



## New Law on Entrepreneurs –

### What You Should Know

A new law on entrepreneurs has come into force as of 1 January 2022 after being adopted by the Georgian parliament in August 2021.

As opposed to its previous version, which allowed the relevant parties to agree (through the company charter or otherwise) on major aspects of corporate relations, the new law takes a vastly different approach, regulating even the minor aspects of day-to-day life for a corporate entity.

Because the new law will influence every business operating in Georgia, BLC has created a guideline outlining some key legal changes that every businessperson or manager should be aware of.

#### **The law has a transitional period that needs to be treated carefully**

The new law states that existing entities will be given two years to bring their respective registered data into compliance. However, there are important conditions to this rule! If an entity wishes to change its existing data or intends to register/change any information currently subject to registration, the public registry will request submission of a new charter in compliance with the new legislation. Therefore, the full two-year transitional period will only apply to entities that do not have active operations or do not intend to make any entries in the register over this period.

#### **Founding shareholders are liable for obligations borne prior to the company's registration**

The new legislation specifies that company shareholders are personally and jointly liable for the entity's obligations born prior to corporate registration unless the relevant obligations have been passed on to the entity itself after registration and the creditor(s) do not object.

This will be relevant particularly for joint ventures or special purpose vehicles, which are often created for a specific project and take material steps before the company is officially registered.

#### **Selection of a company's name is now limited**

The new law prohibits the existence of two entities with the same name. Therefore, it is required to ensure that two entities having similar names are differentiated and, in some cases, an addition/modification must be made to the firm's name to reflect this. The latter shall be done in the Georgian language only. The firm's name is prohibited from being misleading or containing any improper words, and it also may not coincide with the name of a well-known enterprise in Georgia.

#### **Letterhead and webpage**

The company letterhead shall contain the company name, legal address and identification code. If a company is under liquidation or in an insolvency regime, the letterhead shall also contain a clear indication in this regard. The same information shall be (i) contained on a letterhead of a foreign entity's branch office; and (ii) shall be available on the company webpage. Failure to do so can result in administrative liability.

#### **Relationship with the company auditor**

The company directors and supervisory board members are now jointly liable for the preparation, submission and publication of financial statements as provided under the Law on Accounting, Reporting and Audit of Georgia. In addition, the company shareholders are not authorized to terminate an agreement with an auditor without having a good reason for doing so. Disagreement on interpretation of certain financials shall not be considered a valid reason. If termination

does occur, the parties are obliged to notify the Service for Accounting, Reporting, and Auditing Supervision under the Ministry of Finance.

#### **Removal of and exit by a shareholder**

Due to the absence of clear legislative guidance, the possibility of removing a shareholder was previously one of the most heavily debated issues in the Georgian corporate world. The new law explicitly regulates this issue and stipulates that if there are substantial grounds, the court may take a decision on removing a shareholder from a limited liability company. Sufficient grounds can be met if a partner materially prejudices the company's interests or if maintaining a partnership prejudices future activities thereof, on the condition that the partner has been warned of such possibility and the default continues.

Furthermore, a partner has a right to exit a limited liability company if the company management or other partners significantly prejudice the partner's interests. Such examples of prejudice include significant changes made to the business, a failure of the company to distribute dividends for more than three years despite accumulated reserves and existence of favorable financial conditions, and other partners approving additional contributions which apply to that partner as well.

Removal or exit of a shareholder shall be made based on fair valuation of the relevant shareholding interest owned by the departing shareholder.

#### **If you operate as a joint stock company, chances are you want to reorganize into a limited liability company!**

The new law on entrepreneurs has introduced the possibility of having a complex capital structure in an LLC, which was not previously permitted. LLCs can now have authorized capital and issue new shares.

While the new legislation provides more possibilities for LLCs, JSCs are conversely now subject to extreme regulation, reinforcing the idea that only large, public corporations and certain financial institutions with established reporting and transparency systems shall exist in this form.

Here are a few reasons to consider reorganizing into an LLC:

1. Shareholders of an LLC can agree to deviate from certain statutory rules, while there is no such possibility in a JSC. The rules included in the law apply to a JSC notwithstanding the stance of shareholders on relevant matters.
2. Unlike an LLC, having subscribed capital (the amount agreed upon by the founding partners and indicated in the founding agreement) is mandatory for a JSC. The main function of subscribed capital is to form the initial capital of an entity at the time of its formation. Once the entity is registered, the subscribed capital should be used to maintain and increase the entity's property. In essence, it is the same as the statutory capital, legal capital, or charter capital of an entity. The law sets the minimum capital requirement for a JSC at 100,000 GEL (roughly USD 32,800). No such statutory minimum is established for an LLC.

3. Capital is formed by way of initial and additional contributions. The term "contribution" is defined as property transferred to the entrepreneurial entity in exchange for a share (participation interests) in that entity. Having said that, in-kind contributions are also regulated for a JSC and the law states that it shall be evaluated by an independent auditor / valuator prior to contribution to the capital, while provision of services or performance of work cannot be used for paying-up capital in a JSC. The limitation is due to the difficulty in objectively determining the monetary equivalent of the services/works performed.
4. The new law introduced an important, although not compulsory, mechanism for capital protection in the form of reserve capital, which serves to cover losses. A JSC must have reserve capital that amounts to at least 10% of its subscribed capital. Until the reserve capital reaches the above threshold, the JSC must retain 5% of its annual net profit and direct it to the reserve capital.
5. Reduction of subscribed capital in a JSC is a complex procedure, which includes the obligation to publish the relevant decision. In addition, cash outflow is not allowed from a company until six months after publication. In general, taking cash out of the company becomes extremely challenging in the case of a JSC.
6. In the case of both JSCs and LLCs, distribution of dividends is allowed if the net asset value of the company is positive. In other words, distribution is still allowed even if the company has not generated profit, provided that the company has a positive net asset balance and subscribed capital (the net asset value must exceed the subscribed capital). However, JSC dividend distribution is subject to additional preconditions, including the following: (a) prior to or as a result of the distribution of dividends, the net asset value of the JSC provided in the latest financial statements of the company should not be less than the aggregate amount of the subscribed capital of the company and its reserves; (b) the aggregate amount of the distribution must exceed the financial indicators calculated in accordance with the law.

Although the new law was published well ahead of its enactment, number of complications and difficulties have arisen in practice due to the magnitude of the changes made. Therefore, be sure to obtain legal consultation and ensure that your corporate document, as well as internal document flow, complies with the new rules to avoid any unnecessary obstacles or delays.

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Please apply for the professional advice prior to relying on the information given in this article. BLC and its team shall be ready and pleased to provide any information, legal advice and specific recommendations regarding the issues covered herein.

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