Legal Protections for Directors in Georgian Corporate Law: A Comparative Analysis

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Abstract

According to the Georgian Law On Entrepreneurs, director may be removed from his/her position at any time, without any grounds, which is considered one of the main powers of shareholders to compensate for the risks associated with investing funds in an entrepreneurial company. However, in parallel with this, there is little information in the legal literature or judicial practice on the mechanisms that would compensate for the groundles removal of a director at any time.

This thesis, based on the analysis of national and generally accepted international standards and judicial practice, presents an analysis of the regulatory norms for the removal of the director and the possibility of incorporating defense mechanisms for directors into Georgian corporate law as a counterweight to them.

An analysis of the regulatory norms and court practice governing the removal of directors confirms that the Georgian Law On Entrepreneurs requires clarification of the procedure for removing directors and the prior identification and proposal of compensatory mechanisms, which could then be implemented to address groundless removal.

List of Abbreviations

AktG	-	Aktiengesetz
EU	-	European Union
GmbHG	-	Gesetz betreffend die Gesellschaften mit beschränkter Haftung
UK	-	United Kingdom
US	-	United States of America

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1. Introduction

1.1. Background

Under the Law of Georgia On Entrepreneurs, the general meeting of shareholders, or the supervisory board (if constituted), is authorized to remove the director from office at any time, without the obligation to provide grounds for such removal. Any provision in the articles of incorporation or any contractual agreement that contravenes this rule shall be considered null and void.

It is noteworthy that the provision allowing for the groundless removal of a director is not only a recent development in Georgian legislation, but also reflects a widely accepted practice in international corporate governance. However, in contrast to many international legal frameworks, the Georgian Law On Entrepreneurs does not establish compensatory mechanisms to balance the director's vulnerability to groundless removal.

Considering the aforementioned, a legitimate question arises: why would a qualified individual be interested in occupying the position of a director, given the absence of legal safeguards against groundless removal?

Currently, the only defense mechanism that Georgian legislation offers to directors is business judgment rule Based on Law On Entrepreneurs there is no violation of the duty of care, and a director is not obliged to compensate for any damage incurred by the company as a result of his/her business decision, if the director could have reasonably believed that he made the business decision on the basis of sufficient and reliable information, in the interests of the company, independently, and without conflict of interest or another person's influence, but this rule shall not apply if a business decision is made in violation of the duties provided for by law or the statute.

The right of the shareholders' general meeting to appoint and remove the director constitutes a fundamental corporate governance prerogative, which has evolved alongside the development of corporate law. As early as the 18th century, companies established in the United States—irrespective of their organizational or legal form—vested the partners' meeting with the authority to appoint a director responsible for overseeing the management of the company.[2]

Directors hold a vital role in overseeing the operations of a company. Despite the separation of powers between directors and partners, in the early 1940s there was a tendency to expand the powers of partners, which was reflected in the provision of Article 184 of the Companies Act 2006 in the UK (it is worth noting that until 1948, in the UK, the general meeting could not remove a director from office before the expiration of his term of office, unless otherwise regulated by the articles of association of the business company),[3] namely, on the basis of this article, despite the entry in the articles of association of the business company, the general meeting was granted the power to remove a director at any time.[4]

The wording of the law On Entrepreneurs makes it evident that the corporate governance structure in Georgia is centered on the dominance of the board of directors. Within this framework, the general meeting of shareholders holds the authority to appoint or remove a director and to make decisions on matters specifically assigned to its competence by law. The director's primary duty is

[2] Walter W., Corporation Law in Search of Its Future, Columbia Law Review, vol. 81, no. 8, 1981, p. 1631.
[3] R. G. Bailey, Shareholder Control Over Management: The Removal of Directors, McGill Law Journal, 1974, p.86
[4] C. Rehana, The Power to Remove Company Directors from Office: Historical and Philosophical Roots, Fundamina vol. 25, no. 1, 2019, p. 54

to manage the company, while the general meeting retains the right to remove the director at any time. This dual structure results, on the one hand, in increased accountability for the director and, on the other hand, in broad discretionary power for the general meeting.[5] Such a relationship between the rights and obligations of the director and partners allows the director to be constantly under control, but on the other hand, the possibility of removing the director at any time without grounds needs an assessment of the impact on his motivation and productivity.

A competitive market, ongoing innovation, and the pursuit of profit require directors to engage in continuous risk-taking. Given this context, the management process is non-linear. In civil law corporate systems, the business judgment rule serves as a key principle to help protect directors from liability when making business decisions involving risk. However, international practice demonstrates that, in addition to the business judgment rule, there are alternative defence mechanisms that are often more adaptable, efficient, and responsive.

the scope of liability and available protections for directors vary among legal systems. Despite these jurisdictional differences, a shared foundational principle persists: directors are expected to act in good faith and to prioritize the company's best interests above all else.[6]

In the common and the civil legal systems, the most commonly accepted directors' defence mechanisms include the business judgment rule, indemnification, severance pay and directors' liability insurance, while Georgian legislation recognizes only the business judgment rule.

[5] E. J. Waitzer, Addressing the Tension between Directors' Duties and Shareholder Rights – A Tale of Two Regimes, Osgoode Hall Law Journal, vol. 50, no. 1, 2012, p. 177

[6] S. H. Duggin, S. M. Goldman., Restoring Trust in Corporate Directors: The Disney Standard and the New Good Faith, American University Law Review vol. 56, no. 2, 2006. p. 219.

1.2. Thesis objectives

The objective of this thesis is to explore, through an analysis of international corporate legislation and case law, the potential for incorporating director defence mechanisms into Georgian corporate law that would mitigate the effects of groundless removal at any time. The thesis conducts a comparative legal study of the regulatory frameworks and practices concerning the groundless removal of directors, focusing on the United States, the United Kingdom and Germany. The selection of these jurisdictions is based on their significant influence on the development of Georgian corporate law. As stated in the explanatory note to the Law of Georgia On Entrepreneurs, the legislation draws upon the legal experience of the United States, the United Kingdom, and Germany. Moreover, the Supreme Court of Georgia has emphasized that 'German legislative and practical approaches are of particular relevance to Georgia—as a country within the Romano-Germanic legal tradition—especially with regard to the specificities of the liability of the director of a company'.

1.3. Research and Methodology Issues

According to the law of Georgia On Entrepreneurs, the general meeting of shareholders/the supervisory board, is authorized to remove a director from office at any time without indicating any grounds. Given the relatively recent enactment of the current Law of Georgia on Entrepreneurs, relevant judicial practice is still in its early stages, as a result, many company directors may be unaware that, under the new legal framework, they can be removed at any time without any ground. This legal uncertainty and lack of awareness highlight the critical importance of a thorough examination of this issue, within the international legal framework and judicial practice.

This thesis uses comparative legal research methods, by examining the legislative frameworks and judicial practices of the United Kingdom, the United States, and Germany. This thesis will examine the similarities and differences in the rules governing the removal of directors, explore internationally recognized defence mechanisms for directors, and assess the possibility of incorporating such mechanisms into the Georgian legal system.

1.4. Structure of the thesis

The thesis is divided into two chapters. Chapter I provides a brief overview of the development of the role and legal position of directors, highlighting the factors that determine the directors' groundless removal. Chapter II focuses on the defence mechanisms available to directors upon removal and presents a comparative legal analysis of these mechanisms. The thesis concludes with a summary of the identified defense mechanisms and an assessment of their potential integration into the Georgian legislative framework.

I. The Legal Position and Liability of a Director in Corporate Law

1.1. The Role and Duties of a Director

The Director plays a fundamental role in the management of the company and has always been an integral part of the corporate structure, although his role, functions, duties and scope of responsibility have been modified over time.[7]

In accordance with the Law of Georgia On Entrepreneurs, the company must have the board of directors (individual or collegial).[8] The director is responsible for conducting entrepreneurial, day-to-day activities (managerial authority) and for representing the company in relations with third parties (representative authority).

According to the Law On Entrepreneurs the responsibility for managing a company is vested in the board of directors, which may be individual or collegiate but in Georgia corporate management is more commonly exercised by a sole director, whereas the establishment of a collegiate body (the board of directors) is more characteristic for joint stock companies. The formation of a collegiate body is mandatory only for listed companies. The Corporate Governance Code for Public Companies[9] stipulates that public companies are required to establish a board of directors (collegiate body), most commonly including entities such as banks and insurance companies[10].

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[7] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 64, p. 69.

[8] In order to ensure the performance of managerial activities in a company, the company must have a managing body – the board of directors, the Law of Georgia On Entrepreneurs, Article 41.1, Available at: https://matsne.gov.ge/ka/document/view/5230186?publication=12 [accessed 11.06.2025].

[9] The Corporate Governance Code for Public Companies, Available at: https://matsne.gov.ge/ka/document/view/5302151?publication=1 [accessed 11.06.2025].

[10] In Georgia banks and insurance companies are incorporated as Joint Stock Companies, whose shares are generally publicly traded on a stock exchange.

The German Limited Liability Company Act[11] also requires that a limited liability company must have one or more directors.[12] In the case of a joint-stock company, the functions of the directors are performed by a board of directors, which may consist of one or more persons.

The Companies Act of the United Kingdom also contains a mandatory provision regarding the existence of a governing body, stipulating that a private company must have at least one director and a public company must have two directors.[13] In turn, the UK Companies Act provides a very concise and abstract definition of a director, namely, according to section 250, "director includes any person occupying the position of director, by whatever name called".[14]

Unlike the binding rules set forth in the aforementioned legislative acts, Section 141(a) of the Delaware General Corporation Law permits the delegation of a company's management responsibilities to another individual or entity, provided such delegation is authorized by the corporation's charter or bylaws.[15]

While the overall responsibility for managing a business typically lies with the director today, historically, until the early 1800s, such functions were primarily performed by controlling partners. At that time, the director's role was perceived as honorable, yet in practical terms, it often lacked

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[11] The German Limited Liability Company Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung, – GmbHG), Available at: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html [accessed 11.06.2025].
[12] GmbHG, Article 6, Available at: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html [accessed 11.06.2025].
[13] UK Companies Act, Section 154, Avaliable at: https://www.legislation.gov.uk/ukpga/2006/46/section/154 [accessed 11.06.2025].
[14] UK Companies Act, Section 250, Avaliable at: https://www.legislation.gov.uk/ukpga/2006/46/section/250 [accessed 11.06.2025].
[15] Delaware General Corporation Law, Section 141.a., Avaliable at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed 11.06.2025].

substantive authority and remained largely ceremonial. [16] As businesses expanded in size, director's role gradually shifted toward overseeing management. The director came to define the company's direction, goals, and vision, while the operational management was carried out by others. [17]

In 1872, the Supreme Court of Pennsylvania, in Spering's Appeal, made an important clarification on the responsibility of the director.[18] The case concerned the National Safety Insurance Trust Company, a bank based in Philadelphia, whose shareholders claimed damages from the directors for the reckless and unwise management of the company's funds.[19] The Pennsylvania Supreme Court dismissed the shareholders' claim for damages on the grounds that directors were liable only for fraud committed with intent or gross negligence. Later, in 1880, in Hun v. Cary[20] The New York Court of Appeals contributed to shaping the legal framework for directors by clarifying the standard of care expected from them. It concluded that directors should not be held to the strictest possible level of diligence, as such a requirement might discourage capable individuals from serving. Instead, directors were expected to act with a level of care that a reasonable and prudent person would apply under comparable circumstances.[21]

[16] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 69.
[17] Ch. M. Elson, Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 160.
[18] B. C. Rhoads, Personal Liability of Directors for Corporate Mismanagement, University of Pennsylvania Law Review and American Law Register, vol. 65., no. 2, 1916, p. 129-130.
[19] C. B. Rhoads, Personal Liability of Directors for Corporate Mismanagement, University of Pennsylvania Law Review and American Law Register, vol. 65, no. 2, 1916, p. 129-130.
[20] Hun v. Cary, 82 N.Y. 70, (1880).
[21] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 73-74.

Until the 1980s, almost all litigation was decided in favor of directors, because regardless of the extent of the director's error, if he proved that he acted in good faith and in the best interests of the company, within the limits of business judgment rule, his liability was excluded.[22]

The standard of liability for directors changed radically in the 1980s. In Smith v. Van Gorkom,[23] the Delaware Supreme Court used the gross negligence standard to test the directors' knowledge of the matter.[24] In a wave of hostile takeovers and increased competition in the market, the Delaware Supreme Court's decision in Van Gorkom further exacerbated the issue of director's liability.[25]In response to this situation, in 1986, the Delaware General Corporation Law incorporated Section 102 b.7[26], which permitted the limitation or exemption of liability for breach of a duty of care by a director.[27]

The adoption of Section 102 b.7. into the Delaware General Corporation Law eased the legal pressure on directors in duty of care cases. Previously, directors had to invoke the business judgment rule to defend themselves, but under the new provision, simply showing that the claim only alleged a breach of the duty of care became sufficient to avoid personal liability in many cases.[28]

[22] Ch. M. Elson, Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 151.
[23] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
[24] F. Shu-Acquaye, Smith v. Van Gorkom Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002, vol. 3, no. 1, 2004, p. 31.
[25] Ch. M. Elson, Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 152.
[26] F. Shu-Acquaye, Smith v. Van Gorkom Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002, vol. 3, no. 1, 2004, p. 36.
[27] D. A. DeMott, Limiting Directors' Liability, Washington University Law Quarterly, vol. 66, no. 2, 1988, p. 299.
[28] A.B. Badawi, The Business Judgment Rule, Encyclopedia of Law & Economics, Corporate Law and Economics, 2023, p. 9.

Unlike the common law system, in Georgian and German business legislation, the exemption of directors from liability for breaching fiduciary duty is not permitted, as the norms regulating liability are of an imperative nature.

1.2. Legal Position of a Director

In the 19th and early 20th centuries, directors were perceived as trustees of the partners of a business partnership, and at the end of the 20th century, as their agents.[29]

During the 19th and early 20th centuries, directors were often regarded as trustees. Under the prevailing doctrine of that time, they were not only seen as protectors of private interests but were also expected to uphold public interests and contribute to the common good, an idea rooted in the understanding of corporations as entities of political and economic influence.[30]

The main task of directors was to protect, on the one hand, the minority partners of the corporation and, on the other hand, the partners with a controlling stake in the company from harmful decisions (market manipulations).[31] In 1922, in the case of Lofland v. Cahall, the Delaware Supreme Court explained that directors were not entitled to receive compensation from the corporation unless otherwise provided for in the corporation's charter or authorized by the partners.[32] This practice continued until the 1950s, when the Model Business Corporation Act of the United States made compensation for directors permissible.[33]

Over time, the role of directors transformed alongside the expansion of corporations and the diversification of shareholder bases. By the early 20th century, corporations had moved beyond

[29] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 65.
[30] Ibid, pp. 88-89.
[31] Ibid., p. 92.
[32] Lofland v. Cahall, 13 Del.Ch. 370,115 A. 458 (Del. 1921).
[33] Elson Ch. M., Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 144.

being small, locally owned businesses and began to operate on a much broader, frequently global scale.[34]

By the end of the 20th century, the legal literature and case law had established that directors were the representatives (trustees) of the partners in the business community.[35] According to the established opinion in the common law system, the guiding principle for directors in managing a business entity should be to protect the interests of the partners.[36]

This shift in perception introduced the "ownership and control" theory, which conceptualized the business partner as a "principal" seeking to maximize profit, while the director, acting as an "agent," was seen as more inclined toward pursuing personal interests. Both parties, according to this theory, aim to advance their own well-being through the utilization of the company's assets.[37] This conflict of interest ultimately generated representation costs (costs incurred for monitoring the director), the neutralization of which is the transfer of a share/stock of the business entity to the director, which is a proven practice to this day.[38]

Unlike the Anglo-American corporate governance structure, where management authority is typically vested in the Chief Executive Officer (CEO) and other executive officers, who are responsible for the day-to-day operations of the company and governance, including oversight of

[34] Ch. M. Elson, Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 139.
[35] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 132.
[36] J. R. Boatrigh, Fiduciary Duties and the Shareholder-Management Relations: Or, What's so Special about Shareholders?, Business Ethics Quarterly, vol. 4, no. 4, 1994, p. 393.
[37] J. H. Davis, F. D. Schoorman, L. Donaldson, Toward a Stewardship Theory of Management, The Academy of Management Review, vol. 22, no. 1, 1997, p. 22.
[38] D. T. Mitchell, Status Bound: The Twentieth Century Evolution of Directors' Liability, New York University Journal of Law & Business, vol. 5, no. 24, 2009, p. 125.

management and strategic decision-making, is vested in the Board of Directors, within the Georgian legal framework day-to-day decisions are undertaken by a company's directors (Management), while strategic decisions—such as corporate reorganizations, mergers, or alterations to the company's capital structure—fall within the exclusive competence of the General Meeting of shareholders (Governance), oversight of management is typically vested in supervisory board (if established).

In Georgia, the Supreme Court has developed consistent jurisprudence concerning the director's legal status. Contrary to the approach in common law systems, where a director is simultaneously viewed as a trustee and an agent of the shareholders, Georgian courts tend to ground the director–company relationship in the principles of agency law. As clarified by the Supreme Court, the legal nature of an agreement concluded with a director most closely resembles an agency contract.[39] Hence, in Georgian law, the director is generally treated as an agent. However, there is ongoing debate in legal scholarship about the true character of this contractual relationship. Some authors contend that the director's agreement aligns more with an employment contract than an agency arrangement. They argue this is due to the director's subordination to the sharholders general meetings' will and their service to its interests—making them akin to employees hired by the shareholders. Proponents of this interpretation believe that directors should be afforded the legal protections provided by the Labor Code, which would,

[39] Decision of the Civil Chamber of the Supreme Court of Georgia dated April 11, 2024, in case no. 1155-2023.

1.3. Groundless Removal of Directors

The removal of directors from company at any time is closely related to their legal status. Much like in the common law tradition, Georgian corporate law also classifies directors as agents. Interestingly, this classification does not weaken the legal foundation for their removal at any time; on the contrary, it reinforces it. Specifically, under Article 720.1 of the Civil Code of Georgia, either party may unilaterally terminate an agency agreement at any moment. Any contractual provision attempting to waive this right is rendered null and void. This principle is mirrored in Article 44.3 of the Law of Georgia On Entrepreneurs, which states that the general meeting—or the supervisory board, if established—has the authority to remove the director at any time without the need to justify the decision. Any agreement that contradicts this rule is considered legally invalid.

In legal literature and judical practice, risk compensation is appealed to in support of the removal of the director at any time, more specifically, 'in order to compensate the risk of granting the director the right to manage the company, the partners (shareholders) should always have the opportunity to remove the director from office without indicating any grounds, motives or reasons'[40].

It is important to highlight that, alongside the unrestricted right to remove a director at any moment, the Cassation Chamber has also addressed the importance of the procedure involved in such removal, including the necessity of providing the director with certain safeguards. The Chamber clarified that Article 720.1. of the Civil Code does not preclude the inclusion of specific grounds

[40] Decision of the Civil Chamber of the Supreme Court of Georgia dated October 20, 2022, in case no. 478-2020.

for termination within an employment agreement. As stated in its interpretation, 'The right established under Article 720 of the Civil Code does not prevent the parties from agreeing to terminate the agreement with the director either without cause or based on particular grounds (such as failure to fulfill obligations outlined in the company's charter). Distinct procedures may apply in each case—for instance, a compensation scheme might be provided in the event of termination without cause, whereas no such benefit would apply if the removal were based on a cause stated in the charter (e.g., non-performance of duties)'[41].

[41] Decision of the Civil Chamber of the Supreme Court of Georgia dated March 19, 2021, in case no. 551-2019.

1.4. The Legal Classification of a Director Removal in Georgia: Labour Law vs. Corporate Law

In the previous version of the Georgian Law on Entrepreneurs, the absence of explicit provisions excluding the application of the Labor Code meant that directors were often regarded as employees, making the Labor Code applicable to their legal relationships. During that time, courts would examine the legality of a director's removal through the lens of labor law, thereby generally prohibiting groundless dismissal. However, it was the Supreme Court itself that ultimately reversed this approach. In a 2001 ruling, the Court definitively held that the legal connection between a director and an entrepreneurial entity does not constitute an employment relationship, thereby making the application of labor law norms to such arrangements legally inappropriate.[42]

According to Article 45.1. of the current version of the Georgian Law on Entrepreneurs, the provisions of labor law do not apply to a service contract concluded with a director. Unlike the repealed version of the law, which referred to the norms regulating prior notice as prescribed by the Labor Code in the context of a director removal,[43] the current version of the Law on Entrepreneurs contains no such blanket clause.

According to prevailing views in Georgian legal literature and judicial practice, the legal basis for the relationship between an enterprise and its director is the act of appointment and the service

[42] Decision of the Civil, Entrepreneurial and Bankruptcy Cases Chamber of the Supreme Court of Georgia dated 30 March 2001 in case N 253-01.
[43] In the cases provided under subparagraphs a and " of paragraph 7^1 of this article, the parties are obliged, prior to submitting a notification to the registering authority on the termination of powers of the registered person, to send a notice in accordance with the procedure established by Article 48 of Labour Code of Georgia. In case of termination without observing this registration procedure, liability for the damages caused shall be determined in accordance with Georgian legislation, the Georgian Law on Entrepreneurs, Article 7^2.9. (repealed as of 02.08.2021).

contract.[44] This is also derived from the wording of Article 45(1) of the Georgian Law on Entrepreneurs, which provides that a service contract between the enterprise and the director is concluded after the adoption of the decision on appointment (the "act of appointment").[45]

The Supreme Court of Georgia has maintained a consistent position that strictly rejects the application of labor law concepts or principles to the legal relationship between directors and entrepreneurial entities. In one of its rulings, the Cassation Chamber clarified that "an agreement concluded with an LLC director should not be interpreted as an employment contract; rather, it may be conditionally categorized as a service agreement, which belongs to a different legal domain than labor law and is governed by distinct principles."[46] According to the Supreme Court, the contract concluded with a director is distinguished from labor-law relationships by the standard of organizational dependence. While a director, within the framework of fiduciary duties, is fully independent in exercising the powers assigned to their competence on behalf of and at the expense of the enterprise, a person employed under a labor contract engages in "non-independent and socially dependent" activity.[47]

Therefore, the provisions of the Labor Code, which describe in detail the procedure for termination of employment and impose the obligation of prior written notice before removal,[48] cannot be applied to a director. For the purposes of the Law on Entrepreneurs of Georgia, both the

[44] Decision of the Civil Cases Chamber of the Supreme Court of Georgia dated 20 October 2022, in case N 478-2020.
[45] Following the adoption of the decision on the appointment of a director/member of the supervisory board, a service contract shall be concluded between the company and a director/member of the supervisory board, The Georgian Law on Entrepreneurs, Article 45.1., Available at: https://matsne.gov.ge/ka/document/view/5230186?publication=12 [accessed 11.06.2025].
[46] Decision of the Civil Cases Chamber of the Supreme Court of Georgia dated 6 April 2017 in case N 725-689-2016.
[47] Ibid.
[48]Labour Code of Georgia, Article 48, available at https://matsne.gov.ge/en/document/view/1155567?publication=28 [accesed on 12.06.2025].

appointment and removal of a director constitute a corporate law act, to which the provisions of the Labor Code are not applicable.

Although the previous version of the Georgian Law on Entrepreneurs included a reference to Article 48 of the Labor Code—which clearly excluded labor-law protections for directors—it is still worth noting that the requirement to provide prior notice before removal (whether 30 or 3 calendar days) had, in practice, created a norm of advance warning. From a comparative perspective, this norm is considered essential, as it allows the director to prepare a defense and challenge the removal decision before the general meeting. For this reason, advance notice is recognized as a fundamental right in many jurisdictions. However, the current version of the law does not impose any such obligation, leaving directors in a more vulnerable position and diminishing their legal protection.

II. Protection Mechanisms of a Director upon Removal: A Comparative Perspective

Internationally, the introduction of protection mechanisms for directors facing removal is widely supported, especially in light of the evolving legal characterization of the relationship between directors and shareholders. Economic and investment environment shifts often result in stricter liability standards for directors, contributing to a rise in litigation.

In light of the heightened liability and the increased threat of removal for directors, several theories have been established in legal literature that legitimize the right of directors to defense, such as:[49]Risk Theory - If a director is held liable for every act of negligence, it would be nearly impossible to find a qualified person suitable for this position; Hindsight Bias Theory - The actions of directors are always evaluated retrospectively by third parties (such as shareholders, creditors, judges, etc.), who are already aware of the outcome. Accordingly, the steps taken by the director may not be assessed objectively by an external observer, since despite the officer's efforts, the enterprise still suffered a negative result and "Non-Expert" Theory - In Dodge v. Ford,[50] the Michigan Supreme Court explained that judges are not business experts and, therefore, it is beyond their competence to intervene in disputes between shareholders and directors ("non-expert" theory).[51] This perspective is also reflected in the case law of the Georgian Supreme Court. In one decision, the Cassation Chamber emphasized that courts should not evaluate the correctness of a director's business judgment unless specific conditions are met. The burden lies with the claimant

[49] A.B. Badawi, The Business Judgment Rule, Encyclopedia of Law & Economics, Corporate Law and Economics, 2023, pp. 11-15.
[50] Dodge v. Ford, 204 Mich. 459 (Mich. 1919).
[51] A.B. Badawi, The Business Judgment Rule, Encyclopedia of Law & Economics, Corporate Law and Economics, 2023, p. 14.

to demonstrate that one of the core elements supporting the presumption of sound business judgment has been violated before a court may intervene."[52]

[52] Decision of the Civil Chamber of the Supreme Court of Georgia of 1 June 2022 in case No. 783-2020.

1. Director's Right to Challenge Removal

1.1. Legal Regulation of the Removal of Directors

Pursuant to the Law of Georgia on Entrepreneurs, the authority to remove a director lies with the general meeting or the supervisory board (if established). The law affirms that a director may be removed at any time and without any ground. Conversely, under the previous version of the law, there was a requirement to provide advance notice prior to the removal of a director[53], a practice which is well-established in the United Kingdom.

In the United Kingdom, the procedure for removing a director is governed by Sections 168 and 169 of the Companies Act. Similar to the Georgian law, the Companies Act permits the removal of a director at any time, provided that the partner initiating the general meeting gives the company at least 28 days' notice.[54] A written notice is immediately sent to the director[55].

Under the Delaware General Corporation Law, the general rule is that the general meeting has the authority to remove a director without any specific cause.[56] However, there are two exceptions to

[53] In the cases provided under subparagraphs a and " of paragraph 71 of this article, the parties are obliged, prior to submitting a notification to the registering authority on the termination of powers of the registered person, to send a notice in accordance with the procedure established by Article 48 of Labour Code of Georgia. In case of termination without observing this registration procedure, liability for the damages caused shall be determined in accordance with Georgian legislation, the Georgian Law on Entrepreneurs, Article 72.9. (Repealed as of 02.08.2021).
[54] Companies Act, Section 168.1., Section 312.1., Available at: https://www.legislation.gov.uk/ukpga/2006/46/part/10/chapter/1/crossheading/removal/2024-03-04 [accessed 12.05.2025].
[55] Companies Act, Section 169.1., available at: https://www.legislation.gov.uk/ukpga/2006/46/part/10/chapter/1/crossheading/removal/2024-03-04 [accessed 12.05.2025].
[56] Delaware General Corporation Law, Section 141, Available at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed 12.05.2025].

this rule.[57] According to Section 141.k. of the Delaware General Corporation Law,[58] if the terms of office for members of the governing body are classified, removal of a director requires specific grounds unless otherwise provided in the company's charter.[59] Additionally, if the general meeting employs cumulative voting for removing less than the entire governing body, removal of a director necessitates stating a cause.[60]

In Germany, the removal of a director is regulated by the "Act on Limited Liability Companies" (GmbHG) and the "Stock Corporation Act" (AktG), depending on the company's organizational and legal form.[61]According to Section 38 of the GmbHG, a director may be removed at any time. However, Section 38.2 allows the company's articles of association to restrict this right, permitting removal only for specific reasons. In contrast to Article 44.3 of the current Georgian Law on Entrepreneurs, which invalidates any provision excluding the right to remove a director at any time without cause,[62] Section 38.2 of the GmbHG permits the company's articles to stipulate that

[57] Delaware General Corporation Law, Section 141.k. Available at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed 12.05.2025].

[58] According to Section 141.d. of the Delaware General Corporation Law, the governing body of a corporation may be divided into three classes. The first class of directors shall serve until the next annual meeting, the second class for one year, and the third class for two years. Available at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed 12.05.2025].

[59] Delaware General Corporation Law, Section 141.k.1, available at: https://delcode.delaware.gov/title8/c001/sc04 / [accessed 12.05.2025].

[60]Delaware General Corporation Law, Section 141.k.2, Available at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed 12.05.2025].

[61]GmbHG, Available at: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0205 [accessed 12.05.2025]; German Stock Corporation Act (AktG), Available at: https://www.gesetze-im-internet.de/englisch_aktg/englisch_aktg.html [accessed 12.05.2025].

[62] The general meeting, and in the case of the existence of a supervisory board – the supervisory board, is authorized to remove the director at any time without specifying the grounds. Any agreement contradicting this provision shall be deemed void. Law of Georgia on Entrepreneurs, Article 44.3., Avaliable at: https://matsne.gov.ge/ka/document/view/5230186?publication=12 [accessed 11.06.2025].

removal is only permissible for significant reasons, such as gross breach of duty or inability to manage the company properly.[63]

When comparing legal forms, it is notable that the rules applicable to stock corporations are more restrictive. Specifically, Section 84.4. of the German Stock Corporation Act (AktG) states that a managing director may be removed only for cause, such as serious breaches of duty, managerial incapacity, or following a resolution by the general meeting expressing a loss of confidence in the director.[64]

[63]GmbHG, Section 38.2., Available at: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0205 [accessed 12.05.2025].

[64]AktG, Section 84.4., Available at: https://www.gesetze-im-internet.de/englisch_aktg/englisch_aktg.html [accessed 12.05.2025].

1.2. The Director's Right to Be Heard

In UK director's right to be heard allows them to present their removal case before the general meeting and oppose their removal. However, if the law does not require prior notification to the director, this right is limited, and the director is deprived of the opportunity to influence the decision-making process regarding their removal.

The director's right to be heard at the meeting where their removal is to be decided is regulated by Section 169(2) of the UK Companies Act.[65] Beyond allowing the director to express their position regarding the removal at the general meeting, the director is entitled, upon receiving notice of their removal, to prepare a written statement and submit it to the company. The company is then obligated to send this written statement to all partners.[66] Furthermore, under Section 169.4, if the partners receive the director's written statement late (including due to the company's fault), the director may request to read the statement aloud at the general meeting, in addition to presenting their position orally without restriction.[67]

[65] The director (whether or not a member of the company) is entitled to be heard on the resolution at the meeting, Available at: https://www.legislation.gov.uk/ukpga/2006/46/section/169 [accessed 12.05.2025].
[66]Companies Act, Section 169.3, Available at: https://www.legislation.gov.uk/ukpga/2006/46/section/169 [accessed 12.05.2025].
[67] If a copy of the representations is not sent as required by subsection (3) because received too late or because of the company's default, the director may (without prejudice to his right to be heard orally) require that the representations shall be read out at the meeting, Available at: https://www.legislation.gov.uk/ukpga/2006/46/section/169 [accessed 12.05.2025].

2. Compensation

2.1. Compensation as a Legal Remedy: The Georgian Judicial Approach

The Supreme Court of Georgia has addressed the use of compensation as a balancing tool in cases of unjustified removal of directors, especially in light of the connection between removal provisions (as previously found in the now-repealed Law on Entrepreneurs) and the rules applicable to service agreements. The Cassation Chamber emphasized that the law does not prevent the parties from defining specific grounds for removal—either without cause or based on defined reasons, such as non-fulfillment of duties established in the company's charter.[68]"

Notably, the Cassation Chamber emphasized that different procedures could be established for both justified and unjustified removals: "For example, compensation in the case of unjustified termination of the agreement, which the director would not be entitled to if the agreement was terminated due to failure to fulfill duties defined by the charter."[69] It is important to note that at the time of this decision (March 19, 2021), the removal of directors was regulated by Article 9.7^1 and 7^2 of the repealed Law of Georgia on Entrepreneurs, which did not contain imperative provisions regarding the removal of a director at any time without cause. Moreover, Article 9.7^2 required prior notice before removal.[70]

[68] Decision of the Civil Chamber of the Supreme Court of Georgia dated March 19, 2021, in case 553-2019.
[69] Ibid.
[70] In the cases provided under subparagraphs a and " of paragraph 7^1 of this article, the parties are obliged, prior to submitting a notification to the registering authority on the termination of powers of the registered person, to send a notice in accordance with the procedure established by Article 48 of Labour Code of Georgia. In case of termination without observing this registration procedure, liability for the damages caused shall be determined in accordance with Georgian legislation, the Georgian Law on Entrepreneurs, Article 7^2.9. (Repealed as of 02.08.2021).

Under the current version of the Law of Georgia on Entrepreneurs, any agreement opposing the removal of a director without cause is invalid.[71] Although the 2021 interpretation by the Cassation Chamber—which recognized the contractual freedom to terminate the agreement with or without cause—is no longer binding under current law, discussion regarding compensation for grounlessremoval remains highly relevant. Such compensation can be stipulated within the service agreement, allowing a director to claim a predefined amount (e.g., double or triple the salary) upon being removed without valid justification.

In the Anglo-American corporate law system, compensation granted upon the unjustified or groundless removal of a director is known as a severance pay or termination compensation and is widely integrated into directors' service agreement. Sevarnce pay provides financial protection that can mitigate the risk of unjustified or groundless removal, it applies not only to directors but also to senior management and other employees.[72]

Besides severancy pay the "golden parachute" is another form of compensation which is commonly granted to corporate executives (including directors) in the contex of mergers and aqcuisitions that result in their removal. Proponents of golden parachute argue that this tool prevents corporate executives' self-interest from affecting their evalution of merger or tender offers and serve as an important compensatory function to attract and retain top quality personnel[73]. A

[71] Law of Georgia on Entrepreneurs, Article 44.3., Avaliable at: https://matsne.gov.ge/ka/document/view/5230186?publication=12 [accessed 11.06.2025].
[72] T. W. Kim, Decent Termination: A Moral Case for Severance Pay, Business Ethics Quarterly, vol. 24, no. 2, 2014, p. 203.
[73] Bress P. R, Golden Parachutes: Untangling the Ripcords, Stanford Law Review, vol. 39, no. 4, 1987, p. 995.

notable example is the case of Henrique De Castro, former chief operations officer of Yahoo, who received $109 million as golden parachute payment, after only 15 months of service[74].

[74]Available at: https://www.forbes.com/sites/jeffbercovici/2014/01/16/fired-yahoo-execs-109m-golden-parachute-was-one-of-the-biggest-ever/?utm_source=chatgpt.com [accessed 12.06.2025].

3. Directors' and Officers' Liability Insurance

3.1. The Legal Nature of a Directors' and Officers' (D&O) Liability Insurance

In response to the significantly increased civil, administrative, and criminal liability of directors, U.S. corporate law developed the concept of directors' and officers' (D&O) liability insurance.[75] This type of insurance serves two primary purposes: first, to protect directors from personal liability; and second, to reimburse the company for the expenses it incurred while indemnifying its directors.[76]From an economic perspective, D&O liability insurance reduces risks and enables companies to attract qualified individuals to leadership positions.[77]

Similar to the U.S., the emergence of D&O liability insurance in UK corporate law during the 1980s was prompted by a surge in lawsuits against directors.[78]

Initially, D&O liability insurance was a controversial topic in Anglo-American corporate law.[79] Critics argued that transferring personal liability from the director to an insurer could reduce accountability, potentially encouraging riskier behavior and weakening internal company discipline. Additionally, it was feared that D&O insurance might undermine the deterrent effect of derivative lawsuits, which serve to hold directors accountable.[80]

[75] V. Finch, Personal Accountability and Corporate Control: The Role of Directors' and Officers' Liability Insurance, The Modern Law Review, vol. 57, no. 6, 1994, p. 880
[76] R. Cavallaro, Corporate Buyer Beware: Deficiencies in Directors' and Officers' Insurance for Employment Practices Liability, Hofstra Law Review, vol. 26, no. 1, 1997, p. 218
[77] G. Kalchev, The Demand for Directors' and Officers' Liability Insurance by US Public Companies, Panel Data Econometrics: Theoretical Contributions and Empirical Applications, 2006, p. 5.
[78] N. O' Sullivan, Insuring the Agents: The Role of Directors' and Officers' Insurance in Corporate Governance, The Journal of Risk and Insurance, vol. 64, no. 3, 1997, p. 546.
[79] T. C. Lee, Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and the Erosion of the Directors' Duty of Care, 1987, p. 225.
[80] A. Paolini, The Nature of Directors' and Officers' Liability Insurance, University of Southampton, 2005, p 17.

In contrast, legal literature also emphasizes that because insurance policies do not cover liabilities resulting from intentional misconduct, D&O insurance cannot be regarded as an incentive for directors to act against the interests of the company. It should also be noted that all liability insurance policies set a predetermined coverage limit and contain exceptions under which no compensation is paid.[81]

The first D&O insurance policy was developed in 1934 by Lloyd's of London for two major public companies. However, this type of insurance only gained widespread use starting in the 1960s and fully took hold during the 1980s.[82] This expansion was driven by heightened regulatory scrutiny and the increasing number of derivative lawsuits against directors. Given the growing risks of financial liability, many qualified professionals either left their director positions or refused to accept such roles.[83] In response, companies began offering D&O insurance as part of the director compensation package. By 1985, 85% of public companies in the U.S. provided D&O liability insurance to their directors.[84]

In Germany, the first D&O insurance policy was introduced in 1986 and is still actively used today as part of director compensation packages.[85] Typically, the parties agree in advance on a fixed

[81] Ibid,p 19
[82] Ibid, p.228.
[83] Ibid, pp 221- 222.
[84] Ch. M. Elson, Director Compensation and the Management- Captured Board - The History of a Symptom and a Cure, SMU Law Review, vol. 50, no. 1, 1997, p. 148.
[85] T. Baums, Personal Liabilities of Company Directors in Germany law, 1996, p. 15; K. Maddison, Duties and liabilities of company directors under German and Estonian law: a comparative analysis, RGLS Research Papers, no.7, 2012, p. 75.

insurance limit and define exclusions under which the insurer is released from the obligation to compensate (most commonly, these include intentional breaches of duty by the director).[86]

For the purposes of D&O insurance, an insured event typically refers to the filing of a claim against the director. [87]Unlike traditional insurance, which compensates upon the occurrence of an insured event, D&O policies activate coverage if the claim is filed while the policy is active—even if the director's misconduct occurred before the policy's start date. Furthermore, insured individuals may notify insurers of a potential claim in advance, and if such notice is given within a reasonable period, the insurer's obligations are determined by the terms of the policy in force at that time.[88]

[86] K. Maddison, Duties and liabilities of company directors under German and Estonian law: a comparative analysis, RGLS Research Papers, no.7, 2012, p. 75.
[87] J. M. R. Chalmers, L. Y. Dann, J. Harford, Managerial Opportunism? Evidence from Directors' and Officers' Insurance Purchases, The Journal of Finance, vol. 57, no. 2, 2002, p. 613.
[88] Ibid, p 613.

3.2. Directors' and Officers' (D&O) Liability Insurance Crisis

The 1985 decision by the Delaware Supreme Court in Smith v. Van Gorkom[89] created significant uncertainty in common law legal system. Prior to this ruling, courts generally held that directors who acted in good faith, without fraud or personal interest, did not breach their fiduciary duties if their actions fell within the scope of business judgment. As a result, liability for breaches of the duty of care was rarely imposed.[90]

In Smith v. Van Gorkom, however, although there was no bad faith, fraud, or personal interest on the part of the directors, the Delaware Supreme Court found that the duty of care had been violated. The court agreed with the plaintiffs that the directors had failed to take reasonable and adequate steps, and classified this as gross negligence.[91]

In 2001, another event that significantly impacted the discourse on directors' liability was the Enron scandal, widely regarded as one of the greatest corporate collapses in modern history. Enron was extensively involved in financial misconduct, with its management employing a range of fraudulent accounting practices. For instance, the company frequently transferred debt to its subsidiaries while simultaneously including their income in its consolidated financial statements, thereby presenting a misleading picture of its financial health. Former CEO Kenneth Lay was subsequently found guilty on six of eleven counts of securities fraud, highlighting the extent of executive-level accountability in corporate governance failures[92]. As a result the US Congress

[89] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
[90] F. Shu-Acquaye, Smith v. Van Gorkom Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002, vol. 3, no. 1, 2004, p. 19.
[91] T. D. Moskowitz, W. A. Effross, Turning Back the Tide of Director and Officer Liability, American University Washington College of Law, 1993, pp. 898-900.
[92] E. S. Moncarz, R. Moncarz, A. Cabello, B. Moncarz, The Rise and Collapse of Enron: Financial Innovation, Errors and Lessons, 2006, pp. 19-22.

enacted the Sarbanes-Oxley Act (SOX) of 2002 which stipulated that chief executive and financial officers certify the company's financial statements[93].

Following the increased liability risks introduced by the Van Gorkom ruling and post-Enron scandal, insurers responded defensively. Premiums rose sharply, policy exclusions became broader, coverage periods were shortened, and several leading insurers exited the D&O insurance market entirely. Among the ten largest insurers in the U.S., three withdrew from this sector, while others imposed moratoriums on new D&O policies. Those that remained in the market offered policies at historically high rates, effectively pricing out small and medium-sized companies.[94] Meanwhile, lawsuits against directors continued to grow, driven by hostile takeovers and corporate bankruptcies. In this climate, many directors resigned or refused reappointment, as companies could no longer offer adequate protection. Those who remained in their roles often refrained from taking necessary risks to foster corporate growth and instead confined themselves to routine, cautious behavior.[95] It became increasingly evident that without D&O insurance, attracting qualified candidates to director positions was extremely difficult.[96]

93 Ibid, p. 32.
94 T. D. Moskowitz, W. A. Effross, Turning Back the Tide of Director and Officer Liability, American University Washington College of Law, 1993, p. 900
95 Ibid, p. 901.
96 R. M Kaplan, R. J Harrison, Defusing the Director Liability Crisis: The Strategic Management of Legal Threats, Organization Science, vol. 4, no. 3, 1993, p. 422.

3.3. D&O Liability Insurance Structure and Coverage Scope

The objective of a directors' and officers' liability insurance agreement is to insure the pecuniary liability of directors (including in the amount that exceeds the reimbursement limits set by the entrepreneurial company) and, along with it, to compensate the entrepreneurial company for the amounts paid within the scope of such reimbursement.[97]

Regardless of whether the dispute is settled or not, all costs related to the litigation, as well as the amount imposed on the entrepreneurial company/ director by court decision, are compensated by the insurer, if it is confirmed that the director acted in accordance with the duty of good faith.[98] Since directors' and officers' liability insurance covers only claims arising from negligence, if the liability of the director is caused by intentional conduct, the insurer is released from the obligation to provide compensation.[99]

Directors' and officers' liability insurance contracts are structurally divided into three parts – A, B, and C:

Part A insurance compensation: In cases where the entrepreneurial company, either by law (e.g., under Section 145(b) of the Delaware General Corporation Law, the company cannot reimburse the director for settlement amounts in derivative lawsuits[100]) or due to its financial situation, is

[97] A. Paolini., The Nature of Directors' and Officers' Liability Insurance, University of Southampton, 2005, p. 223

[98] E. J. Core, On the Corporate Demand for Directors' and Officers' Insurance, The Journal of Risk and Insurance, vol. 64, no. 1, 1997, p. 63

[99] Y. Brook, K. S. R. Ramesh, Shareholder Wealth Effects of Directors' Liability Limitation Provisions, The Journal of Financial and Quantitative Analysis, vol. 29, no. 3, 1994, p. 724.

[100] S. S. Arsht, J. W. Bishop, S. H. Chalif, F. J. Klink, Liabilities Which Can be Covered Under Statutes and Corporative By-laws, The Business Lawyer, vol. 27, 1972, p. 115.

unable to reimburse the director for costs, Part A protects the property rights of the director in the event of liability.

Part B insurance compensation, also known as "company reimbursement," protects the interests of the entrepreneurial company by reimbursing the monetary amounts it paid to the director within the scope of its indemnification obligation (litigation expenses and monetary amounts imposed on the director by court decision).

Part C insurance compensation directly covers the liability of the entrepreneurial company itself.

Standard policies offered by insurance companies exclude coverage if the director has intentionally violated the law (ex turpi causa non oritur action) or if the claim was filed against the director before the conclusion of the insurance contract.[101] As a general rule, based on public policy interests, only damages caused by negligence are subject to compensation.[102] There is a divergence of opinions regarding indemnification of directors when the claim is filed directly by the entrepreneurial company, since directors' and officers' liability insurance is generally intended to protect the director from liability arising before third parties (typically external parties).[103] Nevertheless, as liability insurance covering damage caused to the entrepreneurial company is not prohibited by law and represents accepted practice in insurance policies, this approach is further supported by the fact that in Parts B and C of the insurance contract, the entrepreneurial company itself is a party to the contract, whereas Part A concerns the personal liability of the director.[104]

[101] T. Baker, S. J. Griffith, Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market, University of Chicago Law Review, vol. 74, no. 2, 2007, p. 500.
[102] A. Paolini, The Nature of Directors' and Officers' Liability Insurance, University of Southampton, 2005, p. 88.
[103] Ibid, p. 83.
[104] Ibid, p. 84.

3.4. Prospects for the Development of Directors' Liability Insurance in Gerogian Legislation

Professional liability insurance is a type of civil liability insurance and is regulated by the Civil Code of Georgia.Within the scope of civil liability insurance, the insurer is obliged to release the insured from the obligation they owe to a third party due to liability arising during the insurance period.[105] In the context of the relationship between the company and the director, this implies insuring the director against liability arising before a third party, which protects them from undesirable material losses. However, it should be noted that the insurer's obligation to compensate arises only when the director is held civilly liable.

Given that, in civil liability insurance, the insured value (i.e., the amount of damage caused to a third party) cannot be pre-calculated, the determination of the insurance premium is primarily based on the probability of the insured risk occurring (i.e., the probability that the insured will be held civilly liable during the validity of the contract). Within the scope of professional liability insurance, the evaluation of the insured risk may be based on the personal characteristics and work experience of the insured.

In the Georgian legislative framework, a reference to professional liability insurance can be found in the Law of Georgia on Lawyers, which mandates liability insurance for the purpose of compensating material damage caused to clients.[106] A similar provision is found in the Law of

[105] Civil Code of Georgia, Article 839.1., Avaliable at: https://matsne.gov.ge/en/document/view/31702?impose=translateEn&publication=133 [accessed 12.06.2025].

[106] The lawyer is obliged to insure their professional liability, in accordance with the procedure and cases established by law, for the purpose of compensating possible material damage to the client. The Law of Georgia on Lawyers, Article 9, Avaliable at: https://www.matsne.gov.ge/ka/document/view/15472?impose=translateEn&publication=16 [accessed 12.06.2025].

Georgia on Notaries, which regulates the mandatory professional liability insurance of notaries. As of today, among the types of professional liability insurance, doctors' liability insurance is the most popular on the Georgian insurance market. This insurance protects doctors from liability imposed by patients.[107]

A legal interpretation in Georgian literature suggests that in the former version of the Law on Entrepreneurs allowed insurance to be included as part of a director's compensation package. This view is well-founded, as the in the former version of Law relevant provisions referred not only to monetary remuneration but also to non-monetary benefits which could reasonably include insurance coverage.

Although the current version of the Law on Entrepreneurs does not expressly regulate the matter of professional liability insurance for directors, there is no legal barrier to incorporating such insurance as a part of a director's compensation structure. The admissibility of professional liability insurance may be inferred from the content of the agreement on "service-related privileges" concluded with the director under paragraph 3 of Article 45 of the Law of Georgia on Entrepreneurs,[108] since service-related privileges encompass both monetary and non-monetary benefits, and it is accepted practice to include professional insurance in non-monetary benefits.

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[107] To ensure compensation for the damage specified in Article 22 of this Law, the notary is obliged to conclude a contract for mandatory professional liability insurance for the entire period of their professional activity. The Law of Georgia on Notaries, Article 23.1, Avaliable at: https://www.matsne.gov.ge/document/view/90928?publication=25 [accessed 12.06.2025].

[108] The employment agreement must specify the amount, form, and periodicity of remuneration for the director, the employment benefits the director will receive during the term of the agreement, as well as their rights and obligations that will remain in effect even after the termination of the agreement. The Law of Georgia on Entrepreneurs, Article 45.3, I sentence, Avaliable at: https://matsne.gov.ge/ka/document/view/5230186?publication=12 [accessed 11.06.2025].

4. Corporate Indemnification of Directors

4.1. The Legal Concept of Director's Indemnification:

If the issue of director liability is transferred from the corporate entity to the courts, the director, like other defendants, will have to bear the costs of legal proceedings. To mitigate such financial losses, the Anglo-American legal system developed the institution of indemnification for directors.[109] The obligation to indemnify directors was first introduced in the United Kingdom in 1845 through the Companies Clauses Consolidation Act.[110]

In the United States, the obligation to indemnify became relevant in the 1930s, a development triggered by the 1929 Wall Street crash.[111] With the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, the issue of director liability came to the forefront.[112] The obligation of indemnification gained particular importance after the 1939 court decision in The New York Dock Company v. McCollom,[113] which ruled in favor of the directors but denied their claim for indemnification (which exceeded $86,000), reasoning that the company had not derived any benefit from the favorable decision.[114]

Following the McCollom case, the need to codify indemnification obligations in American corporate law became apparent. The obligation was included in the New York General Corporation

[109] D. A. DeMott, Limiting Directors' Liability, Washington University Law Quarterly, vol. 66, no. 2, 1988, p. 317.
[110] P. M. Pangelley, Indemnity and Infidelity: Advancement of Defence Costs in Action "By … The Corporation", Canadian Business Law Journal, 2008, p. 398.
[111] R. Gomes, M. Elisabete, Corporate Indemnification: Experiences in USA and Developments in Germany, Italy and Portugal, European Company and Financial Law Review (ECFR), vol. 14, no. 4, 2017, p. 735
[112] P. M. Pangelley, Indemnity and Infidelity: Advancement of Defence Costs in Action "By … The Corporation", Canadian Business Law Journal, 2008, p. 400-401.
[113] The New York Dock Company v. McCollom, 173 Misc. 106 (N.Y. Misc. 1939).
[114] J.J. Hanks, L.P. Scriggins, Protecting Directors and Officers from Liability—The Influence of the Model Business Corporation Act, The Business Lawyer, vol. 56, no. 1, 2000, p. 5.

Law in 1941, the Delaware General Corporation Law in 1943, and the Model Business Corporation Act in 1950.[115]

The goal of codifying the obligation to indemnify was to protect directors who had acted in good faith but were sued by the company/partners (derivative actions) or third parties.[116]

Today, indemnification remains one of the main legal defenses available to directors in the Anglo-American legal system. Once considered detrimental to shareholders, since the 1940s–1950s this institution has become a central protective tool for directors.[117]

[115] M. E. Barret, Mandatory Indemnification of Corporate Officers and Directors, Southwestern Law Journal, vol. 29, no. 3, 1975, p. 727.
[116] J. P. Monteleone., N. J. Conca, Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues, The Business Lawyer, vol. 51, no. 3, 1996, p. 574.
[117] Brook C.B., Directors' Indemnification and Liability Insurance, New York Law Forum, 1975, p. 1.

4.2. Legal Preconditions for Indemnification and Extent of Coverage

In Anglo-American law, the obligation to indemnify directors is classified as either mandatory or permissive.[118]

Mandatory indemnification is prescribed by law, requiring the corporate entity to fully cover litigation costs (both judicial and extrajudicial) when certain legal prerequisites are met.[119]

In the case of permissive indemnification, the preconditions are established either in the corporate charter or in an agreement with the director, making this entirely within the corporation's discretion (e.g., Massachusetts General Law).[120]

To avoid provisions contrary to public policy, the Model Business Corporation Act imposes certain limitations in permissive indemnification cases. Specifically, indemnification is prohibited if the court finds that the director obtained a financial benefit.[121]

The Delaware General Corporation Law provides an example of mandatory indemnification.[122] Section 145 of the Delaware Code governs this obligation, aiming to encourage qualified

[118] J. P. Monteleone., N. J. Conca, Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues, The Business Lawyer, vol. 51, no. 3, 1996, p. 574.
[119] E. P. Mattar, J. F. Hilson, Exposure of Corporate Directors: An Overview of Indemnification and Liability Insurance, The Journal of Risk and Insurance, vol. 46, no. 3, 1979, p. 413.
[120] J. P. Monteleone., N. J. Conca, Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues, The Business Lawyer, vol. 51, no. 3, 1996, p. 576.
[121] Model Business Corporation Act, Section 8.51.d., Available at: https://www.lexisnexis.com/documents/pdf/20080618091347_large.pdf [accessed on 17.05.2025].
[122] E. P. Mattar, J. F. Hilson, Exposure of Corporate Directors: An Overview of Indemnification and Liability Insurance, The Journal of Risk and Insurance, vol. 46, no. 3, 1979, p. 413.

individuals to assume executive roles by assuring them that litigation costs will be reimbursed by the company.[123] This provision also motivates officers to mount a strong legal defense.[124]

Section 145 of the Delaware General Corporation Law provides indemnification only if directors acted in good faith and believed their conduct was in the company's best interest. If, however, the director acted with personal interest, willfully violated the law, or committed gross negligence, indemnification is not permitted.[125]

Indemnification also applies if the proceedings are dismissed.[126] In criminal cases, indemnification is possible if it is established that the director lacked reasonable grounds to believe their conduct was unlawful. Nevertheless, the court retains the discretion to grant indemnification based on the reasonableness standard.[127]

Unlike New York's General Corporation Law, which is stricter, Delaware's law allows indemnification even in cases of partial success, i.e., if part of the director's defense or claim is upheld.[128]

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[123] Delaware General Corporation Law, Section 145, Available at: https://delcode.delaware.gov/title8/c001/sc04/ [accessed on 17.05.2025].

[124] E. N. Veasey, J. A. Finkelstein, C. S. Bigler, Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance, The Business Lawyer, vol. 42, no. 2, 1987, p. 404.

[125] Ibid, p. 405

[126] E. P. Mattar, J. F. Hilson, Exposure of Corporate Directors: An Overview of Indemnification and Liability Insurance, The Journal of Risk and Insurance, vol. 46, no. 3, 1979, p. 413.

[127] S. S. Arsht, J. W. Bishop, S. H. Chalif, F. J. Klink, Liabilities Which Can be Covered Under Statutes and Corporative By-laws, The Business Lawyer, vol. 27, 1972, pp. 117-118.

[128] E. P. Mattar, J. F. Hilson, Exposure of Corporate Directors: An Overview of Indemnification and Liability Insurance, The Journal of Risk and Insurance, vol. 46, no. 3, 1979, p. 414.

It is worth noting that the indemnification obligation applies regardless of whether the person still holds the director position at the time of litigation. According to Section 145, former directors are also entitled to request indemnification.[129]

Under Delawere General Corporation Law, indemnification covers legal costs, which attorney fees and court expneses. Coverage for fines, as well as settlement amounts and penalties imposed on the director must be provided either in the corporate charter or in an agreement with the director.[130]

The scope of indemnification depends on who initiated the proceedings—whether the claim was brought by the company or a shareholder (derivative suit) or by a third party.[131] The Model Business Corporation Act entirely excludes permissive indemnification in the case of derivative actions.[132]

When a derivative suit concludes with a settlement, the company is not obligated to reimburse the director for the settlement amount. In contrast, in claims initiated by third parties, all litigation-related costs—including settlements—are generally indemnifiable. In derivative suits, only attorney fees and other necessary litigation expenses are covered.[133]

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[129] A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director,.., Delaware General Corporation Law, Section 145, Available at https://delcode.delaware.gov/title8/c001/sc04/ [accessed on 17.05.2025].

[130] E. P. Mattar, J. F. Hilson, Exposure of Corporate Directors: An Overview of Indemnification and Liability Insurance, The Journal of Risk and Insurance, vol. 46, no. 3, 1979, p. 416

[131] E. N. Veasey, J. A. Finkelstein, C. S. Bigler, Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance, The Business Lawyer, vol. 42, no. 2, 1987, pp. 579-580.

[132] Model Business Corporation Act, Section 8.51.d., Available at https://www.lexisnexis.com/documents/pdf/20080618091347_large.pdf [accessed on 18.05.2025].

[133] O. Sebring, Recent Legislative Changes in The Law of Indemnification of Directors, Officers and Others, The Business Lawyer, vol. 23, no.1, 1967, p. 103; E. N. Veasey, J. A. Finkelstein, C. S. Bigler, Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance, The Business Lawyer, vol. 42, no. 2, 1987, p. 405;

It is important to highlight that even if a derivative claim ends in a ruling against the director, Delaware's Section 145.b. still allows for indemnification based on the court's discretion.[134]

Typically, indemnification occurs after the case is concluded. However, Delaware law also permits indemnification in advance of the final decision.[135] The only requirement for such advance indemnification is a written commitment from the director to repay the advance if the case ends unfavorably.[136]

[134] J. F. McKeown, Corporate Indemnification of Directors and Officers - The Expanding Scope of the Statutes, Catholic University Law Review, vol. 18, no. 2, 1968
[135] C. E. Black, M. J. Andreini, J. N. Edel, Creditors at the Gate: How Good Are Your Indemnities and D&O Insurance?, Pratt's Journal of Bankruptcy Law, vol. 16, no. 4, 2020, p. 153
[136] Ibid, p.153

4.3. Indemnification under Civil Law Legal System: The Georigian Legislative Perspective

The absence of explicit indemnification provisions for directors in the company laws of continental European countries should not be interpreted as a prohibition.[137]

In Anglo-American law, the focus on indemnification is closely linked to the cost allocation rule in litigation. Under the "American Rule," unless otherwise agreed, each party bears its own legal costs, regardless of the outcome. This is why corporate statutes pay special attention to regulating director indemnification.[138] By contrast, under the "German Rule," which is identical to the rule in Georgian civil procedure law,[139] the losing party must pay the litigation costs incurred by the winning party. As a result, indemnification of directors is a matter of procedural rather than corporate law.[140]

Accordingly, in Georgian corporate law—similar to German law—indemnification is governed by procedural rules.

unlike Delaware's Section 145.b., which allows for indemnification even in the case of an unfavorable outcome in derivative litigation, the Georgian Civil Procedure Code takes a stricter approach. It mandates that the losing party must cover the legal costs of the prevailing party—even if the latter is exempt from court fees. As a result, if a director loses a case brought by the

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[137] R. Gomes, M. Elisabete, Corporate Indemnification: Experiences in USA and Developments in Germany, Italy and Portugal, European Company and Financial Law Review (ECFR), vol. 14, no. 4, 2017, p. 748.
[138] Ibid, p 757-758
[139]The Civil Procedure Code of Georgia, Article 53.1., Avaliable at: https://www.matsne.gov.ge/ka/document/view/29962?impose=translateEn&publication=171 [accessed on 18.05.2025].
[140] R. Gomes, M. Elisabete, Corporate Indemnification: Experiences in USA and Developments in Germany, Italy and Portugal, European Company and Financial Law Review (ECFR), vol. 14, no. 4, 2017, p. 757

company or a third party, they must bear the full cost burden. The court is not granted discretion to reallocate these costs.

In such cases, the only alternative for the director would be a separate indemnification agreement or a charter provision, akin to permissive indemnification under the Anglo-American model.

Since Georgia's "Law on Entrepreneurs" does not regulate indemnification for directors, any advance payments by the company must be addressed under the Civil Procedure Code.

A systemic analysis of the Georgian Civil Procedure Code indicates that it does not provide for advance indemnification of litigation costs. However, it includes certain relief measures, such as full or partial exemption from court fees,[141] postponement of payment, or reduction of the fee amount.[142] Although both mechanisms may be viewed as financial relief for the director, they differ significantly. In the case of advance reimbursement of expenses, the director only needs to obtain a written undertaking. In contrast, when seeking full or partial exemption from, deferral of, or reduction in the amount of court fees, the director must demonstrate their difficult financial situation before the court, which must be supported by appropriate evidence. Therefore, full or

[141] According to Article 47.1. of the Civil Procedure Code of Georgia, if a citizen substantiates their inability to pay court fees and presents conclusive evidence to the court, the court, taking into account the citizen's financial situation, may fully or partially exempt them from the obligation to pay court fees to the state budget, upon which the judge issues a reasoned ruling, Avaliable at: https://www.matsne.gov.ge/ka/document/view/29962?impose=translateEn&publication=171 [accessed on 18.05.2025].

[142] According to Article 48.1. of the Civil Procedure Code of Georgia, the court, considering the financial situation of the parties, may defer the payment of court fees to the state budget for one or both parties, or reduce the amount thereof, if the party submits conclusive evidence to the court, Avaliable at: https://www.matsne.gov.ge/ka/document/view/29962?impose=translateEn&publication=171 [accessed on 18.05.2025].

partial exemption from, deferral of, or reduction in court fees cannot be considered equivalent to the institution of advance reimbursement of expenses.

III. Conclusion

Director plays a crucial role in a company, but how can qualified persons be interested in this position if they know that they can be removed at any time, without any ground. The absence of stability can undermine directors' loyalty, producitivity and it can negatively impact directors' strategic commitment, decision-making and willingness to take initiative, which are the key aspects of successful companies. Every company which we know today is the product of bold, risk-based decisions of directors. Aside Business Judgment Rule, the Law on Entrepreneurs does not offer any legal protections for directors to counterbalance the risk of the removal at any time. As a result, it is credible that only a few companies can be named in the Georgian market that stand out for their risk-based decisions and bold initiatives.

International experience illustrates that compensatory protective mechanisms for the removal of a director at any time serves as a vital medium both for the director and the overall prosperity of a company.

The 1986 amendment to the Delaware General Corporation Law enacted in response to the D&O crisis (allowing companies to limit or eliminate directors' liability for breaches duty of care) underscores the fundamental importance of legal protections in safeguarding and attracting skilled, professional individuals to serve as directors.

In Georgian legal literature and case law the groundless removal of director is justified by the business interests of the partners, however the lack of critical assesment of such removal is notable and indicates the need to raise awareness about the issue.

Georgian Judicial practice generally upholds partners' right to remove directors at any time, although less emphasis is placed on protective mechanisms for directors. In this regard, only a single decision of the Supreme Court of Georgia stands out, considering compensation as a protection measure for directors upon removal at any time[143].

In Georgia director is under the constant therat of removal, Article 44.3. of the Law of Georgia on Entrepreneurs states that the general meeting of shareholders, and in the case of a supervisory board is formed in a company, the supervisory board, is authorized to remove a director from office at any time without indicating any grounds. Any agreement/provision in the articles of incorporation/bylaws that contradicts this provision is null and void, in addition to the fact that statutory autonomy is completely limited, the Law does not provide the obligation to inform the director, therefore his right to challenge the decision on removal is completely denied.

To resolve this issue, it would be the most optimal for the Law on Entrepreneurs to be closely aligned with international practice by allowing statutory autonomy regarding the removal of the director, additionally the obligation to notify the director in advance should be restored in the current version of the Law.

In addition to statutory autonomy, it is noteworthy that the Law permits the implementation of protective mechanism such as directors' liability insurance. To enhance legal clarity and raise awareness of a liabilty insurance, a provision on additional benefits, including liability insurance, should be incorporated into the employment contract regulatory norms of the Law on Entrepreneurs. Furthermore, the employment contract may also regulate the indemnification of

[143] Decision of the Civil Chamber of the Supreme Court of Georgia dated March 19, 2021, case N 553-2019.

expenses and, similar to the Delaware General Corporation Code, permit the advande indemnification of procedural costs. Such legal framework would give directors the opportunity to address the court and challenge their groundless removal.

Upon the above findings, it is clear that the Law on Entrepreneurs, in contrast to international practice, fails to provide directors with a diverse choice of protective mechanisms to counterbalance removal at any time, without any ground. Moreover, the fact that there is little practice of litigation on this topic, emphasises the need to raise awareness of the issue and to consider the issue of removal of directors not solely from the perspective of partners, but also from the perspective of the directors themselves.

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