, p.9.

[6] Christian Strenger, *Corporate Governance Standards: The Importance of Compliance and Main Issues in Germany*, World Bank / OECD The Global Corporate Governance Forum, 5th Meeting of the Eurasian Corporate Governance Roundtable, Session IV: "The Role of National Corporate Governance Principles for Fostering a Culture of High Standards", May18, 2004, p.1-4.

law. In particular, the research will embrace the statutory material for Joint Stock Corporation (JSC) in Georgia and "Aktiengesellschaft" (AG) in Germany, scrutinizing provisions which are considered to be effective in protecting minority shareholders by OECD principles of Corporate Governance. Several important cases from court practice of both countries will also be analyzed.

The method of my research lies in comparison, constant and relevant analysis of two civil legal systems. Georgian and German laws exist on strict rules that are at first glance easy to navigate through, but on the other hand demand profound knowledge in understanding and applying them. That is why it is important for me to base my research not only on the relevant statutory material of Georgian and German law together with relevant comments of honored authors, but go further and look at the law reviews, articles, electronic media as well as some important court cases.

As Georgia does not have the Corporate Governance Code, the main legal source to discuss the issue will be Georgian Law on Entrepreneurs, which follows German model and the "Comments on the law on Entrepreneurs" by respected Georgian scholars, Lado Chanturia and Tedo Ninidze. The book includes important information about Georgian commercial law development along the German law, as well as the effect of different statutes in practice. Important source for my thesis is also corporate governance project materials available at IFC webpage together with the OECD Principals of Corporate Governance. The German legal literature used in this comparative analysis includes books by the respected authors like Kraakman, Hansmann, Stecher, Baums, as well as different articles.

First chapter of the thesis will deal with the general definition of minority shareholders; reasons for different interest groups in a company and give answer to the question why it is essential to guarantee relevant protection for them. Second chapter will move from general to specific and examine the rights exercised by minority shareholders regarding voting, participating in general meeting, the right to information, auditing and control and appointment rights strategy in Georgia and Germany. The third chapter is the final one. It will deal with the leading court cases of both countries analyzing the constitutionality of the squeeze-outs and other aspects of the rule and suggest credible solutions.

Chapter 1 Different Interest Groups within a Company

1.1. Majority and Minority Shareholders- Different Interest Groups within a Company

The phenomena of minority and majority shareholders exist within the different corporate structures in all jurisdictions. *How can we define the majority and minority shareholders? What are the reasons for the different interest groups within the companies?*

To start with, minority shareholders are individuals, or legal entities, who have minority stakes in a company that is controlled by majority shareholders. In other words minority shareholders are often the ones dependant on the will of majority shareholders, who are in controlling position, because of the bigger amount of the share capital they own. If the interests of both groups are the same, then there cannot be any kind of conflict between them.

But, unfortunately, the case is not the same everywhere. The conflict of interests is more likely to arise in publicly held corporations, rather then closely held corporations. The reason for that is that closely held corporations are often family owned companies, with small number of shareholders, where "there is no active trading market for the ownership interests".[7] On the contrary, publicly held corporations can be defined as the ones having "a sufficiently large number of shareholders that there developed an active established market in which shares are traded."[8] In such corporations the ownership changes are so rapid and the number of the shareholders so big, that it is often very difficult to determine even the identity of the small shareholders, nothing to say about the relationship they might have. Because of such dispersed ownership structure, the shareholders in a publicly held companies lack personal trust. Consequently, the less trust and cohesion exists between shareholders, the less eager they are to cooperate with each other.

Another reason for the different interest groups within the company, in particular in the emerging market countries such as Georgia, may be the mass privatization process. During the process the state owned enterprises were converted into privately owned joint stock companies, where the workers were given small portions of the shares. As an outcome, big number of small shareholders appeared, totally unaware of their rights and with no trust to the majority- controlling shareholders.

[7] Robert W. Hamilton, *The Law of Corporations in a Nutshell*, 4th ed. 1996, West publishing Co. pp. 286-287.

[8] *Ibid.*

Whatever the reasons for the different interest groups within the companies, the outcome may be considerable both for the companies and for the states. While each of the group seeks to gain maximum profit from the company, and at the same time the controlling position of majority shareholders gives them opportunity to abuse the minority shareholders, the companies often fail to operate effectively. Because of that, less investment is attracted. Moreover, the behavior of majority shareholders may lead to dissolution of the company. Dissolution of the company may not be beneficial for the states either. That is why the states try to implement relevant legal framework in order to balance conflicting interest within the companies.

1.2. Protection of Minority Shareholders – Why is it Important?

There are several reasons why the minority shareholders should be protected by the states. To start with, protection of minority shareholders is one of the central elements of corporate governance principles. Better protection for them is one of the prerequisites for enhanced corporate governance practice in the country.

To focus on concrete reasons, the protection is needed in order to ensure the stability in functioning of the companies with different interest groups and avoidance of the dissolutions. Furthermore, minority shareholders are the investors of the company who should be protected against the risk they bear: “Investor’s confidence that the capital they provide will be protection from misuse of misappropriation by corporate managers, board members or

controlling shareholders is an important factor in the capital markets."[9] That means that better protection of minority shareholders rights is precondition for them to invest in further development of company. The investments, however, will ensure the economic growth of the country. Same reasons for protection of minorities were emphasized at the 3rd meeting of the Eurasian Corporate Governance Roundtable. As it was said there fair treatment of shareholders and respect of their rights is closely connected with the capital gain for the states. "The continuing need for attracting equity capital to finance corporate growth is one of the most important incentives to enhance shareholder treatment and corporate governance practices in general."[10]

Better protection for the minority shareholders will also guarantee more control for the majority and the management of the company, preventing them from embarking on activities that benefit their own interests at the expense of the minority shareholders.

The reasons for protecting minority shareholders interests are in chain reaction with each other. The importance of protection lies in need of better corporate governance framework and stability within the company performance, which will in turn guarantee the capital gain for states.

[9] OECD Principles of Corporate Governance, p.41.

[10] OECD, 3rd Meeting of the Eurasian Corporate Governance Roundtable, *Shareholder Rights, Equitable Treatment and the Role of the State,* summery record, Kiev, 17-18 April, 2002, p.3.

Chapter 2 Legal Concepts and Relevant Statutory Rules in Georgia and Germany - the Similarities and Distinctions

2.1. The Right to Information, Independent Auditing and Special Right to Control by Minority Shareholders

Minority shareholders have often no opportunity to participate in company management effectively, because of the small amount of the share capital they own. And they often are in lack of representatives on the supervisory board as well. The outcome might be them being less informed about the company activities, facing the risk for the invested money even more than the majority stakeholders of the company. Moreover, informing the shareholders is important in order for them to take qualified decisions, as well as letting them exercise control over management of company. That is why the right to information, independent auditing and control by minority shareholders should be considered as important safeguards for minority shareholders.

In Germany every shareholder, regardless the amount of the shares, has the right to request and receive information from the management. Nevertheless, this right can be exercised only at the general meeting and only to the extent that the information is essential for a shareholder for relevant evaluation of an item on the agenda. The board can only refuse providing such information in limited situations, described in detail in Stock Corporation Act.[11] Each shareholder, who has been denied such information improperly may request the reason for

[11] German Stock Corporation Act, §131.

denial to be recorded in the minutes of the meeting and has the standing to make motion in the court to gain access to the information. "If the motion is granted, the information shall be provided even outside a shareholders' meeting."[12] In case when the information is provided to the shareholder outside shareholders' meeting any other shareholder has right to request such information to be provided to him, even if it is not necessary for the proper evaluation of the item on the agenda.[13] In Georgia the shareholders have right to request information regarding any item on the agenda from directors as well as supervisory board also during the shareholders' meeting.[14] The reason for the legislator to permit the disclosure of information only on the shareholders' meeting is that the cost for disclosing information to any shareholder anytime would be very high for the company.[15]

Unlike Germany, the Georgian Law on Entrepreneurs does not determine the circumstances for the denial of such information to the shareholders in accurate way.[16] The only thing that the law says is that "refusal on granting the information can only be based on the essential interests of the company only."[17] However, this is a matter of individual judgment in each particular case. The violation of essential interests of the company may be disclosure of

[12] German Stock Corporation Act, §132.

[13] *Ibid.* §131, (4).

[14] Georgian Law on Entrepreneurs, Art. 53.3^1.

[15] L. Chanturia, T. Ninidze, *Comments on the Law on Entrepreneurs*, third addition, published by "Samartali", Tbilisi, Georgia, 2002, p.350 (author's translation).

[16] Georgian Law on Entrepreneurs, Art. 53.3^1.

[17] *Ibid.*

company's technology and commercial secrets, or any other information that may be harmful for the company.[18]

If we look at the general part of the Georgian Law on Entrepreneurs, we will see that it also includes the right for every shareholder to receive the annual report as well as all publications of the company, check the annual financial report and all the related documents himself or with the help of auditor and request any clarifications from the company after presentation of the annual financial report but before the approval of it by the general meeting of shareholders. The right to control and supervision may be diminished only by the law, and extended by the articles of association as well.[19]

The special right to control is connected with the defined amount of the shares in the Joint Stock Company in Georgia. In particular, the holders of 5% shares can demand the special examination of the economic activity and the annual balance in case they consider that there are violations. [20] The holders of the same amount of the shares in JSC have the right to demand the copies of the agreements concluded in the name of the company or request information about the agreements to be concluded in the future. [21]

[18] L. Chanturia, T. Ninidze, *Comments on the Law on Entrepreneurs*, third addition, published by "Samartali", Tbilisi, Georgia, 2002, p.350.

[19] Georgian Law on Entrepreneurs, Art. 3.10.

[20] *Ibid.* Art. 53.3^{2},.

[21] *Ibid.* Art. 53.3^{5}.

In AG if the *Sonderprüfer* (special auditor) is not appointed by the shareholder meeting, the shareholders whose shares equal at least to one-hundredth of the share capital or a nominal value of 100 000 Euro can ask the court to appoint a special auditor, "provided that facts exist which give reason to suspect that improprieties or gross violations of law or the articles have occurred in connection with such matter."[22] "A gross violation is recognized as such especially when it creates a claim for damages on behalf of the corporation."[23] Furthermore, shareholders whose shares comprise at least of one-twentieth of the share capital or a nominal value of 500 000 Euro can submit a request to court to appoint special auditor when there are reasons to suppose that certain items are considerably undervalued in the approved financial statements or information requested on the shareholder's meeting is not contained there. [24]

As it can be observed minority shareholders right to information, appointment of audit and some special rights of control have been successfully embodied in relevant regulations of Georgian and German jurisdictions. However, there are some differences between the two. First is the fact that Germany has even less requirement for the special control by minority shareholders (appointment of special audit), while Georgian jurisdiction sets minimum requirement of 5% of the shareholdings to exercise the right of control by minority shareholders. Second and more important detail to be mentioned is that legislator in Georgia evaded the accurate definition for the circumstances for denial of information to minority shareholders by the board. In my opinion the article should be drafted more carefully, since

[22] German Stock Corporation Act, §142, II.

[23] Matthias W. Stecher (editor), *Protection of Minority Shareholders*, Series editor: AIJA, 1997, p.92.

[24] German Stock Corporation Act, §258, I.

the failure to do so will always give the controlling shareholders possibility to use their power in detriment of minorities.

2.2. Influence on Decision-Making Process by Minority Shareholders

How can the minority shareholders influence decision-making process within the company? The first and foremost opportunity for them is their participation in general meeting of shareholders as well as chance to propose the items on agenda and not least important the right to request calling of the external shareholder meeting. The second part of the OECD Principles of Corporate Governance also emphasizes the importance of shareholders having opportunity to place items on the agenda of general meetings, as well as propose resolutions, but subject to reasonable limitations.[25] The principle is vital for Georgia as well as Germany.

To start with, the minority shareholders' right to call the external shareholder meeting and publish additional items on agenda is the important mechanism of protection of the shareholders who due to little amount of stock have no opportunity to influence the general meeting decisions.[26] But "since the right is exercised by the minority specifically in cases of disagreement between the minority and the board, the law must also provide for a way of enforcing the right if the board refuses the request." [27] Let us have a look on country specific

[25] OECD Principles of Corporate Governance, 2004, pp.34-35.

[26] L. Chanturia, T. Ninidze, *Comments on the Law on Entrepreneurs*, third addition, published by "Samartali", Tbilisi, Georgia, 2002, p. 351.

[27] Matthias W. Stecher (editor), *Protection of Minority Shareholders*, Series editor: AIJA, 1997, p.6.

regulations, as well as relevant enforcement mechanisms in order to ascertain the level of protection for minority shareholders at the stage of decision-making in the JSC as well as AG.

According to the Georgian law on Entrepreneurs, stockholders whose holding in aggregate equals at least to 5% of the share capital have right to call an external shareholder meeting. This right is exercised through the management or supervisory board (depends on the charter of the company). Several requirements should be met by minority shareholders in order for request to be fulfilled: first is the written form together with the agenda of the meeting and second, the items on agenda should be in reasonable compliance with the corporation's goals and business practices. Only after that is the management or supervisory board obliged to convene the external meeting, no later than 3 months after receiving the request. The right to make amendments to the agenda of the shareholders' meeting is also put into effect by stockholders possessing 5% of shares. [28]

In Germany the right to call external meeting is exercised by the holders of at least one-twentieth of the share capital, although a smaller amount of the share holding can be specified in the articles of association unlike the Georgian law. In the same manner the holders of the same amount of capital or the possessors of the share with *pro rata* value of 500 000 euros may demand the items on the agenda of the shareholders' meeting be published.[29] In Georgia, the Law is silent about the rights of minority shareholders in case the meeting is not convened

[28] Georgian Law on Entrepreneurs, Art. 53.3^3.

[29] German Stock Corporation Act, §122, (1), (2).

during three month period or if the amendments are not made to the agenda of shareholders' meeting according to their request. In Germany, conversely, the court may authorize the minority shareholders to call an external meeting or publish items on agenda, if the management board fails to call the external meeting or comply with the request for the amendments to the agenda, which can then empower the minority to convene the meeting or make the amendments to the agenda themselves. Moreover, the company will have to bear the costs of the proceedings if the minority shareholders are successful. [30] The Georgian Law on Entrepreneurs, before it was amended in March 2008, determined shorter period for the external shareholder meeting to be convened by the management or supervisory board, which was only 20 days after submitting the request by the minority shareholders.[31] Now the 20 days period applies only when the only item on the agenda of the external shareholder meeting is the removal of one of the directors of the management board. If the meeting is not convened by the management or supervisory board during the 20 day period, the minority shareholders have right to arrange the external meeting themselves. [32]

The new article which gives minority shareholders in Georgian Joint Stock Corporation the right to arrange the external meeting themselves, seems to be effective mechanism for realizing the minorities' rights only at first sight. The article has one pitfall and it can be easily detected if we put side by side to the legal procedure for calling external shareholder meeting and general meeting. The quorum for the external shareholder meeting is 75% of the

[30] *Ibid.*, §122, (3), (4).

[31] Georgian Law on Entrepreneurs, Art. 53.3.3. , before amended in 14.03.2008.

[32] Georgian Law on Entrepreneurs, Art. 53.3^4.

share capital. If the quorum is not presented, minority shareholders have the right to call the meeting second time with the same quorum. Third time, however, the court is entitled to force the board of directors of supervisory board to convene the meeting during 3 month period. *Ex altera parte* the set quorum for general meeting of shareholders is majority of the share capital, only 25% of the capital at the second call of the meeting and no quorum requirement for the third call.[33] Consequently, on the third try the shareholders meeting is authorized despite of the share capital presented there. In contrast, in Germany the Stock Corporation Act doesn't contain any regulations with respect to a quorum, though this may be defined in Articles of Association.[34]

As it can be observed, the calling of the external shareholders' meeting does not guarantee the appropriate protection of minority shareholders and demonstrates once more how favorable is the Georgian legislator to the majority shareholders, furnishing them with controlling power within the company. The rule in Georgia lacks the relevant enforcement mechanisms by the minority shareholders, as well as the time period of three month for calling the external shareholder meeting should be considered as too extensive. In the meantime, the German Stock Corporation Act sets no quorum as an obstacle for the external shareholder meeting to be authorized to make decisions.

[33] Georgian Law on Entrepreneurs, Art. 54.5.

[34] German Stock Corporation Act, §133.

2.3. Voting Rights of Minority Shareholders

"Shareholder voting in back on the agenda of public debate for several reasons. One is the investors' internationalization of capital investments and the raising of funds globally by companies."[35] In the meantime the right to vote is one of the fundamental rights of shareholders. This right gives them, as the investors of the company, possibility to influence the major changes in corporate policy of the company and prevent their investments from being misused without their consent.[36] "This leads to the question of how the law deals with this development and its problems"[37] and to what extent does it offer protection for minority shareholders.

To start with, Georgia alongside with Germany requires supermajority shareholder approval for essential changes.[38] Thus, 25 percent plus one share of minority shareholders will sometimes have the blocking power. But the difference between two jurisdictions is that recent amendments to Georgian Law on Entrepreneurs made the rule of supermajority approval optional, letting for different regulations by articles of association that does not state clearly whether the shareholders are allowed to decrease the majority requirement or the only option is to increase it.[39] Anyway, the cost of protection by majority requirement is not high

[35] T. Baums, E. Wymeersch , *Shareholder Voting Rights and Practices in Europe and United States*, 1999, p. 109.

[36] *Ibid.* p. 110.

[37] *Ibid.* p. 109.

[38] Georgian Law on Entrepreneurs, Art. 54.7, German Stock Corporation Act § 179, 182, 222, 262, 65, 176, 240.

[39] Georgian Law on Entrepreneurs, Art. 54.7.

for the company, but the payback for minority shareholders is also inadequate, "since supermajority requirements are unlikely to aid dispersed public shareholders."[40] This rule makes it harder for the dispersed equity holders to exercise their control by legal devices. The reason for majority rule may be the will of the legislators to make the regulation more flexible for the major investors of the company because that is the only solution in order to achieve affective decision making process, while giving shareholders, regardless the number of shares they own, the right to veto will make the decision making process endless.[41]

Another issue in connection with the minority shareholder protection which should be mentioned is the trusteeship strategy. The trusteeship strategy is used in many jurisdictions to protect minority shareholders' rights requiring board to propose initial changes for approval of shareholder meeting.[42] Contrary to that, the jurisdictions, like Germany, where the shareholders are considered good decision-makers, the law allows them to propose organic changes without board support.[43] By contrast, the Georgian jurisdiction practices the initiation of initial changes in company by management as well as the supervisory board.[44] This rule matters "only if either body is expected to correct the mistakes of the other."[45] That is not the case for Georgia, as the reason behind the trusteeship strategy is more likely to be

[40] R. Kraakman, P. Davies, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, E. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach,* Oxford University Press, 2004, p.57.

[41] Cf. T. Baums, *Shareholder Representation and Proxy Voting in the European Union: A Comparative Study*, in Hopt *et al*. (ed.), Comparative Corporate Governance, 1998, p. 547.

[42] Kraakman, supra note 40, at p.139.

[43] *Ibid.*

[44] Georgian Law on Entrepreneurs, Art. 54.

[45] Kraakman, *supra* note 40, at p.139.

mass privatization process, which gave birth to minority shareholders unaware of their rights and duties as shareholders.[46]

Another drawback for the minority shareholders exercising their voting rights is that they are often not informed relevantly in order to take qualified decisions. That is why "voting as a decision mechanism suffers from collective action problems."[47] The rationale for that is the significant cost for the company. Very often "the cost of informing oneself in order to cast an intelligent vote on a management proposal will exceed the expected benefits. Therefore, the voters who hold a small fraction of shares only will remain rationally ignorant."[48]

Because of collective action problems that minority shareholders face, the selling of shares is considered to be more desirable for dissatisfied shareholders than the cost of informing them. But the legislator in Germany tries to resolve the problem by "lowering information and transaction costs for shareholders to cast their votes."[49] For example, the German Corporate Governance Code states that "the company should make it possible for shareholders to follow the General Meeting using modern communication media (e.g. Internet)."[50] As for Georgia, the law does not explicitly allow the use of modern communications during the general meeting.

[46] OECD, *Corporate Governance in Eurasia: A Comparative Overview*, 2004, pp. 29-30.

[47] T. Baums, E. Wymeersch , *Shareholder Voting Rights and Practices in Europe and United States*, 1999, p. 111.

[48] *Ibid.*

[49] *Ibid.* p.112.

[50] German Corporate Governance Code, Article 2.3.4.

What should be done in Georgia in order for minority shareholders to exercise their voting rights in more effective way? Looking at the regulations provided in German Stock Corporation Act as well as the recommendations contained in German Corporate Governance Code, first thing for Georgian legislator to do is to fix the minimum majority requirement for the organic changes in the company and do not give the shareholders right to change this requirement in Articles of Association. As I already mentioned above the supermajority requirement may not aid the dispersed minority shareholders, but at least will leave more possibility for them to influence company decisions if they unite. Second problem that should also be solved in the process of building good minority protection mechanisms in the country is informing minority shareholders better on company matters. One of the suggestions may be using internet sources by the companies for sending additional information to the shareholders for shareholder meeting, providing them with annual reports. This approach will definitely lower information costs for the company and more likely benefit the minority shareholders.

2.4. Appointment Rights Strategy for Minority Shareholders

Another item on agenda of my comparative analysis is the appointment rights strategy for minority shareholders. Let us first refer to cumulative voting and its advantages for minority shareholders. Good corporate governance requires ensuring the equal treatment of shareholders within the corporations. Incorporation of cumulative voting is one of the preconditions of achieving the aim. The issue is widely discussed in the western countries as

well as in Eurasian countries.[51] Turning to the Germany and Georgia, there are two ways to elect the supervisory board in Georgian stock corporation company: by cumulative and straight voting.[52] In Georgia the rule is optional. On the contrary the rule is not known in Germany.[53]

Cumulative voting helps minority shareholders to have at least one representative on the supervisory board, as it allows allocation of votes to one or several candidates.

> With cumulative voting, there is no deviation from one share, one vote in the sense that some shareholders carry voting rights greater than their cash flow rights. Rather, the deviation occurs as a result of the voting procedure, which allows shareholders to concentrate their voting rights on one preferred candidate.[54]

If we imagine the three seat board, in case of cumulative voting, the shareholders will have to vote for each candidate separately, as in straight voting. The difference is that in cumulative voting each shareholder's number of shares is multiplied by the number of the candidates to be elected. In our case if a shareholder holds 50 shares it will be multiplied by 3, that will be 150 votes. The core distinction is that each shareholder has right to divide their votes between the candidates or cast all votes for single candidate. This is not allowed in straight voting. That is why in case of straight voting the majority will dominate over the minority shareholders and the majority will be able to elect all their candidates for supervisory board.

[51] Ezra Berch, *Cumulative Voting*, Quarterly Bulletin on Corporate Governance, issue #6, December-February 2004-2005, (authors translation), http://www.ifc.org/ifcext/gcgp.nsf/AttachmentsByTitle/QB6A8/$FILE/QB6Article8.pdf.

[52] Georgian Law on Entrepreneurs, Art. 54.8.

[53] German Stock Corporation Act, §101 (no cumulative voting for freely transferable shares).

[54] Robert E. Litan, Michael Pomerleano, Vasudevan Sundararajan (editors), *The Future of Domestic Capital Markets in Developing Countries*, Brookings Institution Press, 2003, p.337.

On the other hand, in cumulative voting the minority shareholders have potential opportunity to elect the candidates by uniting all their votes. Despite of the small structural difference between the two ways of voting, the outcome may be significant. Granting minority shareholders with the power to elect their representatives on the supervisory boards presupposes the existence of the boards that will suit their interests more.[55]

Still, unfortunately only 15.8% out of the 152 Georgian joint stock corporation used the cumulative voting mechanism according to survey conducted in 2004 by International Financial Corporation. [56]

In my opinion the benefit of cumulative voting should be considered more seriously by majority shareholders, since it will help to avoid the conflict between two parties and guarantee the votes for minority, without diminishing the legal status of majority. Without cumulative voting it would be much easier to ignore the minorities. Notwithstanding the advantages of cumulative voting in protecting minority interests, nevertheless, none of the main jurisdictions mandate it.[57] The rule is out of favor in many jurisdictions, because "controlling shareholders fear both strategic behavior (hold-ups) by minority shareholders

[55] Kenneth A. Kim, Pattanaporn Kitsabunnarat, John R. Nofsinger, *Shareholder Protection Laws and Corporate Boards: Evidence from Europe* , 2005, p.4. http://wintersd.ba.ttu.edu/Seminar%20Papers/Law%20and%20Corporate%20Governance.pdf

[56] Berch, *supra* note 51.

[57] Kraakman, *supra* note 40, at p.55.

and higher decision- making costs arising from the risk of conflict and possible deadlock on the board."[58]

Some authors consider the cumulative voting as less beneficial for minority shareholders, in particular "mobilizing collective action for cumulative voting also depends on the availability of sufficient information about the way the procedure works." The unawareness of the minority shareholders of their rights in emerging markets may result in disability to use the cumulative voting system successfully.[59]

Another option for protection of minority shareholder rights is one-share, one-vote rule, which is mandatory in Germany: *"Mehrstimmrechte sind unzulässig – Multiple voting rights shall be prohibited."*[60] The respected legal scholars, such as Kraakman, Hansmann, Hopt and Kanda believe that the rule reflects the interests of minorities in the company and weakens the domination by majority.[61]

The only exception is Volkswagen. The State of Lower Saxony was granted special rights in the company through certain provisions of the 1960 Volkswagen Law. In 2003, the European Commission demanded from Germany to present explanation regarding the Volkswagen Law

[58] *Ibid.* p.56.

[59] Gregory F. Maassen, Rilka Dragneva, *Cumulative Voting and the Protection of Minority Shareholders in the CIS* .

[60] German Stock Corporation Act, §12, (2).

[61] Kraakman, *supra* note 40, at p.56.

and in 2004 decided to take the matter to the European Court of Justice.[62] The court determined that Germany was not able to present the justification for the Volkswagen Law and how the Law was to protect the interest of minority shareholders. Moreover, the court stated that the right exercised by Federal State and the Land of Lower Saxony to appoint two representatives each to supervisory board exceeds the right granted to them under general company law and gives them possibility to exercise dominating position within the company.[63]

> It is thus possible for the Federal State and the Land of Lower Saxony to exercise influence which exceeds their levels of investment and thus to reduce the influence of the other shareholders to a level below that commensurate with those shareholders' own levels of investment.[64]

So, the deviation from one-share one-vote rule may have serious consequences for minority shareholders as far as it gives the majority unjustified dominating position within the company.

The one-share, one-vote rule is also applicable by Georgian Law on Entrepreneurs, Article 52.1. All holders of the common shares are entitled to participation and voting in general meetings with regard to one-share one –vote rule.[65]

[62] *Application of the one share – one vote principle in Europe*, Deminor rating, March 2005, commissioned by Association of British Insurers, p.23. http://www.abi.org.uk/BookShop/ResearchReports/Deminor_Report.pdf.

[63] Press Release No 74/07, 23 October 2007, Judgment of the Court of Justice in Case C-112/05, *Commission of the European Communities v. Federal Republic of Germany*, http://curia.europa.eu/en/actu/communiques/cp07/aff/cp070074en.pdf

[64] *Ibid.*

[65] Georgian Law on Entrepreneurs, Art. 52.1.

Above discussed appointment strategies for protection of minority shareholders' interests should be carefully re-evaluated by the companies in Georgia. While the one-share one-vote strategy more or less prevents the domination by majority shareholders in both jurisdictions, practice of cumulative voting may be seen as much more beneficial for Georgia at this stage of development. Indeed, the countries that try to improve corporate governance practices should reconsider the benefits of cumulative voting regarding the election of members of supervisory board.[66]

Chapter 3 The Squeeze-Out Rule in Georgia and Germany

3.1. Background for the Squeeze-Out Rule in Georgia and Germany

Black's Law Dictionary defines the term *Squeeze-out* as "an action taken in an attempt to eliminate or reduce a minority interest in a corporation."[67] To say it in other words, squeeze-out is a process whereby majority shareholders of Joint Stock Company can force out the minority shareholders by giving them adequate compensation. Although a squeeze-out right for majority shareholders exist in many jurisdictions, the regulations differ.

In Germany "the possibility to squeeze-out remaining minority shareholders of a company (target company) was incorporated into the AktG on January 1, 2002."[68] Silvia Elsland and

[66] Berch *supra* note 51.

[67] Bryan A. Garner (editor in chief), Black's Law Dictionary, 8th ed. 2004.

[68] Silvia Elsland and Martin Weber, *Squeeze-outs in Germany: Determinants of the Announcement Effects*, 2005, p.2.

Martin Weber compare the existing squeeze-out to "a very special case of a merger and going private transaction", due to the fact that the holder of the 95% or more of the share capital can force out the remaining minorities and as a going private transaction, because very often the aim of the squeeze out is replacement of the "publicly owned stock in a company with complete equity ownership by a private group, so that the company is delisted from the stock exchange and can no longer be purchased in the open markets."[69]

In Georgia the rule was first introduced in 2005. The Parliament of Georgia added article 53^3 to the Georgian Law on Entrepreneurs. Under the above mentioned article the shareholders that held more than 95% of a company's shares had the right to squeeze-out the rest of 5% by paying them a fare price for the shares owned. However, later this article was abolished and article 53^4 came into force, with the same content but dissimilar regulation of the squeeze-out procedure. According to new article in Georgian Law on Entrepreneurs the court is authorized to determine the price of the shares in squeeze-out.

In order to analyze the benefits and drawback of the squeeze-outs in Georgia and Germany vital is to find out first what was the economic as well as the social need of introducing the squeeze-outs in both countries.

In developed countries like Germany, where the stock exchange market stands at its height the shareholders are more aware of their rights and how to exercise them. On the contrary, in

[69] *Ibid.*

Georgia the process of mass privatization gave birth to many Joint Stock Companies soon after the dissolution of Soviet Union. The employees of the enterprises were given small shares in privatized joint stock companies, where they used to work before. As a consequence, big number of small shareholders appeared. "People became shareholders without realizing the related implications and without clear understanding of their rights."[70] That is why many enterprises were able to buy out the shares of minority shareholders even without the help of squeeze-out article of the Georgian Law on Entrepreneurs.

In Germany the squeeze-outs were also well-liked - 125 listed companies declared squeeze-out between 2002 and 2003 years.[71] The regulation is not less popular nowadays as well. Major stockholders continue to "kick out" the minority stockholders out of joint stock corporations of Germany as well as Georgia, stating several reasons for that: first of all, the existence of hundreds of minor stockholders is not attractive for the investors. Secondly, the high cost for calling general meetings of shareholders with a view to the participation of minority shareholders and also costs related to other rights exercisable by minority shareholders, such as calling of meetings of shareholders, requests for information, rights to file suits, etc.[72] "Costs and risks associated with a small number of minority shareholders are used as justification for the introduction of a squeeze-out right." [73] But there should be other reasons why the majority shareholders are so eager to exercise their right to force the

[70] OECD, *Corporate Governance in Eurasia: A Comparative Overview,* 2004, p.29-30.

[71] Elsland and Weber, *supra* note 68.

[72] Kakha Kutchava, *Squeeze Out - Violation of Rights or a Path to Better Corporate Governance*, Quarterly Bulletin on Corporate Governance, issue #11, October-November-December 2007, (author's translation), http://www.ifc.org/ifcext/gcgp.nsf/AttachmentsByTitle/QB11A1/$FILE/QB11A1.pdf.

[73] Elsland and Weber, *supra* note 68.

minorities out of the company. Indeed, "a squeeze-out is often desired by the majority shareholder in order to gain full control of the firm," [74] not only avoiding the additional costs that they might face in relation to the rights exercisable by minority shareholders, but it is also another circumvention in order to protect themselves from the minority shareholder control.

But talking about the benefits of the squeeze-out rule for the majority shareholders, we should remember that the other side of the story is the relevant protection that the states should provide for the minority shareholders. As Peter Zumbansen said:

> It might be just another facet of the recent euphoria over shareholder-value, which dominated global capital markets and the corporate world, that we are now hearing cries for adequate regulation of so-called *squeeze-outs* of minority shareholders. Yet, it is far from evident whether such an explicit regulation would actually provide effective protection of small, *i.e.* minority groups of shareholders.[75]

Therefore, the question is what should be done by the states to provide effective protection for minority shareholders' interests in squeeze-outs? In order to answer it let me first scrutinize the issue of constitutionality of the rule in Georgia and Germany and then suggest the solution that might be relevant.

[74] Peer Zumbansen, *German Corporate Law in Constitutional Perspective: The Squeeze-Out,* German Law Journal Vol. 2 No. 2 – 1, February 2001.

[75] *Ibid.*

3.2. Challenging the Constitutionality of Squeeze-Out Rule

While examining the constitutionality of the squeeze-outs in Georgia and Germany let me turn to the court practice in both countries. To start with Georgia, after the new amendment to Georgian Law on Entrepreneurs in 2005 several suits were brought challenging the constitutionality of the squeeze-out article in the Constitutional Court of Georgia. Among the claimants were the minority shareholders of four joint stock corporations incorporated in Georgia: JSC "Telenet", JSC "Davit Sarajishvili and Enisel", JSC "Ekrani" and JSC "Kaspitsementi" and the suit of the Public Defender of Georgia against the Parliament of Georgia. The cases were united.[76]

The main argument against the squeeze-out article presented by the claimants was that it violated the fundamental right of ownership granted by the Constitution of Georgia, in particular Article 21, which states:

> 1. The property and the right to inherit shall be recognized and guaranteed. The abrogation of the universal right to property, of the right to acquire, alienate and inherit property shall be impermissible.
>
> 2. The restriction of the rights referred to in the first paragraph shall be permissible for the purpose of the pressing social need in the cases determined by law and in accordance with a procedure established by law.
>
> 3. Deprivation of property for the purpose of the pressing social need shall be permissible in the circumstances as expressly determined by law, under a court decision or in the case of the urgent necessity determined by the Organic Law and only with appropriate compensation.[77]

[76] The Constitutional Court of Georgia, Decision #2/1 – 370, 382, 390, 402, 405, 18th of May 2007, Tbilisi, Georgia (author's translation).

[77] Constitution of Georgia, Art.21.

However, one of the witnesses on the side of respondent, the State Minister on Economic Reform Issues, Kakha Bendukidze argued about the benefits of the rule, justifying the need of the pertinent article and noted that the minority shareholders usually do not have the opportunity to participate in management of the corporation. They simply hinder the major shareholders in developing the corporation. Because of the huge amount of minority shareholders, it is also not easy to determine their identity. These are the reasons for considering them as the financial, not strategic investors of the company. In the opinion of State Minister, if not the existence of squeeze-out rule, the majority would have found other mechanisms to force out the minorities. Furthermore, the liquidation process of the company may have the same outcome for the minorities as the squeeze-out. The settlement for them in this case is that they get cash compensation instead of their shares, while in the event of liquidation they might have lost the shares, or the buyout would have occurred at an unfair price.[78]

Another justification for the debated legal norm is the social necessity. Because of the fact that most of the joint stock companies in Georgia were created after long and complicated privatization process and were less aware of the advantages or drawbacks of the legal form, now they are not able to use the opportunities presented to them, are not able to attract the investments from foreign markets and are at the edge of bankruptcy. Their shares are not traded on the Stock Market either. There is a need to transfer this kind of quasi joint stock corporations into limited liability companies, which can be done only after the majority

[78] See *supra* note 76.

shareholders have full control of the company. Taking in consideration the arguments presented, the State Minister found the restriction of property rights of minority shareholders as acceptable.[79]

After assessment of the arguments presented by both parties, the Constitutional Court outlined two main points while discussing the issue. First, whether the squeeze-out rule was constitutional regarding the property rights guaranteed by the Constitution of Georgia, while the second point discussed was the fairness of the procedures contained there. The outcome of the case was that the Constitutional Court declared Article 53^3 unconstitutional, stating that it violated the 1^{st} and 2^{nd} parts of the 21 Article of Constitution and abolished it. The Court emphasized that the need of squeeze-out rule cannot be discussed in the context of "pressing social need" and cannot be regarded as a legitimate aim for the restriction of property rights granted by the Constitution of Georgia. Furthermore, the Court objected to the argument presented by the State Minister on Economic Reform Issues, by saying that the aim of the legal norm was not the possibility of transforming the joint stock corporations into limited liability companies; moreover, Joint Stock Company is the legal form that is considered most attractive for attracting the investments. The reason for malfunction of the joint stock companies in Georgia is not often the legal form, but the lack of effective management mechanisms.

[79] *Id.*

Turning to the second point, the Court said that the main problem with Article 53^3 in practice was that it did not contain the accurate mechanisms for fair price valuation of the shares. Indeed, the main problem seemed to be not the fact of the squeeze-out itself, but the rule of determining the price of shares that was considered unfair by minority shareholders. The article offered two ways of evaluating the shares: to determine the price by Charter of the company or to determine it with the help of the independent expert (auditor) or broker agent. In case the minority shareholders considered the price unfair, they had right to challenge it in the court. One of the appellants was dissatisfied with the unjust valuation of their shares in JSC "Telenet". Each share was valued at 40 Tetri (Georgian currency), which equals to 0.20 EURO. The Court stated that the article does not provide for the relevant protection of minority shareholders and underlined the necessity of guaranteeing the balance between the majority and minority shareholders in the corporation by the state, expelling the opportunity to use the economic power by majority shareholders. In this context the most crucial for legislator is to determine the legal procedure for determining the fair price of the shares in a way that would be clear enough in order not to give any party the opportunity to manipulate. This task is not so easy to enforce. As the Constitutional Court stated in its decision of May 18, 2007, one can hardly find anywhere the perfect mechanism to determine the fare share price. Any evaluation process is the matter of subjective process. [80]

[80] See *supra* note 76.

If we look at the example of Germany, the major shareholders are the ones who determine the reasonable amount of compensation for the minority shareholders in the resolution, which has to be passed by simple majority voting rights:[81]

> The principal shareholder must give the shareholders meeting a written report that presents the basis for the transfer and explains and justifies the adequacy of cash compensation. The adequacy of the cash compensation shall be reviewed by one or more expert auditors. These shall be selected and appointed by the court on application of the principal shareholder.[82]

The rule is included in the Stock Corporation Act and the reference is made to the fact that the squeeze-out should not be considered as the legalization of the expropriation in any way and is not violating the Constitution of Germany.[83] Nonetheless, the issue of share price determination for minority shareholders is widely discussed here as well. "An issue often arising in this context is whether or not and in what way the stock price of the company should be a benchmark for the appropriateness of compensation".[84]

Current decision of the Federal Constitutional Court (FCC) is expected to have considerable effect on the future practice of squeeze-outs in the Germany.[85] "The Court's decision can be seen as falling in line with those voices in the debate that favor the discretion of the firm's majority, limited only by the obligation to adequately compensate for shares purchased."[86]

[81] German Stock Corporation Act, §327 b.

[82] *Ibid.* §327 c (2).

[83] Kutchava, *supra* note 72.

[84] Silvia Elsland and Martin Weber, *Squeeze-outs in Germany: Determinants of the Announcement Effects*, 2005, p.2.

[85] Peer Zumbansen, *German Corporate Law in Constitutional Perspective: The Squeeze-Out*, German Law Journal Vol. 2 No. 2 – 1, February 2001.

[86] *Ibid.*

That is why decision of the FCC is interesting to examine in comparison with the decision of the Georgian Constitutional Court. The issues emphasized in these decisions illustrate the similarities as well as divergences two jurisdictions may face in protection of minority shareholder rights in the squeeze-outs.

The constitutional complaint was brought in FCC by 1% minority shareholder of the close corporation "Moto-Meter", attempting to declare the squeeze out action void. [87] "The FCC concluded that the majority's discretion is constitutionally valid under Art. 14 Basic Law as long as certain protections of the minority's interests are guaranteed."[88] The Court emphasized that the minority shareholders' interests should be protected on the stage of evaluation of the fair price for their shares and that the ruling out of the minorities is constitutionally justified as long as they are compensated sufficiently. On the other hand, the FCC said that the forms of evaluating sufficient compensation of the shares applied in practice in squeeze-outs are unconstitutional as long as they do not guarantee relevant protection of private property. The FCC demanded that the share valuation should be conducted by the courts and not an expert which is contracted by the majority shareholders. This is indispensable, as the FCC clarified, in order to protect the minority shareholders' rights.[89]

[87] *Ibid.*

[88] *Ibid.*

[89] *Ibid.*

The decision of the FCC is rather complicated one. After having examined the constitutionality of a squeeze-out procedure, the FCC established that first, that there was no actual loss incurred by minority shareholders, and second, that the case didn't not heave new constitutional matters that had not been yet discussed by the FCC. In its decision the Court gave emphasis to material value of the shares in squeeze-out rule and not the membership interest of the minority shareholders. That is why the Moto-Meter minority shareholder could not succeed in claiming "the loss of membership as the basis of an objection to the squeeze-out."[90] The FCC stated that the crucial aspect of the constitutional protection for minority shareholders is "protection based on the capital market, i.e. material value, of the shares held."[91]

As it can be seen from the perspective of the German law development "the general statement that the markets are not liable in the case of a squeeze-out cannot be supported"[92] German practice of determining the share price according stock exchange price can be seen as more or less good protection for minority shareholders.

But if we apply the same rule to Georgia, it may cause difficulties, because there is no effective Georgian Stock Exchange today, as only some companies are listed on the stock market and trade shares there. Accordingly, there is no mechanism to determine the fair price.

[90] *Ibid.*

[91] *Ibid.*

[92] Silvia Elsland and Martin Weber, *Squeeze-outs in Germany: Determinants of the Announcement Effects*, 2005, p.26.

Everyone understands how independent can be the "independent expert", which is invited by majority shareholders in evaluating the shares.[93] However, the situation is different in those courtiers, including Germany, where the tradition of using the independent experts and brokerage companies has been practiced for many years and none has doubt in their objectiveness. In case of Georgia it can't be said.

Soon after the abolishment of the squeeze-out article, another article, number 53^4 was added to the Georgian Law on Entrepreneurs with the similar plot but another heading. In this case the legislator changed the procedure of share price evaluation and gave the right to determine the price to the court. In particular, only the court has right to make decision regarding the squeeze out procedure as well as to determine the price of the shares according to the Civil Procedure Code of Georgia.[94] The court does not determine the price itself but appoints the independent expert or brokerage company to evaluate the shares.[95]

But even the new solution to the existing problem seems rather weak safeguard for the minority shareholders, as far as the majority shareholders can still influence the independent expert or Brokerage Company nominated by the court.

Challenging the constitutionality of the squeeze-outs in Germany and Georgia led us to the new problem in Georgian jurisdiction, which is a need for implementation of fare price

[93] Kutchava, *supra* note 72.

[94] Georgian Law on Entrepreneurs, Art. 53^4.

[95] Civil Procedure Code of Georgia, Chapter $XXXIV^2$

evaluation methods. The only rational solution suggested is limiting the scope of the squeeze-out article only to the companies that are listed on Georgian Stock Exchange (GSE). In this case the price will be determined according the market value of the shares and not the independent evaluation of the expert nominated by the courts. On one hand that will guarantee more fair system of evaluation and on the other hand give company opportunity to attract investments offering its shares on stock exchange. The later will help the development of stock exchange in Georgia. [96]According to the Georgian Capital Market Overview there are only 278 companies admitted to trading at GSE.[97] The number is not so high, but the recent developments on the GSE ensures relevant gain of the companies that will be trading on the stock exchange in the future.

Conclusion

Scrutinizing how Georgian legal regime protects minority shareholders in comparison to German law gave me possibility first, to detect the problems existing in Georgian corporate law and second, to put forward some possible solutions. Some existing statutory material of Georgian and German law was examined regarding the topic and some vital aspects discussed in the research. Nonetheless, it was not easy to compare these two legal systems, whereas Germany has long tradition of corporate governance, Georgia only recently focused on the importance of minority shareholder protection in the framework of good corporate

[96] Kutchava, *supra* note 72.

[97] http://www.gse.ge/QuickTour/GSEPresentation_files/v3_document.htm, slide #16.

governance practices. Lack of literature about the subject matter in Georgia also made the process complicated.

To summarize the implications of the research the foremost difficulty that Georgia faces is the uninformed and passive small shareholders as a result of mass privatization process. Therefore, the government should concentrate on the introduction of the public awareness programs. Compared to Germany the existing regulations in Georgia should define more precisely the circumstances for denial of information to minority shareholders by the board in order to avoid the abuses by the directors who are the potential representatives of the majority shareholders. Minority shareholders' right to call an external shareholder meeting does not guarantee the appropriate protection for them as well; it lacks the enforcement mechanisms alongside the requirement of excessive quorum as an obstacle for the meeting to be authorized to make decisions.

On the example of German law Georgian legislator should also reconsider the mandatory supermajority requirement for the major changes in company for the effective implementation of the voting rights by minority shareholders together with the application of cumulative voting. Another problem that should also be resolved in the process of building good minority shareholder protection mechanisms in the country is informing minority shareholders better on company matters. One of the possible suggestions is allowance of modern communications (internet) by the Georgian law in official exchange of information with shareholders. As stated above this approach will also benefit companies in lowering information costs. Not least important is the determination of efficient means for evaluation of fare share price in squeeze-outs. Taking into account the experience of Germany the

credible solution is to determine the price according to market value of the shares that is why limiting the scope of the squeeze-out article only to the companies that are listed on Georgian Stock Exchange can be considered as the expedient way out.

And as a conclusion, I would like to admit that the rights of minority shareholders should be better defined by Georgian legislator. Furthermore, the resent amendments to the Georgian Law on Entrepreneurs that made the regulation of joint stock corporation more flexible for the majority shareholders, making the mandatory regulations optional, should be revised and afford should be made to introduce corporate governance code. In order to improve the investment environment in country and ensure better protection for the minority shareholders from managers, board members or majority shareholders, policy makers need to focus on creating efficient judiciary as well as regulatory institutions in combination with the effective monitoring system.

Comparative analysis of the two countries showed that Germany is the country with strong corporate governance tradition and effective protection of minority shareholders rights that should be followed by Georgia on its way of development.

Bibliography

Books

Bryan A. Garner (editor in chief), Black's Law Dictionary, 8th ed. 2004

Fabrizio Barca, Marco Becht (editors), *The Control of Corporate Europe*, Oxford University Press, 2003.

Lado Chanturia, Tedo Ninidze, *Comments on the Law on Entrepreneurs*, third addition, published by "Samartali", Tbilisi, Georgia, 2002.

Matthias W. Stecher (volume editor), *Protection of Minority Shareholders*, Series editor: AIJA, 1997.

Robert E. Litan, Michael Pomerleano, Vasudevan Sundararajan (editors), *The Future of Domestic Capital Markets in Developing Countries*, Published by Brookings Institution Press, 2003.

Robert W. Hamilton, *The Law of Corporations in a Nutshell*, 4th ed. 1996, West Publishing Co.

R. Kraakman, P. Davies, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, E. Rock, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, Oxford University Press, 2004.

T. Baums, E. Wymeersch , *Shareholder Voting Rights and Practices in Europe and United States*, 1999.

T. Baums, *Shareholder Representation and Proxy Voting in the European Union: A Comparative Study*, in Hopt *et al.* (ed.), Comparative Corporate Governance, 1998.

Statutory Material and Cases

Constitution of Georgia, 1995.

Civil Procedure Code of Georgia, 1997

German Stock Corporation Act, 1965

Georgian Law on Entrepreneurs, 1994.

German Corporate Governance Code, 2002

The Constitutional Court of Georgia, Decision #2/1 – 370, 382, 390, 402, 405, 18th of May 2007.

Articles and other Legal Material

Application of the one share – one vote principle in Europe, Deminor rating, March 2005, commissioned by Association of British Insurers.

Commission of the European Communities v. Federal Republic of Germany, Press Release No 74/07, 23 October 2007, Judgment of the Court of Justice in Case C-112/05.

Christian Strenger, *Corporate Governance Standards: The Importance of Compliance and Main Issues in Germany*, World Bank / OECD The Global Corporate Governance Forum, 5th Meeting of the Eurasian Corporate Governance Roundtable, Session IV: *The Role of National Corporate Governance Principles for Fostering a Culture of High Standards,* May18, 2004.

Ezra Berch, *Cumulative Voting*, IFC Quarterly Bulletin on Corporate Governance, issue #6, December-February 2004-2005.

Gregory F. Maassen and Rilka Dragneva, *Cumulative Voting and the Protection of Minority Shareholders in the CIS*.

Kakha Kutchava , *Squeeze Out - Violation of Rights or a Path to Better Corporate Governance*, IFC Quarterly Bulletin on Corporate Governance, issue #11, October-November-December 2007.

Kenneth A. Kim, Pattanaporn Kitsabunnarat, John R. Nofsinger, *Shareholder Protection Laws and Corporate Boards: Evidence from Europe,* February 1, 2005.

OECD, 3rd Meeting of the Eurasian Corporate Governance Roundtable, *Shareholder Rights, Equitable Treatment and the Role of the State,* summery record, Kiev, 17-18 April, 2002.

OECD Principles of Corporate Governance, 2004.

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

Peer Zumbansen, *German Corporate Law in Constitutional Perspective: The Squeeze-Out*, German Law Journal Vol. 2 No. 2 – 1, February 2001.

Silvia Elsland and Martin Weber, *Squeeze-outs in Germany: Determinants of the Announcement Effects*, 2005.