

# Addressing Shareholder Deadlocks: Insights from GEORGIA'S New Company Law of 2021

Georgia embarked on its journey towards a market economy with the adoption of its inaugural Company Law in 1994. This legislative milestone, preceding the enactment of other key economic laws, signified a pivotal step towards fostering entrepreneurship and economic development in the nation. Over time, Georgia underwent significant economic reforms, particularly in 2008, aimed at liberalizing economic legislation and enhancing its global business ranking. While these reforms bolstered Georgia's ranking on the Ease of Doing Business index, they left certain areas, notably the resolution of shareholder deadlocks, inadequately addressed.

Shareholder deadlocks occur when conflicts between shareholders imperil business operations and pose a considerable challenge to business sustainability. Unlike in mature market economies where deadlock mechanisms are often ingrained in shareholder agreements, Georgia initially lacked - and still lacks in many ways - comprehensive legislative provisions to address such impasses. Many businesses have signed "standard charters" drafted by the Public Registry, which are not sufficient for addressing complex aspects of business and corporate dynamics.

Consequently, such businesses can find themselves entangled in disputes without adequate legal recourse, potentially jeopardizing their viability and hindering economic growth.

## The Company Law of 2021

Recognizing the need to enhance the legal framework surrounding shareholders' autonomy, Georgia introduced its new Company Law in 2021. While still affording business owners significant flexibility in structuring their enterprises, the law sought to mitigate the risks associated with shareholder conflicts through default mechanisms. These mechanisms attempt to provide a safety net for businesses lacking detailed shareholder agreements by offering predefined solutions to deadlock situations.

Three noteworthy default mechanisms introduced in the new law are withdrawal, expulsion, and compulsory liquidation (dissolution). Withdrawal allows aggrieved shareholders to exit the company and receive compensation for their shares at a fair value, which is particularly beneficial

for minority shareholders. Withdrawal is allowed in several cases, including when the company has funds to distribute dividends but has not chosen to do so for three consecutive years. Expulsion empowers remaining shareholders to remove those jeopardizing the company's interests, subject to judicial oversight and fair compensation. The courts can establish exact criteria for the expulsion; however, the general direction of case law relates to actions of a shareholder that damage the long-term interests of the company. Compulsory liquidation enables shareholders to extract value from dormant assets, safeguarding against situations where one shareholder may exploit control for personal gain. Since dissolution effectively ends the business, the legislation grants a buy-out right to the opposing side within an established deadline, thus allowing prolongation of economic activity.

## Room for Improvement

Since the law's enactment, there has been a notable increase in court cases invoking these default provisions to resolve deadlock disputes. However, the evolving nature of court practices underscores the need for further refinement and clarity, especially concerning fair market valuation, the interaction between contractual agreements and statutory rules, as well as application of interim measures suspending the voting rights during the court litigation. Despite these challenges, we continue to navigate and monitor these cases closely, assessing the efficacy of default mechanisms in alleviating deadlock-induced strains on businesses.

As Georgia's business landscape evolves, the successful resolution of shareholders' deadlocks assumes paramount importance in fostering a conducive environment for entrepreneurship and economic prosperity. Some may argue that shareholder deadlock is a private matter, not warranting legislative intervention. However, considering the substantial number of registered and active businesses—358,041 legal entities registered as of April 1, 2024, with 88,013 marked as active according to Geostat—shareholder deadlock could impede otherwise thriving or potentially successful enterprises and assets, hindering wealth generation and impeding the nation's economic growth.

While legislative interventions provide a framework for dispute resolution, fostering a culture of proactive shareholders' agreements remains crucial in preempting and mitigating the impact of future deadlocks. By embracing the principles of transparency, accountability, and collaboration, Georgian businesses can navigate uncertainties and capitalize on opportunities for sustained growth and resilience in an ever-changing economic landscape.

In conclusion, the adoption of Georgia's new Company Law represents a significant milestone in addressing the complexities surrounding shareholders' deadlocks. By providing default mechanisms for dispute resolution, the law offers a vital lifeline to businesses navigating tumultuous waters. However, continued vigilance, refinement, and proactive engagement among stakeholders are essential to ensure the law's effectiveness in promoting economic stability and fostering a vibrant entrepreneurial ecosystem in Georgia.



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