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COMPARATIVE ANALYSIS OF PREEMPTIVE RIGHTS IN GEORGIAN AND UKRAINIAN LLCs – A STATUTORY RULE OR A CONTRACTUAL PRIVILEGE

1. Introduction

The article briefly displays an objective coverage of the legal consequences of the shareholders' preemptive rights in limited liability companies (furthermore, LLCs) in Ukraine and Georgia. Over the past few years, individual shareholders have reshaped into professional and institutionalized funds, which bestows a wider range of controlling mechanisms on their part (1, pp.15-18, 113-118). Albeit, the protection of shareholders' property rights has attracted interest in the academic circle. Indeed, recent scholastic endeavors endorse the actuality of the topic (2, pp.1-6; 3, pp.53-54, 61-68.); nevertheless, the extant literature on the recent legislative novelties still, have hitherto failed to provide an in-depth comparative study. Contemporary European company law has been paying a thorough attention to the legal framework, which, has, so far, manifested in the establishment of the shareholders' enhanced participation in corporate governance (4, pp.253-265). Thus, a new tendency revealed itself in legislative novelties and adoption of new legal mechanisms (5). Likewise, such an inclination has been followed by a number of countries, including Ukraine and Georgia. In both of these countries, a business organization's practice shares a lot in common, including the fact, that LLCs are one of the frequently incorporated business forms. The Ukrainian Parliament has, recently, adopted a new law on "Limited Liability Companies and Additional Liability Companies" (6). In 2017 Georgia also amended the regulatory policy in regards to the LLCs (7). Recent legislative revisions in both of these countries have had a significant impact on the exercise of the shareholders' preemptive rights, which for now embraces meticulous procedural provisions on the matter. By comparing Georgian and Ukrainian regulations, the paper elucidates an essence of the shareholders' whether a statutory or a contractual privilege towards the "first refusal to buy a share" and illustrates novel insight into the topic. The premise of the article is to bridge between the Georgian and the Ukrainian legislative novelties, and hence, to expose coherent challenges with respect to the equal and fair treatment of the shareholders.

2. Brief Elucidation of the Preemptive Right

2.1. “Right to the First Refusal” – Shareholders’ Perspective

At an outset, partner’s identity plays a crucial role in LLCs, since in the closed companies all members are closely concerned to each other. Hence, in most of the cases, shareholders are reluctant about selling their holding or letting the third-party in (8, pp.197-199). Although, due to the personal reasons a shareholder might wish to exit the company by cashing-in own share at a decently fair price. Access to the secondary market envisages the share disposal at a premium price. However, market efficiency and availability cannot be guaranteed. The complexity of the share valuation and less forcibility of the share’s price in the closed companies (9, pp.277-278) may also trigger hesitation on behalf of the third-party while making investments. Therefore, at some point, the shareholders’ preemptive right creates certain availability of the share transfer and increases the probability of share liquidity. Thus, a member wishing to sell the shares may count on the fellow shareholder’s preemptive rights. On the flip side, the members do not anticipate alien identity by losing the control over the new memberships.

In general, a preemptive right is a remedy to protect the share participation from the dilution (10, pp.520-522). Shareholders’ expansion of the participation interest in the equity capital is feasible through the first offer to buy shares. Additional shares can be obtained to the extent equivalent to the previous participation. Therefore, the principle of proportionality is meticulously observed.

2.2. Preemptive Right as a Shield of LLCs’ Capital Structure

Due to the company’s distinct legal personality (11, pp.3, 5-9) free transfer of the shares is described as one of the coherent features of all capitalistic business organizations. Therefore, the share transfer cannot affect the legal existence nor a financial standing of the company. However, the Articles may impose an approval requirement by the shareholder’s meeting, which must be granted by weighing the best interests of the company against to the right to sell the share (12, pp.24-25). However, public corporations do not usually accommodate stringent regulations on the share transfer and thus, are subjected to a public trade. Restriction on transferability is prevailing in the small or medium-sized, closely-held companies (13, pp.2-24; 14, pp.5-8). This kind of mechanism restricts a free admission of a new participant and sustains personal, closed capital structure of the company. In the absence of such a condition, it may be deducted, that the same objective is targeted by the preemptive right. From the perspective of the company, this can be utilized as a defensive tool from the hostile takeovers; especially when the sale of the majority ownership is considered.

3. Comparison of the Legislative Novelties

In 2008 Georgian Entrepreneurial Law adopted US-American provisions, which had become a bedrock of the exclusion of mandatory articles and the selection of default rules. Liberalization of entrepreneur policy had an immense impact over the Articles regulating the companies' capital structure along with the shareholders' property rights. Consequently, nowadays "Entrepreneurs Law of Georgia" spells more space for default rules, which has been criticized for jeopardizing capital maintenance of the company (15, pp.1-10). Although, with an expressed political intention (16) of complying with a European standard, Georgia and Ukraine has been undertaking regulatory amendments and yet, plausible revisions are being held. Introduced innovation is a step forward.

3.1. Challenges while Exercising the Preemptive Right

As a result of the vast contractual freedom in the LLCs Law (17, pp.223-225), in some of the countries preemptive right is not exercised upon the mandatory regulation, instead, it is established through the Articles. According to the Georgian law, preemptive right is defined as a selling member's obligation to offer shares to fellow shareholders at the same price and terms, which would be negotiated with the third-party (18, Sec.461.8). Yet, this obligation may be altered via the Articles. As it is stated in the Ukrainian law, member's preemptive right may also be abolished (19, Sec.20.6.); however, if the share is intended to be sold to a third party, the Charter may prescribe a member's obligation to hold negotiations on the sale with the fellow members at first (20, *ibid*). The latter is a way favorable solution for the sake of the company's closed structure and shareholder's ownership. Georgian policy is absent from such a strategy, but it can be adopted through the Charters. As stated in the Georgian law, the Articles in respect to the preemptive right may be amended by an ordinary majority (if the higher requirement is not set), whilst Ukrainian law posits, that at least, all members must attend the meeting resolving the editions to the Articles (21). Therefore, it may be deducted that Ukrainian law enables stronger defensive shield in support of the shareholders' rights. However, it may also be argued, that in the need of exclusion of the preemptive right such a requirement might prolong related processes. Conforming to the Georgian regulations, the member wishing to sell a share must address fellow shareholders in written (electronic communication is also allowed), whereby an amount of the shares, price and payment date is to be fixed (22, Sec.461 2; 3; 6; 7). In spite of the default nature of governing rule, the Article may even disregard an obligation to address in written. Consequently, there is a higher possibility that an offer will fail to be delivered. Under the Ukrainian law

written address is highly emphasized and is perceived as a crucial protection mechanism (23, Sec.20.3.). The responding consent of the fellow shareholders must be sent in due time, which is the case of Georgia is stipulated by 10 days at least; nevertheless, the Ukrainian law observes longer time-frame, such as 30 days (24, Sec.461 2; 25, Sec.20.3.). Therefore, it is quite clear, that Ukrainian regulations consider a better support of shareholders' access and enjoyment of the preemptive rights. Whilst 10 days may seem insufficient period for obtaining relevant fund in order to exercise the preemptive rights. Georgian regulations leave a regulatory gap which in practice may result in shareholders' unequal and unfair treatment. Moreover, Ukrainian law frames due date for concluding the purchase agreement and assists both of the parties with ample remedies, which in Georgian policy is missing.

3.2. Risk of a De Facto Withdrawal of the Preemptive Right

The shareholders' preemptive right can be fully or partially excluded upon the resolution of the meeting. The reasons causing exclusion may vary in a wide range, such as third-party debt financing, for the means of raising additional capital in a timely fashion. The cumbersome regulations might hamper further capitalization. All members of the LLCs are bounded by the duty of loyalty to the fellow members along with the company (26, p.225). A decision on withdrawal must be endorsed by the relevance of such a measure: exclusion must be begotten from the best interest of the company, should be suitable for the intended purpose and should be used as a last resort (27, p.154). Since the Georgian policy does not state this criterion, there is a higher risk, that majority may achieve abrogation of preemptive rights through the resolution devoid of any objective argumentation. Despite the legal capability to sue the decision, time-consuming disputes and related costs might discourage a resented member to do so. De facto exclusion from the preemptive right (28, p.155) is often times related to the overpricing of the selling shares. Due to such circumstance, it is impossible for the fellow shareholders to purchase the selling shares. Georgian regulations do not encompass legal preconditions for the share valuation. Neither does a shareholder carry an obligation upon which the basis for the calculation of the share price would be stated. In contrast, the Ukrainian regulations, the company enables an access to the financial documents which are necessarily needed for determining the share price (29).

4. Concluding Remarks

Brief comparative analysis has given a prudent capacity to conclude the following remarks. The first part of the paper endeavors to display the advantages of the preemptive rights in LLCs. As it is found, such a right provides a better strategy against dilution of the shareholder ownership and

a closed structure in the company. The second part of the thesis displays the legislative novelties in Georgian and Ukrainian regulatory environment. Subsequently, the paper aims to give remarks on building a credible policy for achieving a defensive shield in favor of the shareholders. Upon the comparative analysis, thesis vividly draws existing regulatory lapses in Georgia. Firstly, it is highly recommended to reconsider the due time of the responding consent in which the shareholders have to exercise their preemptive rights. Ukrainian law enables a feasible access to the financial documents upon which the share prices are fairly stipulated. It would be indeed beneficial to encourage Georgian shareholders' to actively utilize their non-property rights in order to fairly determine the share value. Due to the rapid need for debt financing, it is also recommended to avoid the cumbersome procedure for the exclusion or alteration of the preemptive rights.

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Tokhadze A. Comparative Analysis of Preemptive Rights in Georgian and Ukrainian LLCs – A Statutory Rule or A Contractual Privilege

To date, the protection of shareholders' property rights has been greatly argued. Recently, Ukraine and Georgia have undertaken vast legislative amendments in respect to the LLCs. Legislative revisions have had a significant impact on the exercise of the shareholders' preemptive right, which at present is executed under the meticulous procedural provisions. The premise of the paper is to bridge between Georgian/Ukrainian legislative novelties; hence, to expose coherent lapses with respect to the equal and fair treatment of the shareholders. By the same token, thesis endeavors to understanding the essence of the preemptive rights from the perspective of the shareholders as well as the company. An exclusion of the preemptive right is also reasoned. The paper gives concluding remarks on building the credible police in favor of shareholders' enjoyment of preemptive rights.

Key words: Preemptive rights in LLCs, Georgian and Ukrainian regulations., shareholders' protection.