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Conflict of Interest Transactions in Corporate Law

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1. Introduction

1.1 General Legal Framework

At the end of the 20thcentury, after receiving the independence of Georgia the law and economics movement has fundamentally changed in the country. The establishment of market economy required adequate legislative basis that did not exist before.[1]

While Law on Entrepreneurs was one of the earliest laws adopted since the independence of Georgia, many undefined and vague areas have been revealed, many of them changed, but most of the issues are still waiting to be determined and fully understood.

Law on Entrepreneurs as one of the first legal acts that introduces modern standards of corporate legal system in Georgia and on the other hand, Law of Georgia on Securities Market that promotes the form of investments through the Stock Market will help to encompass all the issues defined under the thesis. This thesis will try to precise the law defects, which were detected in practice and provide discussions around the foresaid developing procedures in Georgia.

Lack of court practices and the unstudied fields of law should not become an obstacle for the legislative or economics development, but on the contrary, creating optimal legal structure has to attract investments and give equal guarantees either to domestic or foreign investors to be well protected under the Georgian laws.

1.2 Purpose of the Paper

Increase of business activities increased the conflicting interest transactions that gradually became an accepted business reality for any type of corporations of any country or region around the world.[2] For a long period of time, in the United States and in Europe those transactions used to be void, while today currently most legal systems made them legal, but still are voidable, if they are challenged.[3]

The main reasons of different approaches had motivation to identify whether conflict interest transactions were illegal acts, had adverse effect on the rights of majority

[1]Chachava, S. Review of Legal Literature, 2007,394.
[2]Sitkoff, R. H. The Economic Structure of Fiduciary Law. 2011,1048
[3]O'Kelly C. R. T. Kilpatrik, M. E. Thompson R. B. Corporations and Other Business Associations, 2014, 301.

shareholders which could have had negative impacts on the development and growth of the corporations. On the other hand, the conflict of interest transactions structured and orchestrated by the persons in charge may even be advantageous or in the best case may not cause any kind of monetary damages to the corporation.

Identification the real nature and purpose of the issue definitely would have decisive guidance function for companies and its bodies in everyday governance process. Thus, utilizing courts practices and providing comparative legal analysis between Georgian, US and EU member countries' legal systems will help to observe that conflict of interest transactions are not automatically void, but may be voidable and should be managed through narrow legal tests and doctrines, in order not to deprive the corporations from some of the gains that may exist in interested transactions.

Without doubt "Conflict of Interest" *per se* is a complex concept. However, research has intention not to leave any vague provisions and grasp essence of corporate regulations for the future legislative and economic development.

2. Background

2.1 Self-Interested Transactions

Terms: self-dealing or interested-transactions have one and the same definition, which raises conflict of interest in transactions. These are transactions in which a director operates on behalf of its corporation, but on the other hand he/she is directly or indirectly represented as the other party of the transaction.[4] In this situation, director is obliged to protect the best interests of the company, but there is a reasonable threat that, personal interests will override the latter.[5] As usual, exactly these circumstances become one of the main subjects of court evaluations.

2.1.1 Regulatory Provisions under the Georgian Laws

As we have already observed in the introduction of this thesis, Law on Entrepreneurs is one of the main laws regulating business activities of the non-listed legal corporate forms in

[4] Goshen, Z. Conflict of Interest in Publicly-Traded and Closely-Held Corporations: A Comparative and Economic Analysis, 2005, 278.
[5] Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 321.

Georgia,[6]but the law provisions do not directly refer to or define self-interested transactions (with the exception of competition with corporation which is outside the scope of this research). Only abstract concept forces the lawyers to litigate in case of challengingself-dealing transactions in courts. Specifically, it is the concept of good faith, established in the first paragraph of Article 9 (6) ofGeorgian Law on Entrepreneurs. This provisiongives ability claim for self-interested transactions, but international practices have shown that additionally other concepts and principles might be also used for full adjustments.

As for the Georgian Law on Stock Market it only regulates listed legal entities[7] operating on the Georgian Stock Exchange. Article 16^1 (2)of the lawregulatesspecific situations in which self-dealing transactionsoccur. It is the first precedent, when such transactions fell under the law regulations. Except the fact that, Article 16^1(2) directly identifies self-interested transactions, it also gives the specific list of persons in corporation who might be prescribed as interested parties in conflicting transactions. For instance, provision directly states that, members of a governing body of a corporation and directly or indirectly 20% or more shareholders might be called interested parties, if they are involved in the aforementionedself-dealing transactions.[8]

2.1.2 Mutual Processes

Despite the fact thatlisted and non-listed companies have differentoperating areas and characteristics in connection with self-dealing transactions both categories might be discussed equally when it comes to technicalities of legal regulation. However the question of degree of regulation is different, since protection of public and private investors vary significantly in almost every legal system. The main reason of this intention is that,while the conflicts of interest problem within publicly traded (listed) corporations receives different treatment in the different jurisdictions – either a fairness rule or majority of the minority rule – closely held (non-listed) corporations receive the same treatment of an imposition of duties of loyalty and fairness.**[9]**

[6]Georgian Law on Entrepreneurs, article 1.
[7]Gifis, S. H. Law Dictionary. 2011,318. Explanation: a company trading stock on an organized stock exchange.
[8]Georgian Law on Stock Market, articles 16^1 (2).
[9]Goshen, Z. Conflict of Interest in Publicly-Traded and Closely-Held Corporations: A Comparative and Economic Analysis, 2005, 295.

Current legislations and court practices give chance to the self-interested transactions be valid, if some of the preconditions are applied. For instance, it is always under investigation, if self-dealing is approved or ratified by disinterested parties or whether transaction satisfies fairness test or not. Of course, those elements will be discussed in details later, but here might be observed that, they take self-interested transactions in a "safe harbor", which directly stipulates transactions to be protected from being void.[10] Hence, synthesis of the formal and material facts of self-dealing transactions provides validity of these transactions in both categories of corporations.

3. The Problem of Conflicting Interest Transactions

If we agree on the idea that gaining profit for shareholders is one of the main targets in corporations' existences, which stand above any personal interest of shareholders or other company governorsthen it is assumed that, conflict interest transactions could become one of the mechanisms for disrupting these processes.

Lack of court practices or unstudied fields of legislation regulating conflicting transactions may cause financial damages, losing profits or even a bankruptcy of a very successful corporation. Financial failures or weaknesses may grow into a global problem and finally, suggesting irrelevant business climate to the investors definitely will have outcome on the economic growth of a country. It is already a well-known fact that, business always escapes from the jurisdictions that may not guarantee optimal protection of investors and their property rights.

Very generally, "conflict of interest it is a situation, when a person's impartial performance of duties or decision-making, within the function he/she is performing, is jeopardized because personal business interests are involved, or even the family's interests, his emotions, political or natural (favorable or unfavorable) disposition or any other related interests with other natural or legal persons".[11]

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[10]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law. 2006. 322.

[11]Bonich, R. Conflicts of Directors Interests With the Interests of the Company in the Context of Financial and Economic Crisis (a comparative overview of some EU countries), 2011, retrieved from http://virtusinterpress.org/IMG/pdf/CONFLICTS_OF_DIRECTORS_INTERESTS_WITH_THE_INTERESTS_OF_THE_COMPANY_IN_THE_CONTEX_OF_FINANCIAL_AND_ECONOMIC_CRISIS_a_comparative_overview_of_some_EU_countries_by_Rado_Bohinc.pdfLast checked on 10/2/2016.

One of the main types of activity arising conflict of interest transactions is a self-dealing transaction, which could become the reason to void the latter. The main issues of conflict interest transactions are represented in this classical sense.

So, what kind of activities shall be provided not to violate the law requirements or the interest of corporations and keep the transactions valid, at the same time?

For illustration, suppose a free market involving only homogeneous products.In this market company X can purchase ordinary chips for producing mobile phones. Selling the produced mobiles is the main source of income for that company.After certain period of time competitor companies sophisticated devises by substituting ordinary chips with imported microchips and have attracted morecustomers. Company X income seriously reduced. Besides, the company had no financial ability to buy imported microchips on the market due to the high price of the product. In this situation, director of company X appeared to be the only person who could supply its own company with the imported microchipsin an acceptable price and save the entity from financial crisis, or even from a bankruptcy.

Accordingly on the one hand, corporation may have an appropriate reason for contracting off themarket and the director might own a product for which there was no substitute, or might be willing to give better terms than could be obtained on the market.[12] Example illustrates that; in certain cases conflict of interest transactions are not only beneficial but also vital for company operations and profit gaining. Therefore, automatically voiding those transactions could be either legally or financially unreasonable. However, above circumstances do not absolve the interested party or director of disclosure requirement.

3.1Alleged Legal Assessments

If we assume that the company in question is regulated under the Law on Securities Market the applicable regulatory framework would be Article 16[1].

Article 16[1]directly regulates transactions provided through the self-dealing arising conflict of interest. It includes the voting methods, as the expression of the disinterested “group preference”, [13] full disclosure of the interested party, owing fiduciary duty to the

[12]Eisenberg. M. A. Self-interested transactions in corporate law. 1998,997.
[13]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003, 399.

corporation[14] and considers the legal results of that transactions, which is the most discussed part of the thesis.

On the other hand, if the company were not a company regulated under the Law on Securities Market, then applicable rules from the Law on Entrepreneurs and obligations of the interested Director would be Article 9 (6).

The first paragraph of the Article 9 (6) is strongly related to the concept of good faith of the governors of corporation and indirectly regulates self-interested transactions, which are not directly regulated under the Law on Entrepreneurs. It means that, self-interested transaction might be claimed through violation the concept of good faithof the Law on Entrepreneurs.

3.2Conflicting Interest Transactions Influences

Nevertheless, Article 16[1]is under a serious observation.It is true that it covers conflicting interesttransactions referred only to the Reporting Companies,[15] but in case of success it will be extended to the non-listed companies also, registered under the Law on Entrepreneurs.[16] Such kind of changes definitely will have effect on the general policy of legislation and on the governance of non-listed companies, which have abilities on the free market without intervention, take autonomous decisionsor automatically generate appropriate solutions; even eliminate self-dealing situations on an individual basis. This of course, “is more efficient than working backward from a general, law-imposed solution”.[17] But nonintervention will fail, if market would not become “perfect” and the efficient level of a capital market still will be based on legal conditions in a given jurisdiction.[18]

To illustrate nonintervention approach having in Georgia on the free market, suppose that company having a developer status hires another constructing company, which directly

[14]Georgian Law on Stock Market, articles 16[1] (8), (8[1]).
[15]Georgian Law on Stock Market, article 1, Explanation: a company that has a class of publicly held securities, admitted for trading on a stock exchange.
[16]Kuchava, K. Conflict of Interest and Information Disclosure, 2007. 4. Retrieved fromhttp://www.nplg.gov.ge/gsdl/cgi-bin/library.exe?e=d-01000-00---off-0period--00-1----0-10-0---0---0prompt-10---4-------0-1l--11-ka-50---20-about---00-3-1-00-0-0-11-1-0utfZz-8-00&a=d&cl=CL4.5&d=HASH01cd7ae5c41f14683726285d.16Last checked on 10/2/2016.
[17]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003, 404.
[18]Id. at 405.

builds apartments upon the agreement. In both companies one and the same shareholder is an interested person and stands on both sides of the contract. The remaining shareholders in the development company are fully informed about it, but nobody is seeking for changes in charter or sees any threat in this agreement due to the trust parties have in each other. Remaining shareholders have information on the goods they pay money for and believe that self-interested shareholder offers best terms existing on the free market. It can be said that, nonintervention allows free market to generate appropriate solutions on an individual basis.[19]

But, what would happen if the interested party favors its own interest in conflicting transaction? What kind of protection mechanisms does the company or non-interested shareholders have? And finally, what would be the legal results of those transactions provided through a conflict of interest?

Once again, represented situation highlights the positive side of giving companies free movement areas, independently decide involve in conflicting interest transactions or not, but sometimes problems become much more escalated, if uncontrolled.

If we take above example and assume that price charged for building materials is 300% higher than the price for similar goods, then non-interested shareholders of the company are not making profit and their confidence become unreasonable.

Complexity of the issue makes difficult to take a unique decision. Therefore, the questions posed in thesis definitely need answers and the issues require critical examination.

4. Non-Listed and Listed Companies

4.1 General Characteristics

Why do we need to characterize legal entities separately under the thesis?

First of all, always when we discuss conflict of interest transactions it is vitally important to identify the people who may have direct influence on a decision making processes in corporation. Those people have ability to decide whether enter in conflicting interest transactions or not. Therefore, legal discussions will continue within describing all types of

[19]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003,404

entities admissible under the Georgian laws and there will be highlighted the governors and representativesof corporations who have real ability of taking decisions toinvolve in the processesof providingconflicting interest transactions.

Secondly, the most significant reasons for separating companies in different categories is to illustrate that,provisions for regulating conflicting interest transactions for listed companies arean obligatory requirement, while non-listed companies are free from the latter obligations.Despite separation, conflict of interest should be reviewed equally either innon-listed and listed companies, because international practices have shown that conflict of interest transactions may appear in both categories of companies, without distinction.

4.2 Entrepreneurs

However, there exist assumptions that Georgian Law on Entrepreneurs' root is related to the Commercial Code of Czech Republic, Continental Europe, especially German Law influences on the Law on Entrepreneurs is an unambiguous fact.[20]Similarly, the starting points of the Georgian Law on Entrepreneurs shall be found out in the Civil Code of Georgia too.[21]

4.2.1 Joint Venture

Having no legal form, establishment of Joint Venture is regulated under theCivil Code of Georgia with the aim to achieve economical, commercial or related collaborative objectives and gain profits from the activities.[22]Because of mutual nature, Joint Venture as a union of natural persons could be prescribed as a "Parent" of different types of legal entities directly defined under the Law on Entrepreneurs.[23]

4.2.2Cooperative Society

Georgian Law on Entrepreneurs recognizes five private legal entities, latter called corporations. As usual, the main mutual character of all the entities is the aim of receiving profits from their commercial business activities, but Cooperative Society is the only entity

[20]Chanturia, L. Ninidze, T. Law on Entrepreneurs Comments, 2002, (preface of first edition)
[21]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003,300
[22]Georgian Civil Code, article 930
[23]Krofholer, I. German Civil Code Comments, 2014,3 – 4

whose members are oriented only to satisfy their own narrow interests rather than to gain profits to a corporation.

After the second and each of the next agricultural year members of the company get profits in proportion of their shares, if the charter does not provide differently. They have no limitation and at any time upon the statement may leave the membership of a corporation.

Structurally, board of directors is a legally binding body of a corporation, required to have no less than two directors elected for four years. They have representative and governing authority and are obliged to act in a good faith.

General assembly represented by the members of corporation performs decision-making functions in society, but in case of exceeding defined numbers of members decision-making functions might be performed by a representative assembly.

In case of members decision supervisory board could also be established for providing monitoring on the activities of the aforesaid assemblies in corporation.

Corporate Society as a legal entity is the most suitable entrepreneur for uniting farmer forces in order to lead the agricultural economy in the country.

4.2.3 General Partnership

Continental Europemight be characterized with more legislative regulations, control and intervention in corporate legal system. But, over a certain period of time Georgian legal system changed its policy and decided to give more abilities to the corporations act in a free operation area, independently, without redundant regulations. Optional rules became relevant opportunity for shareholders adjust business or personal relationships. General Partnership as a legal entity, admissible under the Law on Entrepreneurs is a clear example of those changes.

According to the law two or more partners for carrying out collaborative business objectives could establish the corporation. Comparatively to the other forms of entities both the partners as well as the corporationis jointly responsible for the damages to third parties.

Mutual representative and governing functionsfor all the partners, in case of none defining it by charter could become one of the most impressive issues for thattype of corporation.[24] Nowadays, all the members of the corporation are authorized to providerepresentativefunctions independently. It is obvious that such kinds of circumstances may seriously interrupt decision-making procedures in corporation, because any activityprovided by a partner on behalf of the corporation could be expected to appear under a question.[25] So far, the most relevant solution seems to beallocation partners' functions in advance by the charter of the corporation.

Additionally, General Partnership mightbe characterized with the internal relationship between its own partners and the corporation, itself. For instance, it is not forbidden for a partner to act as a third party and conclude for example a loan agreement with its own corporation. In case of breaching the contractual obligations this partner may claim for damages from the corporation. As usual, basing on the duties partners have in corporation, lender partner with remaining partners is liable to take into account its quota of responsibility, too. Being a partner of General Partnership does not preclude aforementioned partner's liability; even he/she was a third party of transaction.[26]

Due to the fact that partners have joint liability for the damages, customers believe in them and boldly apply those types of corporations in business.

4.2.4 Limited Partnership

Limited Partnership might be established upon the agreement of two types of partners: general partners and limited partners. General partners' responsibility is unlimited to the third parties, while the limited partners' responsibility could be determined according to their contribution in corporation.

Corporation may only be represented and governed by general partners. They are people who have particular role protect the duty of care and loyalty in corporation. Limited partners do not participate in managerial or decision-making procedures. They have no right of vote without certain exceptions or even go against the work provided by general partners, if

[24]Georgian Law on Entrepreneurs, article 9
[25]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003,302
[26]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003,304

general partners act within ordinary commercial activities. However, by charter it is possible to expand limited partners' authority to carry out certain legal actions in corporation. These activitiesshall go beyond the scope of their trust;otherwise limited partners responsibility will be defined similarly as for the governors and representatives of a corporation.

Nowadays, basing on the current statistics, no more than 180 Limited Partnerships are registered in Georgia and most of them have legal consulting status.[27]

4.2.5 Limited Liability Company

Limited Liability Company is one of the most popular forms of entrepreneur in Georgian commercial reality. Its popularity might be explained with different reasons. For instance, registration procedures are very simple. Indicating certain kind of obligatory data in partners' agreement, called registration statement is enough for company registration in Public Registry of Ministry of Justice of Georgia.

Besides, it is a legal entity with limited liability to the third parties.Founders prevail avoidingjoint personal liabilities. However, in current decisions of Georgian Courts was used apiercing the Corporate Veil, which means to disregard the limited liability and hold shareholders personallyliable for corporation's obligations.[28]

Startup capital for establishment the corporation is not required. It might be determined in any monetary or non-monetary amount. Shareholders may even perform certain work or suggest providing services as a contribution. Assessed contributions are prescribed in percentage shares, which is 100% in total. However, because of the fact that corporation shares are not prescribed as securities, Limited Liability Company is not allowed to enter the Stock Market for public trading.[29]

Director is a legally binding governing body of a corporation, if the charter or partners' agreement does not provide differently. One of the main functions is to represent the corporation to third parties. Unlikely to the governing rights, director's representative

[27] https://enreg.reestri.gov.ge/main.php?m=new_index&state=search, last checked on 10/2/2016.
[28] N.as-1158-1104-2014 decision of Supreme Court of Georgia; N.as-1307-1245-2014 decision of Supreme Court of Georgia
[29] http://www.investopedia.com/terms/p/privatecompany.asp, last checked on 2/10/2016

functions could not be reduced.[30]For instance, shareholders have ability to limit director's rights for concluding certain kinds of contract with third parties, but it is impossible to ban their representative functions.

General assembly represented by shareholders is another obligatory governing and decision-making body in Limited Liability Company. They take every serious decision, among is establishment a supervisory board as an internal control body of a corporation.[31]

One of the most significant characteristics of Limited Liability Company is that even one person has right to establish it, but relatively to the EU practices Georgian law does not give forward regulations or any limitations upon it. According to the Article 5 of Twelfth Council Company Law Directive of EU, when the sole member concludes contract with his company represented also by him, it shall be recorded in a minute or drawn up in written.[32]Such kinds of requirement might also be relevant for Georgian private limited liability companiesfor more transparency in their internal transactions.

4.2.6 Joint Stock Company

Economic developments might be measured upon the operating numbers of Joint Stock Companies in a country. One of the main reasons for this approach could be found out in the large amount of material and non-material wealth these legal entities may own, as usually.

Joint Stock Company as a legal entity is a strictly regulated entrepreneur under the Law on Entrepreneurs. Its capital is divided into a particular class and number of shares. Shares as intangible securities guarantee and confirm the commitment of the corporation to the shareholders and the rights of the shareholders in a corporation.

According to the Law on Entrepreneurs in certain kinds of situations, corporation is obliged to hire an independent registrar for share accounting. Such kind of strict references shall

[30]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003, 322
[31]Georgian Law on Entrepreneurs, articles 9[1]
[32]Twelfth Council Company Law Directive of 21 December 1989 on single-member private limited-liability companies (89/667/EEC)Retrieved fromhttps://publications.europa.eu/en/publication-detail/-/publication/91221671-6801-44a0-8695-3ff5ff03041f/language-en

be précised as an intervention for providing control on the great financial resources that may exist in Joint Stock Companies.

Structurally, governing functions are allocated between directors, supervisory board and general assembly.

Typically, director has governing and representative functionswith abilities tovector corporationgeneral policy. According to the Law on Entrepreneurs the term of director's tenure is not defined. Therefore, it might be assumed that director will have authority until the supervisory boardwill not dismiss.

Establishment of supervisory board is obligatory only in a certain circumstances. In case of non-existence, its functions might be allocated to the other bodies of corporation. Members of the supervisory board are chosen by the general assembly. The most significant task for the supervisory board is to provide monitoring on directors everyday activities and define their scope of authority, control and inspect financial documents, establish general principles of economic policy of corporation.

Current amendments in law prohibits for one and the same person act as a head of supervisory board, as well as a director of a corporation.[33] The aim of this recording is to avoid any kind of conflicting interests of director and the supervisory board may have in transactions. In practice, when the head of supervisory board is separated from director, the latter always suffers psychological and legal pressure, strongly feels the liabilities trough the corporation and obeys the good faith requirements defined under the law provisions.

As for the general assembly it is a union of shareholders allocating important functions in corporation. According to the Law on Entrepreneurs either shareholders of 95% and 75% have privilege powers. For instance, 95% of shareholder has right of redemption, which might not be provided without court evaluation.[34] Court decision is used as a shield for the minority shareholder not to be oppressed by the majority shareholder.[35] If the owner of 75% of shares is only one person, general assembly meeting is not required and he/she

[33]Georgian Law on Entrepreneurs, article 55 (3^1)
[34]Georgian Law on Entrepreneurs, article 53^4
[35]Hetherington, J.A.C. The Minority's Duty of Loyalty in Close Corporations, 1972, 935

solely takes decision on any issue.[36] This decision is equivalent of the general assembly decision.

As for the general assembly it might be compared to the pillars of Joint Stock Company. It is empowered to:[37]

A) Take changes in the charter of a corporation;
B) Take decisions on reorganization or liquidation of a corporation;
G) Cancel all or part of the shareholder's pre-emptive right on the securities (in case of increasing the capital by the securities publication);
D) Accept or reject the supervisory board or directors proposal for the use of profits and if the authorities fail to make an agreed proposal – make decision on the use of net profit;

E) Take decision on the establishment of as supervisory board (except when it is obligatory under the law requirements);

V) Elect the members of a supervisory board or lead them from the board. Define the term of authority of the members of a supervisory board;

Z) Approve director and supervisory board reports;
T) Decide the issue of remuneration for the members of a supervisory board;
I) Choose an auditor;
K) Take decisions about participation in the trials against a supervisory board and director, including the appointment of a representative of these processes;
L) Take decisions on concluding a purchase or alienation contracts (or provide related transactions). Encumber real property of a corporation, which value might be more than half of the corporation assets, if it is not defined otherwise under the charter. It does not include transactions that are not usual business activity of a corporation.

Requirements estimated under the point "L" means that general assembly has expanded its authority, converted mentioned transactions under its control and reduced the risks of conflict interest trough the transactions. Establishment of special procedures, which

[36]Georgian Law on Entrepreneurs, articles 54 (1^1)
[37]Georgian Law on Entrepreneurs, articles 54 (6)

meansfor assembly having ability to voteon a specific transaction definitely protects corporation from financial risks and fails.[38]This recording might also play a vital role in protection of minority shareholders' interest in corporation, because giving them right to be involved in decision making procedure would be more relevant rather than using the right of redemption and lead them out of the corporation.

Similarly to this provision, in many jurisdictions disinterested directors or supervisory board members consent is one of the best ways to avoid abuse of rights and reduce risks of concluding agreements referred to the conflict of interest.[39] However, it might not mean that the contracts containing elements of conflicting interest are automatically void.

4.2.7Reporting Company

Since 2003 amendments basically made in the Law on Entrepreneurs and in the Law on Stock Market served two main points. Initially, changes were aimed to improve corporate governance procedures in the country and on the other hand, strengthen governmental supervisory policy within legislation.[40]

Amendments in Law on Stock Market thoroughly determined the definition of a Reporting Company and observed that any corporation established under the requirements of the Law on Entrepreneurs, which issued Public Securities,[41] is a Reporting Company. It means that, according to the Law on Stock Market any types of Joint Stock Company and all Nominal Holders of Public Securities might be prescribed as a Reporting Companies. Besides, Public Securities are considered as securities admitted for trading to the stock exchange.[42]

Georgian stock exchange and its policy is another subject of discussions, but it might be observed that, developed securities market has direct effect on economic growth and plays serious role in attracting foreign investments in the country.

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[38]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003,315-316
[39]Betaneli, Q. Masbaumi, M. S. Corporate Law in Georgia, 2003,315-316
[40]Jibuti, M. Tivishvili, M. Khoranashvili, Q. Legal Tendency, Normative Acts Established in 2003 Revision in the Field of Securities, 2004,40
[41]Jibuti, M. Tivishvili, M. Khoranashvili, Q. Legal Tendency, Normative Acts Established in 2003 Revision in the Field of Securities, 2004,42.
[42]*Id*. at 42

In 2007 for the first time in history of Georgian legislation Article 16[1]on Conflict of Interest and Information Disclosure were added to the Law on Stock Market. This was a significant amendment requiring members of a management of a Reporting Company (issuer) to disclose any transactions in the securities of the corporation under management.

Changes laid the basis for a conflict of interest transactions' concept in Georgia. Hence, studying the concept of conflicting interest transaction will show what kind of positive or negative influences it may have on the legislative and economic developments of the country.

5.Related Party

Always when representatives or managers of the foregoing entities decide to enter into negotiations and finally conclude contracts as a result of their agreement, it shall be assumed that they act in the best interest of their corporation. They have no secrets and hidden relationships, act independently and obey the general rules of the free market. Such interpretations may justify that undisclosed conflict of interest might not ever exist in corporate transactions, if parties are not acting in concert.

More specifically, conflict of interest transactions appear between a corporation and a party that effectively controls and manages the corporation or between the corporation and the entities that are related to the controlling or managing party.[43] Related Parties become central "driving force" for interested transactions. Sometimes, it is possible that single individual or entity with small shareholding might become able to have an influence upon a particular or entity acting in concert, with others.[44]

Basically, personal benefit may be assumed to be one of the reasons why related parties use the chance to enter into conflict of interest transactions. However, "transaction's personal value (as opposed to its value to the corporation as a whole) lies at the root of the conflicts of interest problem".[45]

[43]Goshen, Z. Conflict of Interest in Publicly-Traded and Closely-Held Corporations: A Comparative and Economic Analysis, 2005, 278
[44]Accounting Standards Board, Related Party Disclosure, 1995, 14
[45]Goshen, Z. Conflict of Interest in Publicly-Traded and Closely-Held Corporations: A Comparative and Economic Analysis, 2005, 278

Provisions of conflict interest transactions, which additionally defines list of related parties, are internal part of every developing and already developed corporate laws around the world, but in Georgia amendments were made nearly nine years ago.As it was already mentioned in above chapters, despite positive tendency changes occurred only to a Reporting Company and not to the non-listed companies determined under the Law on Entrepreneurs. Nowadays, new amendment is under revision.[46] If the foresaid regulation will effect successfully in practice, it may be derived in the same condition, but in wider area of corporate legal system and at once be used towards to the entities defined under the Law on Entrepreneurs. However, undeveloped stock market, having no large transactions in this field hinders accelerated procedure of implementation.

5.1 Related Party under the Georgian Law

It was the first attempts for the independent country specifically to identify the list of Related Parties in and outside the corporations through the conflict transactions. According to the Article $16^1$of Georgian Law on Stock Market, party considers to be related if he/she is the member of a governing body of Reporting Company and/or directly or indirectly is owner of 20% or more of the authorized shares of the corporation.[47]

A member of the governing body of areporting companyor at least 20% shareholder is considered as Interested Party if the Reporting Company or its subsidiary (company, in which it holds more than a 50% of the shares) enters into transaction at the time of which such person meets one of the following conditions[48]

A) Ison the other side of transaction.

- For illustration,a person who is at least 20% shareholder and/or a member of the governing body of Reporting Company A, which concludes a transaction with him/her personally.[49]

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[46]Kuchava, K. Conflict of Interest and Information Disclosure, 2007,4. Retrieved fromhttp://www.nplg.gov.ge/gsdl/cgi-bin/library.exe?e=d-01000-00---off-0period--00-1----0-10-0---0---0prompt-10---4-------0-1l--11-ka-50---20-about---00-3-1-00-0-0-11-1-0utfZz-8-00&a=d&cl=CL4.5&d=HASH01cd7ae5c41f14683726285d.16Last checked on 10/2/2016

[47]Georgian Law on Stock Market, article 16^1 (1)

[48]Georgian Law on Stock Market, article 16^1 (2)

[49]Kuchava, K. Conflict of Interest and Information Disclosure, 2007, 2-3. Retrieved fromhttp://www.nplg.gov.ge/gsdl/cgi-bin/library.exe?e=d-01000-00---off-0period--00-1----0-10-0---0---0prompt-10---

B) Directly or indirectly holds 20% or more shares in a company, which is the other side of a transaction.

- For illustration, a person who is at least 20% shareholder and/or a member of the governing body of the Reporting Company A concludes transaction with company B in which aforementioned person directly or indirectly holds 20% of shares.[50]

C) He/she is a member of a governing body of other side of a transaction.

- For illustration, a person who is at least 20% shareholder and/or a member of the governing body of the Reporting Company A concludes transaction with company B in which aforementioned person is a member of the governing body.[51]

D) Is appointed or elected as member of a governing body of a Reporting Company upon nomination of a shareholder that is on the other side of the transaction or by the person (persons) that holds at least 20% or more of total number of votes in the person on the other side of the transaction.

- For illustration, a person who is a member of the governing body of the Reporting Company A which concludes transaction with Company B, whose at least 20% shareholder has nominated such person on the governing body of the Reporting Company A.[52]

E) Receives money or other benefits that are not related to the ownership of shares in a Reporting Company or to the membership of a governing body of the company.

- For illustration, a person who is a member of the governing body of a Reporting Company A, has relationship or is just related person to a company B's head or member of supervisory board or at least 20% shareholder of the company and this person upon the relationship gets certain monetary or non-monetary benefits.[53]

4-------0-1l--11-ka-50---20-about---00-3-1-00-0-0-11-1-0utfZz-8-00&a=d&cl=CL4.5&d=HASH01cd7ae5c41f14683726285d.16last checked on 10/2/2016.

[50]Id. at 2-3

[51]Id. at 2-3

[52]Kuchava, K.Conflict of Interest and Information Disclosure, 2007, 2-3. Retrieved fromhttp://www.nplg.gov.ge/gsdl/cgi-bin/library.exe?e=d-01000-00---off-0period--00-1----0-10-0---0---0prompt-10---4-------0-1l--11-ka-50---20-about---00-3-1-00-0-0-11-1-0utfZz-8-00&a=d&cl=CL4.5&d=HASH01cd7ae5c41f14683726285d.16last checked on 10/2/2016

[53]Id. at. 2-3

F) Is defined as an interested person under the charter of a Reporting Company.

- For illustration, a person employed as staff of the corporation, who is neither a head nor member of a governing body or director or shareholder of such corporation.[54]

According to the Article 16[1]an interested person is liable to inform forthwith a supervisory board concerning any transactions in writing, in which he/she has personal interest, as well as inform about the nature and capacity of the transaction. Conflicting interest transactions are subject of prior approval of a supervisory board, but in case of non-existence the latter in corporation approval shall be made by a general assembly. Absolutely the same requirement is applied for an interested person who acts or acted as an interested person in transaction but, did not know about his/her status and still is liable to inform a supervisory board when this fact becomes known for him/her.

Additionally, this provision has a strict exception. Any interested person with any kind of interest in conflicting interest transaction is prohibited from voting in any internal bodies of a corporation. If the majority of a supervisory board is comprised with interested persons, or the value of a transaction exceeds 10% of the balance value of company net assets, or a lesser amount provided for by the company charter transaction is a subject of approval by supervisory board. However, if the transaction value exceeds 50% of the assets value it will be approved only by general assembly.

5.2 Related Party Responsibility

A person, who fails to disclose personal interest in a particular transaction and that deprives better opportunities from the company, shall be liable for any damages as a result of the transaction.

If conflict of interest transaction is concluded in the violation of the law requirements, a member of governing body of a Reporting Company or/and 5% or more shareholders of a Reporting Company or the group of shareholders, if this Reporting Company is a type of Joint Stock Company, but in case of other legal types of Reporting Company – each

[54]Kuchava, K.Conflict of Interest and Information Disclosure, 2007, 2-3. Retrieved fromhttp://www.nplg.gov.ge/gsdl/cgi-bin/library.exe?e=d-01000-00---off-0period--00-1----0-10-0---0---0prompt-10---4-------0-1l--11-ka-50---20-about---00-3-1-00-0-0-11-1-0utfZz-8-00&a=d&cl=CL4.5&d=HASH01cd7ae5c41f14683726285d.16last checked on 10/2/2016

partner within 18 months has right to claim for invalidation the transaction or/and compensation for damages and claim for returning the personal benefits which were received through the conflict of interest transaction, if available.[55]

European experience became inspiration for applying aforementioned regime in Georgian legislation.Seeking for the reasons of current amendmentthrough the disclosure shall be found out in international practices and in strong intention to establish modern corporate standards in Georgia. Specifically, new regulation was directly derived from the Companies Act 1985, Article 317, of the United Kingdom.[56]UK believed that conflict of interest in companies represents threats for corporations' development and growth. "Section 317 shows the importance which the legislation attaches to the principle that a company should be protected against a director who has conflict of interest duty". [57]

Within discussion, there should not be omitted the fact that legal connection between Law on Entrepreneurs and Law on Stock Market is really significant. This fact might also be approved with Article 55 (2^1) of Law on Entrepreneurs, which directly indicates that, "if a Joint Stock Company is operating as a Reporting Company admissible under the Law on Stock Market, whose securities are issued for trading on the stock exchange, in this corporation at least one member of supervisory board should be a person, who is not the employee of this entity or directly or indirectly related person to the corporation. He/she should not be involved in its daily activities and be independent from it".[58] Seeking the aim of the changes will definitely take us to the conclusion that, the laws jointly maintain to reduce related parties influence in conflicting interest transactions of corporations.

5.3 Identification Process (Recommendation)

Related parties are directly obliged, on its own initiative, make disclosure and inform its own corporation about the personal interests, but except legal provisions or court practices, what kind of mechanisms could corporations haveto identify related parties, itself and be protected from hidden conflicting interest transactions? Almost no leverage exists, but

[55]Georgian Law on Stock Market, article 16^1(9)
[56]Chokheli, N. Svanidze, A. Papuashvili, SH. GEPLAC Activities, Reform of the Law on Entrepreneurs, 2005,26
[57]Dignam, A. Hick's and Goo's Case & Materials on Company Law, 2011,331
[58]Law on Entrepreneurs, Article 55 (2^1)

there could be considered a view to elaborate an internal “identification” process of related parties.

As a recommendation, corporations by its own effort might create special informational bases which directly contain a list of related parties who may directly or indirectly have any personal business interest with theircorporation. For instance, informational bases will contain the list of governors or managers of a corporation who are shareholders in different corporations or even founders of any legal entities, operating in the same or different businesses and create potential risksto become the other side of a transaction with its own company.

Accounting the list of related parties might not be financially unreasonable, nor requires additional employees in company. Director might combine collecting and supplying corporations with information and documentation referred to the related parties.

Reference list of the related parties, documents and information shall be reviewed and updated from time to time in corporation entries.[59]

6. Test and Doctrines

6.1 Prohibition

A strict regulation is not an effective mechanism preventing corporations from conflict interest transactions. Flexible policy of legislation rather than rigid approaches, which is customized to the modern reality is always more effective for balancing the issues.

In different periods of time and in different jurisdictions, approaches of the law have changed. Historically, prohibition of dealing rising conflict of interest in transactions was under a strictest regulation and directly ruled out.[60]

During 19th century, in the United States any dealings concluded within conflict of interest was automatically void, regardless to the fairness or unfairness of a transaction.[61] This was a rule, used by judges in different cases, which stated powerful terms for a long period of

[59] Procedure Governing Related-Party Transactions, 2014,17 Retrieved fromhttp://www.edison.it/sites/default/files/documenti/procedure-governing-related-party-transactions2014.pdflast checked on 10/2/2016

[60] Marsh, H.Jr. Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 36

[61] Id. at 36

time.[62] Scientifically, such kind of decisions directly or indirectly supported the left-wing rooted ideology of the law, which prohibited, put in question or did not agree interested transactions in corporations, regardless of economic benefits to both sides of a transaction.

More specifically, focus was made on a director, which was bound with strict regulations to avoid damaging corporations and shareholders' interests.Besides, provisions ruled out the possibility of abuse of governors to realize their privileged positions. Justice Davies of the New-York Supreme Court pointed with the same explanation that, "the moment the directors permit one or more of their number to deal with the property of the stockholders, they surrender their own independence and self-control".[63]

Accents of prohibitions, which were made in this, and similar cases were unambiguous for every interested party, but in practice interested parties still found ways act around strict regulations. When director tried to conduct such transaction, they were establishing a new company to hide the common status and instead of them appointed a dummy director, thus they attempted to hide transactions arising conflict of interest. Despite the ability of the courts to identify dummy directors in corporations it was said that, "common directors are bound and common directors are better than 'dummies'".[64] Therefore, the law has kept pace with new challenges and became more flexible. Fairness became the turning points for avoiding contracts automatically.[65]

From the position of this thesis, directly prohibition of conflict interest transactions could not be prescribed as a sole solution. Certain kinds of examples will show the errors of the strict regulations. At first glance, activity of a person in charge could be assumed to be inefficient transaction, however fundamental determination may show that outright prohibition could deprive the gains that may exist in such kind of transactions.

6.2 The Majority of the Minority

Once and forever "waging war" against conflict interest transactions has fundamentally terminated. Upon the principle, called The Majority of the Minority, self-interested dealings by related parties became legal. This doctrine encompasses two main values: protects the

[62]Id. at 35
[63]Id. at 37
[64]Id. at 38
[65]Id. at 39

interests of the disinterested minority shareholders and on the other hand, it is interested parties' duty to act fairly and disclose all their activities related to the conflict of interest transactions.[66]

Disinterested minority shareholders consent makes the dealings valid, considering the requirements that there should not be found any unfairness or fraudulent activities by the courtsif challenged.[67] Georgian legislation, according to the Law on Stock Market also shares this doctrine and guarantees the minorities protection.[68] In different situations, which were already described in thesis, only the remaining disinterested shareholders or members of governing body might authorize transactions containing conflict of interest in Reporting Companies. For more clarity, it could be approved even when the remaining parties are no more than 1%of shareholders and all other related interested parties – 99%. Besides, the latter parties are forbidden to participate and vote on transactions in which they have self-interest. Hence, decision makers for approving the transactions will be calculated within the remaining 1% of shareholders and not from the 99% of self-interested shareholders. Noteworthyis also the fact that, legislation obliges Reporting Company, itself forthwith to inform the National Securities Commission[69] about the approved transactions containing conflict of interest. Information should contain detailed characteristics of the transaction and should be published on the website of the corporation, on the website of the Security Market or in Mass Media.

Benefits of the doctrine are varying. The most significant is the respectful approach to the minorities will, which means that any conflict of interest transaction that precludes minorities wish and involvement will have no fate and future. Willing of minorities not to provide conflicting interest transactions could be enough for its viability. Besides, it is not necessary to take a transaction into the courts for further objective evaluations.[70] Minorities always have possibility and intention take decisions objectively, without prejudice of the whole corporation's interest.

[66]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003, 402
[67]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 40
[68]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 48- 49
[69]Georgian Law on Stock Market, articles 1 (5)
[70]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003, 402

Despite advantages, doctrine of the Majority of the Minority cannot be fully accomplished. Likewise to the Georgian law, EU member countries France and Italy also have adopted provisions for approval by disinterested shareholders as an additional control over the potential abuse of transactions.[71] However, placing the minorities in a controlling position and giving the approval voting ability should be explained carefully not to ignore the risks, which may arise in their hands. In certain situations, minority shareholders may hold transactions with the aim of receiving more gains, rather than expected from the transaction.[72] It always causes misunderstanding in corporation and insights parties apply for different mechanisms, even promotes to provide unlawful activities to neutralize minorities "equitable" hold out.[73] Situation becomes more complicated when minorities or the group of minority shareholders continue the holding-out process for a long period of time. Hence, devastation might not be the aim for corporations and its minority shareholders.[74]

6.2.1 The Majority of the Minority of Directors

Except shareholders' approval, disinterested directors' ratification may also validate transactionsprovided through a conflict of interest. Approval needs to satisfy additional requirements. First of all, during ratification disinterested directors might take decision within the concept of good faith.[75]Besides, any kind of personal interests or information related to the transaction should be fully disclosed for them.[76]

Disinterestedness is one of the main points for ratification therefore interested director should be precluded from that procedure. Additionally, ALI Principles[77] and MBCA[78]also pay a serious attention to the fact of impartiality. ALI Principles examine almost every kind of situation and observes that, a director who is not a party of a transaction still has no right to participate in voting procedure, if indirectly has business, financial or family relations with the party of a transaction and if this relations may have influence on the ratification

[71]OECD. Related Party Transactions and Minority Shareholder Rights, 2012, 34
[72]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003, 402
[73]Id. at 402
[74]Id. at 402
[75]Marsh, H. Jr. Conflict of Interest and Corporate Morality, Are Directors Trustees? 1966,40
[76]Id. at 40
[77]Eisenberg. M. A. An Overview of the Principles of Corporate Governance, 1993, 1271
[78]Model Business Corporation Act, 2002, chapter 3, 23.

results.[79]Absolutely the same definitions might be found out in MBCA.[80] For instance, in *Gries Sports Enerprise Inc. v. Cleveland Browns Football Co.* caseoutside director who was not directly involved in conflicting transaction still was recognized as an interested director by the court, because for the dismissal fear he voted conflicting interest transaction provided between corporation and another general director.[81] Hence, when interested director provides conflicting interest transaction through the good faith it should be believed that, transaction is correct and fits to the interest of a corporation.

6.3The Fairness Test

"There is no difference between the "fairness" standard, the "intrinsic" fairness standard, the "entire" fairness standard, and the "inherent" fairness standard. They are all the same standard: fairness".[82]

Fairness as a character of dealings always becomes a subject matter for courts evaluation. As it seems the only body, which is authorized to determine objectively the fairness of dealing, is a court.[83] However, some of the scholars additionally observe that, because of fairness general concept courts are deprived from the opportunity to take decisions on value assessments without the help of special professionals. [84]

Fairness is an established test under the case law. This test is used independently in different jurisdictions to verify conflict interest transactions, but still it is strongly related with the full disclosure and the disinterested majorities' approval in a corporation.[85] For instance, in the United States it is hard to say when the courts started using the new test for transaction assessments in litigation. In different places as it is Vermont or West Virginia there still is required that contracts shall be accepted by the disinterested directors, whereas the interested directors shall not be presented at the process of consideration.[86] Thus, disclosure and consent of minorities is privileged, eligible and strongly rooted in the

[79]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 327
[80]Id. at 327
[81]Gries Sports Enerprise Inc. v. Cleveland Browns Football Co.No.85-704, Supreme Court of Ohio,(1986)
[82]Norwood, P. Beveridge, Jr. The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 1992,681
[83]Goshen, Z. The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 2003,403
[84]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 327
[85]Marsh, H. Jr. Are directors trustee? Conflict of Interest and Corporate Morality, 1966,44
[86]Marsh, H. Jr. Are directors trustee? Conflict of Interest and Corporate Morality, 1966,48

conflict of interest transactions, but of course such approval does not reduce the function and ignore application of fairness test, because approval of interested transaction without the full disclosure is pointless for fair transaction and on the contrary.[87]

Fairness test is a very broad concept. There exist no specific characteristics, which might identify whether transaction is fair or not. Nevertheless, an unspecified frame gives the test more flexibility to be precisely adjusted in a different situation related to the conflict interest transactions. Again, upon the US case-law examples fairness of dealing is considered by the fairness of price and the fairness of process. *Weinberger Vs. UOP, Inc.*Case held by the Delaware Court examined the background of "fairness" and it was said that, according to the fairness test there exist two main aspects: initially, it is a fear dealing and then fair price.[88] After the court's evaluation fairness test was also called Weinberger's concept of fairness.

Fairness of price is strongly used for economic and financial consideration of the transaction, which may be related to the proposed mergers, including acquisition, assets, real property, market value, future plans and other elements that may have effect on the stock of a company. [89] To illustrate fare price meaning in a specific situation, supposecompany X owned by A with no experience of business governance. He has hired assignee B who was a director of the company and also gave business advices to A. Company X had a real property, land with two-story office in suburban area in assets. Once, company A decided to enter into a purchase agreement with company Y, which was ready to buy the property in a fair prize. B also was the sole owner of company Y, but he has hidden that fact. Additionally, he has undisclosed the fact that, in the territory of the real property, was found a crude oil, which increased the market value of the property. Despite this fact, contract with the previous terms was concluded and fair price was paid. B has breached his duties to the corporation.

As for the fair dealing, it answers to the question when the process of a transaction began, how was it proposed, planned, negotiated, agreed and disclosed to the disinterested discovers and how the approvals of the directors or the shareholders were received.[90] For

[87]Eisenberg. M. A. an Overview of the Principles of Corporate Governance. 1993,1002
[88]Weinberger Vs. UOP, Inc. 457 A.2d 701 (Del. 1983)
[89]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 325
[90]Id. at 325

illustration, imagine absolutely the same situation, only with one exception. Purchase agreement was made during the period of money devaluation believing A that it will continue for a long period of time and purchase will be more profitable today than further. However, basing on the central bank's information devaluation would last for a short period of time and B had information about the latter. Even though, dealing was reached and owner - A got as much gains as it was possible from the transaction at that time. Here, duty of fair dealing was also violated.

6.4Disclosure

There have already been mentioned disclosure in thesis and externally it seems to be considered separately, but the following discussions will prove that, disclosure is one of the main elements with certain tests and doctrines, which directly defines the legal fate of conflicting interest transactions.

More specifically, persons "who are in a relation of trust and confidence with those with whom they deal" shall disclose every kind of information related to a transaction, especially there involvement in conflicting interest transaction.[91]

Disclosure requirement of law represents one of the guarantees for validity of a transaction and encourages a decision making body of corporation to take an objective decisions on a specific transactions approval. But, fully disclosure, itself does not automatically mean that agreement is valid. In *Voss Oil Co. v. Voss* case the court said that, "self-dealing transaction should be fair and disclosed, also".[92]

Substantial is the fact that, even a very slightest interest in transaction is a subject of observation according to the practices of the US courts. For instance, in *HMG/Courtland Properties, Inc. v. Gray* Case one director who was not involved in conflicting transaction, but he had information about another director's self-interest, did not reveal the information and voted for the transaction, expecting income from interested director.[93] Court decision is a clear example that, even such kind of secondary information needs transparency, not to breach certain duties in corporation.

[91]Eisenberg, M. A. Self-Interested Transactions in Corporate Law, 1998, 998
[92]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 328
[93]HMG/Courtland Properties, Inc. v. Gray N.15789, Court of Chancery of Delaware, (1990)

Georgian Law on Stock Market procedurally recognizes “two-stage” disclosures. Interested parsons recognized as by the Article 16^1 are required to fully disclose their conflicting interest and make notice in a written form to a supervisory board or general assembly of a corporation. After that, Reporting Company itself is obliged to send the notice to the Agency about the approval of the transaction, concluded by the interested parties, indicating transaction volume and character, as well as other basic conditions. The whole philosophy of these “two-stage” disclosures is that, interested persons might act as a deterrent.[94]

6.4.1 Responsibility for Non-disclosure under Georgian Law on Stock Market

According to the Article 16^1(8 and 8^1),if non-disclosure or/and despite restrictions, voting on a conflicting interesttransaction, which caused damagesor deprived better opportunities of a corporation,interested person is obliged to compensate the damages and return the personal benefits which he/she were received through the conflict of interest transaction. Besides, if the members of the governing body are having information about conflicting interest transactions, they are also obliged to make notice about the conflicting interest. Otherwise, they have liability to compensate jointly for the damages sustained to the entity.

Disclosure of a conflicting interest as a factmight be used as an argument to make interested persons and conflicting interested transactions immune from the aforementioned legal results.[95] For instance, in *Goodman v. Futrovsky* Case where conflict of interest transaction was provided the Supreme Court of Delaware observed that, “the transaction between the two corporations were immune from attack, because the arrangement between them had been fully described in the Prospectus and therefore the initial buyers of the public stock were precluded from questioning it, as were all subsequent holders as their successors in interest”.[96]

Disclosure is a subject matter for American Law Institute defined in Principles of Corporate Governance, Section 5.02. It does not use the term of “full disclosure”, but clarifies the importance of the material facts in conflicting interest transactions.[97] According to the

[94]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 50
[95]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 51
[96]Id. at 51
[97]Principles of Corporate Governance, supra note 1, Section 5.02(a) (1), (2) (A)

Section 1.09 reasonable person “makes a “disclosure concerning a conflict of interest” if he discloses to the corporation decision maker…who authorizes or ratifies the transaction the material facts… known to him concerning his conflict of interest…”[98] For instance, if there is a product selling on the market and its fair price is from $5 dollars to $10 dollars and the purchaser buys it for $7 dollars it means that, disclosure of material fact is failed. Because there is no evidence that, purchaser would definitely have bought the goods for $7 dollars, if he were aware of the material fact. If there had been full disclosure, purchaser might have agreed to buy only at some price lower than $7 dollars.

Despite its function and importance, there still is doubt against the requirement of disclosure that, it is too tempting for courts to determine whether undisclosed fact was material or not.[99]However, ALI Principles have found decision and provided that disclosure requirement is satisfied if after the following disclosure transaction is ratified by the board, the shareholders, or the corporate decision maker who initially approved the transaction.

Nevertheless, self-interested transactions ratified trough the disclosure is oriented only to the nondisclosure fact and not to the unfairness of a transaction.[100] Hence, disclosure the facts of a self-interested transaction do not mean fairness of the transaction, itself.

7. Fiduciary Duties

Involvement in conflicting interest transactions may directly breachthe fiduciary duties. Therefore, it is important to understand what is fiduciary duty and kind of significance it might havefor corporations.

Thesis has already discussed about the people who have governing and managerial functions in different types of corporations, but for more clarity legal discussions will continue through the fiduciary duties, specifically in the light of Director, which definitely is a good example and symbol of governing body in corporation.

Fiduciary duty as a term does not exist in Georgian legal system, because obligations set forth in the law, set the standards for the fiduciary duties. Traditionally, fiduciary obligations are divided into the separate duties of care, loyalty and sometimes good faith.[101]

[98]Principles of Corporate Governance, supra note 1, Section 1.09
[99]Eisenberg, M. A. Self-Interested Transactions in Corporate Law. 1998,1000
[100]Eisenberg, M. A. Self-Interested Transactions in Corporate Law. 1998,1000

According to the Article 9 (6) of Law on Entrepreneurs director has liability and responsibility act with the obligation of fairness and manage other people's property within a good faith and belief that, his/her actions are in the best interest of a corporation. Liabilities and responsibilities integrated with the obligation of fairness should be prescribed, as the same as the "Fiduciary Duty".Because of this reason directors are fiduciaries.[102]

Law might be the relevant method to regulate relationship between corporation and director;but relations might also be regulated by charter or by service contract, which generates specific liabilities directors having towardsa corporation.[103] Despite the vary mechanisms of control, during governance directors always have various tempt to deal with subordinate, an equal, a superior, the board of the shareholders, have direct or indirect influence on themand favor his/her personal interests.[104] Director's position gives serious ability forvectoring procedures in company; even enter into a self-interested transaction. However, fiduciary duties are used exactly for to prohibit self-interested transactions "even where they are intended to benefit the corporation and maximize profits".[105] Thus, for corporation success it is always important that, governors activities were delicate and in accordance with the law requirements.

Article 9 (6) of Law on Entrepreneurs aim is to discourage directors from involving in conflicting interest transactions. And in case of breaching the duties impose strict penalties on them. But, strict responsibilities should not be prescribed as a threat for directors. They might be promoted to govern effectively, take new and innovative decisions in corporation.

One more interesting issue when we talk about the duties is to identify who is the real governor and representative of a corporation, who has the biggest ability solely take decisionsand even enter into conflicting interest transactions. The first sentence of article 9 (6) of Law on Entrepreneurs imposes requirements not only to a director, but also to

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[101]Rosenberg, D. Delaware's Expanding Duty of Loyalty and Illegal Conduct: A Step Towards Corporate Social Responsibility. 2012,83

[102]Norwood, P. Beveridge, Jr. The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 1992,656

[103]Lazarashvili, L. Contract of Service with Company Director, Partner and Director in Internal Partnership, 2009, 309

[104]Eisenberg, M. A. Self-Interested Transactions in Corporate Law. 1998,998

[105]Rosenberg, D. Delaware's Expanding Duty of Loyalty and Illegal Conduct: A Step Towards Corporate Social Responsibility. 2012,83.

supervisory board members and requires acting in a good faith, equally. Some scholars expressed suspicion, whether this means that the legislator made the director and the supervisory board members equal in company management or not.[106]However, "apparently imposing director's duties on the members of supervisory board is a clear violation of the law".[107] Therefore, according to the Article 55 (7^2) it is possible that director's functions be delegated to the supervisory board only to while it is directly determined under the charter of a company. Hence, allocation of power and functions between decision-making bodies might be clear and strongly defined to avoid confusions not to impose responsibilities with errors in case of having conflicting interest transactions in corporation.

7.1 Duty of Care

According to the Georgian legislation fiduciary duty might be divided in two different foci: duty of care and duty of loyalty. German Corporate and US Laws also recognize such kind of modification.[108]

Duty of care is expressed in the first paragraph of Article 9 (6) of Law on Entrepreneurs having absolutely the same definition as it is interpreted in the Principles of Corporate Governance of the American Law Institute.[109]According to the definition, governor is liable to exercise obligations diligently, with the principle of good faith and act in the best interest of a corporation. Nevertheless, there is a new established approach that duty of care is not distinctively fiduciary, because in recent Delaware Court decisions duty of loyalty encompasses all breaches of fiduciary duties, including actionable bad faith of good faith and actionable breaches of the duty of care.[110] However, still in Georgian legislation it is considered as a procedural part of the fiduciary duty and as a standard of managing corporation.

Duty of care is used to answer the question posed, how director came to a specific decision or conclusion.

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[106]Chanturia, L. Law on Entrepreneurs Comments, 2002,124
[107]Id. at 124
[108]Chanturia, L. Corporate Governance and the Heads of Responsibility in Corporate Law, 2006, 302-303
[109]Eisenberg, M. A. An Overview of the Principles of Corporate Governance. 1993, 1280-1284
[110]Rosenberg, D. Delaware's Expanding Duty of Loyalty and Illegal Conduct: A Step Towards Corporate Social Responsibility. 2012,83

7.2 Duty of Loyalty

“A director is not a trustee, he is fiduciary, and he does have a duty of loyalty”.[111] Despite this fact exists assumption that using “fiduciary” as the word should be stop, because everyone who works for the corporation isfiduciary.[112]

Duty of loyalty is the essence parts of the fiduciary duty. It fulfills the law of corporations and basing on its significance gives ability instead of fiduciary, continues using the term “duty of loyalty”.[113] Abolishment the duty of loyalty means that, relationships among concerned shareholders, a board of directors and management would be cancelled.[114]

Duty of loyalty requires putting interest of a corporation ahead of personal. Therefore, it is used as a shield for hindering directors receive personal gains from abuse of their duties.

Self-dealing transactions is one of the most litigated aspects of duty of loyalty.At the moment when director starts providing self-interested transactions in corporation, he/she could be prescribed as an “interested director”.[115] As for the self-interest itmight be prescribed in a financial interest of director. Hence, if a holder duty of loyalty provides transaction with a personal financial interest, it means that conflict of interest is presented and in case of its voidance duty of loyalty is automatically breached.

Professor Ruder has given a list of situations which defiantly rise conflict of interest through the transactions: self-dealing, diversion, dealings by a corporate partner with its subsidiaries, majority shareholder injury to minority shareholders in corporate acquisition and reorganization transactions, excessive compensation, use of corporate funds to perpetuate control, sale of control at a premium, insider trading, corporate opportunities, competition by corporate officers and directors with their corporation, and fiduciary obligations in bankruptcy.[116] Of course, these are not full list of transactions or situations

[111]Norwood, P. Beveridge, Jr. The Corporate Director’s Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 1992,658
[112]Id. at 687
[113]Id. at 688
[114]Id. at 658
[115]Marsh, H. Jr. Conflict of Interest and Corporate Morality, Are Directors Trustees? 1966,65.
[116]Norwood, P. Beveridge, Jr. The Corporate Director’s Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 1992,657

arising conflict of interest, but they always have been resolved by duty of loyalty analysis.[117]

Despite aforementioned circumstances duty of loyalty in Georgian Law on Entrepreneurs is separated from duty of care and good faith. Externally it is defined by the first paragraph of Article 9 (5) and by the second paragraph of Article 9 (6), but contently it has no connection with conflicting interest transactions.According to the Articles the governors and supervisory board members without the consent of supervisory board are prohibited provide the same business activities, which is carried out by its own company or additionally use its own company's business information for receiving personal gains. Therefore, in reality according to the Georgian legislation "duty of loyalty" is not duty of loyalty by its nature, but it is the rule of prohibiting concurrency in corporations.[118]

8. Conflicting Interest Transactions through the Georgian Law on Entrepreneurs

In thesis has already been discussed a lot about the Article 16^1 and its sole reference to the Reporting Companies. But, still because higher amount of non-listed companies operating in corporate legal system, it is also very important to identify how conflicting interest transaction could be regulated under the Law on Entrepreneurs, if available.

Fortunately or unfortunately, lack of Georgian court practices in this field is a fact. In addition to this circumstance Law on Entrepreneurs also does not cover conflicting interest transactions directly.

Despite, these facts some kinds of practices have already been established. Some of them were added from the EU practices, but basically US case law influences appearvisible. US case law has already established more sophisticated methods and typically does not automatically invalidate conflicting interest transactions. Courts always assess the fairness of the transactions terms and if it causes no damages remains validity, discussed latter in specific cases. However, still what kinds of leverages do the remaining directors or shareholders have against transactions in which they have no interest and challenge for its invalidity.

[117]Id. at 657
[118]Chanturia, L. *Corporate Governance and the Heads of Responsibility in Corporate Law*, 2006, 311

For illustration it would be relevant, if we imagine a non-listed Limited Liability Company X in which operates 80% shareholder A and 20% shareholder B. Shareholder A because of its dominant position enters into self-dealing transaction with its own company X. A has not disclosed his personal interest and as a majority shareholder performed transaction. B claimed for non-disclosure, argued that conflicting interest transaction was not ratified and Ahas violated good faith obligation. B challenged for voiding transaction.

The only way under the Law on Entrepreneurs to evaluate self-interested transaction is the concept of good faith established in the first paragraph of Article 9 (6). Good faith as an institute is one of the main internal parts of the principles of Georgian private legalsystem[119] applicable for private legal entities or natural persons, which participate in legal relations.[120] Good faith could also be prescribed as a moral event[121], but as the Supreme Court establishes its function is to generate fair outcomesfor corporation and at the same time avoid apparent unfair consequences.[122] Good faith shall always be considered within the criteria of fairness and is used to limit freedomof action[123] of governors and supervisory board members in corporations.

While A was providing conflicting interest transaction, accordingly to the Article 9 (6) he should have believed that this transaction was the most favorable for corporation. However, except the belief of A through the court evaluations B has ability prove the unfairness of that transaction. For instance, foundout whether transaction contains the facts of fraud or even a waste[124]. If the court has confirmed one of unfair facts and if it evaluates activities as bad faith of 80% shareholderthen additional legal way for voiding transaction would be used. Article 9 (4) of Law on Entrepreneurs directly says that, agreement will be void, if parties of transaction deliberately act to damage business entity. It means that if A prevail his personal interest and does not take care to the company, which occurs damages there exists legal leverage to cancel conflicting interest transaction. Indirect, but solution seems to exist under the Law on Entrepreneurs.

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[119]N.as – 23-18-2011 decision of Supreme Court of Georgia, 70 – 73

[120]*Georgian Civil Code*, article 8

[121]Chanturia, L. *Comments for Article 8 of Georgian Civil Code*, 2015, 4 Retrieved fromwww.gccc.ge/wp-content/uploads/2015/11/Artikel-8.pdf,last checked 10/2/2016

[122]N.as – 221-213-2012, Decision of Supreme Court of Georgia, 71 – 77.

[123]Chanturia, L. *Comments for Article 8 of Georgian Civil Code*, 2015, 4 Retrieved fromwww.gccc.ge/wp content/uploads/2015/11/Artikel-8.pdf, last checked 10/2/2016.

[124]Chanturia, L. *Corporate Governance and the Heads of Responsibility in Corporate Law*,2006, 325.

9. Legal Results of Conflicting Interest Transactions (Case Analysis)

9.1 Automatically Voidable Transactions

The most interesting part for the thesis is to answer the question posed, what are the legal results of transactions provided through a conflict of interest?

In comparison with the Georgian corporate legal system, regulation of conflict of interest transactions or intentional lack thereof is very aged in the US Common Law. During centuries, case law proved to be sufficiently stable to determine the legal status of the transactions, which were concluded within conflict of interest.

As it was already mentioned in thesis frame of mind was always vary. Mr. Justice Wayne stated: “the general rule stands upon our great moral obligation to refrain placing ourselves in relations which ordinary excite a conflict between self-interest and integrity…In this conflict of interest, the law wisely interposes. It acts not to the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty”.[125] Such a strong belief denied any possible conflicting interests between parties. Company interest always prevailed and director was liable to act in the interests of a corporation.

The general rule that contracts concluded within conflict of interest was voidable, regardless its fairness or unfairnesswas settled in many court decisions and judges’ interpretations were based on that philosophy.[126]

In *Wardell v. Union Pacific R.R. Co.*Case Mr. Justice Field stated that: “it is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matters, as agent for another, whose interests are conflicting…The two positions impose different obligations, and their union would at once raise a conflict between interest and duty; and “constituted as humanity is, in the majority of cases duty would be overborne in the struggle”…The law, therefore, will always condemn the transactions of a party on his own behalf when, in respect of the matter concerned, hi is the

[125]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 35
[126]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 36

agent of others, and will relieve against them whenever their enforcement is seasonably resisted. Directors of corporations, and all persons who stand in a fiduciary relation to other parties, and are clothed with power to act for them, are subject to this rule; they are not permitted to occupy a position, which will conflict with the interest of parties they represent and are bound to protect. They cannot, as agent or trustees, enter into contracts on behalf of those for whom they are appointed to act, and then personally participate in the benefits".[127]

Additionally, at least two main reasons may also be indicated as the dominant positions of voiding conflicting interest transactions. The Maryland Supreme Court stated: "when a contract is made with even one of the directors, "the remaining directors are placed in the embarrassing and invidious position of having to pass upon, scrutinize and check the transactions and accounts of one of their own body, with whom they are associated on terms of equity in the general management of all the affairs of the corporation"".[128] Hence, equitable situation precluded directors' ability control each other.

All the "doors" for interested parties were closed. That period of tendency continued to avoid any kind of activities that even slightly contained any circumstances that may raise conflict of interest. Ostensibly, courts tried not to establish new regulations for corporations and made no intervention by a "flexible" law.

The second term is strongly related to the personal weaknesses of directors in which Justice Davies of the New York Supreme Court expressed that: "the moment the directors permit one or more of their number to deal with the property of the stockholders, they surrender their own independence and self-control".[129]

After this era, in his article Harold Marsh pointed out that, decision of the Supreme Court of Massachusetts in *Union Pacific Railroad Co. v. Credit Mobilier of America*Case was the first precedent, where court denied voiding transaction automatically only for the reasons that, this contract was concluded between the corporation and its own director.[130] For the

[127]O'Kelly C. R. T. Kilpatrik, M. E. Thompson R. B. Corporations and Other Business Associations, Cases and Materials, 2014, 301
[128]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 37
[129]Id. at 37
[130]Id. at 38

first time, there was mentioned “the absence of fraud”, by which the judge was aware to leave the contract valid.[131]

Although, breakthrough decision was made new established principle was not developed, because of the fraud’s evasive nature.[132]Despite having no fraud in transaction there was established a view still stating that, the interest of the shareholders are placed in such a circumstances that directors opportunity for self-advancement is more numerous and declaring “the absence of fraud” is not worthy of consideration.[133]

Increasing business activities through the US boundaries automatically triggered litigations around the transaction arising conflict of interest. Therefore, case law contribution in this field is obvious. New approaches, law amendments and court interpretations were ready enough for new challenges. And together, with the common law moving away from the position that conflict interest transactions were void, legislatures began enacting conflict of interest regulatory statutes.

10. Valid Transactions

10.1 Marciano VSNakash Case[134]

Nakash and Marciano families formed LTD Gasoline. The partners shared stock ownership as well as composition of the board equally.

Due to the financial troubles business turned out to be deadlocked. Company was placed in custodial status. Neither family appeared willing to invest additional funds or provide guarantees to motivate LTD Gasoline to function as a profitable commercial entity. There were no prospects of running the business and court approved plan of liquidation. According to the plan, the assets of LTD Gasoline were going to be sold and all the valid debts of the company shall be paid. At last, the net proceeds would have been distributed to the shareholder families.

Without the consent of Marciano, Nakash made approximately $2.3 million dollars loan to LTD Gasoline for the purpose to pay outstanding bills and acquire inventory. On the one

[131]Id. at 38
[132]Marsh, H.Jr.Are Directors Trustees? Conflict of Interest and Corporate Morality, 1966, 39
[133]Id. at 39
[134]Marciano VS Nakash, Supreme Court of Delaware, 1987, 535 A. 2d 400

hand,Nakash owned company U.F Factor by which Nakash family became LTD Gasoline's lender arranged lending the money. Besides, Jordan Enterprises another entity of Nakash family required payment from LTD Gasoline of two percent of company's gross sales or $30.000 dollars for warehousing and invoicing services.

At the time of sailing the assets, Nakash family and its entities appeared to be the general creditors of LTD Gasoline and in case of their satisfaction, it would exhaust the assets of company leaving nothing for Marciano family.

Marciano family claimed for voiding the loan transaction. A State Law permitted corporation to be engaged with an interested directorin conflicting transaction, if it was ratified by stockholders or board of directors, but this transaction had no approval of majorities, therefore Marciano family argued that, it was *per se* voidable, notwithstanding its fairness or the good faith of its participants. Marciano supported their arguments with the recording of the law that, a Delaware Statute might be the only mode to "immunize a self-dealing" transaction and without approval of majority of directors loan agreement was invalid.

The Court of Chancery held that, relationship between LTD Gasoline and Nakash family was not the only factor to void conflicting interested transaction, besides the loan was valid and it was enforceable debt for the company. The Court has found that, U.F. Factor loans compared favorably with the terms available from unrelated lenders" and the need for external financing had been clearly demonstrated.

Marciano family might not be blamed for refusing to supply company with additional equity funding, but LTD Gasoline financial needs had been met through external borrowings. Company was able to function only through cash advances and loans obtained by Nakash family.

In the part of majority approval, court held that, deadlock situation prevented the process of ratification of the loan transaction, but litigation continued in the part of finding fairness of the transaction. Marciano family argued that, Nakashes failed to demonstrate the full fairness of the loan transaction in respect of the cost of borrowings and the use of funds and blamed them in unfair dealing. However, during investigation the fairness of the transaction, it was found out that, fairness was particularly appropriate because Nakash family acted with the intention to remain Gasoline in business. Additionally, by arranging

the loan interested directors were not depriving gains from the company, rather provided benefits, which were unavailable elsewhere. The Court found full fairness from the Nakash family.

10.2 Globe Woolen Co. VS Utica Gas & Electric Co. Case[135]

Marciano versus Nakash families' case is a classic example of how to protect corporation from losing the profits, which may appear in conflicting interest transactions. In comparison with the foresaid case, *Globe Woolen Co. v. Utica Gas & Electric Co.* case represents interested transactions in a very different way. Case may be briefly stated.

John F. Maynard was an owner of Globe Woolen Co. operating two mills in the city of Utica. One was for the manufacture of worsted and the other for that of woolens. At the same time, he was in the board of directors of the local electric power – Utica Gas & Electric Co. However, he had no stock, hence had no property interest in this corporation.

Both mills were running by steam, but upon the suggestion of the Utica Gas manager, Mr. Maynard accepted to substitute it by electric power. Despite this fact, he was fearful for the costs of conversion and required guarantees for saving in the cost of operation. Mr. Greenidge the manager of Utica Gas was the only person who was engaged in negotiations with Mr. Maynard and finally, two contracts were concluded for supplying the mills by electricity.

For further evaluations it is important to highlight that, before concluding contracts when parties were in the process of negotiation and Mr. Greenidge calculated the cost of operation, investigated the power plant and wrote reports about its conditions, he was still Utica Gas employee and was paid by Mr. Maynard.

Despite impracticality, contracts included some guarantees stipulating that, the monthly cost of electricity would be at least $300 dollars, which was less than Globe Woolen Co.'s prior steam expanses. After the agreement between Mr. Greenidge and Mr. Maynard contracts were represented to the board of directors for ratification. Mr. Greenidge vouched

[135]Globe Woolen Co. VS Utica Gas & Electric Co. Court of Appeals of New York, 1918, 224 N.Y. 483,121 N.E.308

the contract. As for Mr. Maynard, he kept silent, said nothing about stipulated guarantees, put resolution but did not vote for the contracts.

Time by timeGlobe Woolen increased productions and the usage of electricity power which generated mounting losses for Utica Gas. Soon, it was found out that, Mr. Greenidge had miscalculated about the costs, because calculation was made only on a prior production levels and there was made no calculation for increased power consumptions. For the high amount of losses, Utica Gas gave notice of cancelling the contracts. However, Mr. Maynard sued for specific performance and compelled the contractor for supplying with electric current to its mills.

Court held that, contracts were unenforceable, because they were unfair, oppressive and made under the dominating influence of a common director. These contracts were void.

Annulling contracts was the best solution of the issue and it has its legal reasons. Self-dealing itself has not been the reason for voiding that transaction, even automatically, because Utica Gas board of directors already had information, that there board member Mr. Maynard was on both sides of thistransaction. Andthe remaining board members believed that, Mr. Maynard as one of the director and Mr. Greenidge as the manager of the corporation was acting through their duties honestly. But, everything happened on the contrary.

Mr. Maynard took advantage because of his superior position to Mr. Greenidge as a subordinate and they framed the contracts together. Besides, during negotiations Mr. Greenidge was paid by Mr. Maynard and always tried to serve director’s pleasure.It was obvious that, after certain period of time increment of production, significantly would lead parallel increments of power consumption.

Fairness of the parties in transaction was breached. Court held that, Mr. Maynard as a director had duty to inform the board members about the risks associated with the contracts and despite externally providing beneficial transactions it has indirectly deprived the gains from Utica Gas and privileged his personal financial interests. Additionally, the court highlighted that, despite avoiding voting the transaction by Mr. Maynard does not mean that he acted in a good faith.

Great legal parallels might be made between the previous decision and Georgian Law on Stock Marker recording. Article 16[1](4) says that, “interested person is prohibited to vote transaction in which he/she has direct or indirect self-interest”. According to the decision, avoiding voting self-interested transaction does not automatically mean that transaction is valid and interested party acts in a good faith. Person in charge has duty fully inform the others about the risks that are hidden in contracts and which may financially weak corporations.

Each kind of self-interested situation needs to be individually examined and the findings shall be provided accordingly.

10.3 LTD Talant VSBakhtadzeCase[136]

Mr. Bakhtadze was a director and 30% of shareholder in LTD Talant. At the same time he was the sole owner and director of LTD B.E.J.

Mr. Bakhtadze as a natural person entered into a purchase agreement with LTD Talant represented also by him as a director. The subject of the contract was a real property owned by LTD Talant. After acquisition Mr. Bakhtadze has put purchased property into the capital of LTD B.E.J.

Remaining shareholders of LTD Talant: Mr. C owner of 23.35%; Mr. F owner of 23.35% and Mr. D owner of 23.3% claimed for the purchase agreement required for cancelling the contract and reimbursement for the damages.

As a result, court has voidedtransaction and the claim for reimbursement waspartially satisfied, but what were the legal reasons for that?

Despite the fact that, transaction was made through the conflict of interest where one person was standing on both sides of the transaction, similarly to the aforementioned US court decision it was not automatically void only for that reason. It seems that, Georgian courts recognize it as a legal transaction. They share international practices and without evaluation of its advantages or disadvantagesdo not take rapid decisions.

[136]LTD Talant v. Bakhtadze, N.as-281-270-2012 decision of Supreme Court of Georgia

Before taking the final decision, basically the court has focused on some important circumstances. It was the fact of disclosure, good faith of director, approval of the majority of disinterested shareholders and focus also was made on the fairness of the transaction.

Initially, Mr. Bakhtadze argued that, he has fully disclosed information about the transaction. For evidence, he has represented the annual rapport of LTD Talantwhich contained general information about director's activities, besides there was added information about the purchase agreement in which he was indicated as a receiver of the property, with reference the price of the property, indicating as paid.This general annual report was evaluated as satisfactory and the shareholders approved it. However, court has refused his argument and indicated that, transaction shall only deem to be accepted, if the remaining shareholders directly approve the transaction. Therefore, indirect approvalof the report might not be enough for satisfying the requirements. The degree of disclosure, of course, is another part of discussions, but the evidence that Mr. Bakhtadze has not hidden information about the transaction is a fact. In my point of view, when the remaining shareholders received specific information about the transaction in written report, they had ability and fiduciary duties to investigate provided transaction characteristics and evaluate its beneficial nature for the company. But, they have ignored it.

As for the approval of remaining shareholders, it is not directly regulated provision for non-listed companies under the Law on Entrepreneurs. But, the court has privileged The Majority of The Minority doctrine in case and held that; according to the *article*approval was obligatory. Interested director has not received it, therefore breached the law requirement.It means that, according to the Georgian courts established practice approval of remaining shareholders is the element of validity for conflicting interest transactions.

Court's evaluation continued on the good faith of Mr. Bakhtadze. According to the Article 9 (6) of Law on Entrepreneurs he, as a director had liability exercise obligations diligently, with the principles of good faith, through the interests of the company. Thus, discussions were focused on two main situations: the price real estate was sold and the personal interest of Mr. Bakhtadze.

During discussions, it was found out that, Mr. Bakhtadze was one of the creditors of LTD Talant and as he repeatedly said,that he wanted to satisfy his claim as a creditor interests

and believed it was fair. This fact was enough for court assumption that, Mr. Bakhtadze has put personal interests above the company, but I do not disagree this reasoning.As it was already mentioned in thesis, self-dealing without personal interest and more specifically, without financial interest does not exist. The court might have taken into account that, financial or other types of interests are not the sole reason for voiding transaction when approval of the shareholders or fairness of transaction is present. Having financial interest in transaction does not automatically mean that, the company's interest is condemned. Hence, court's discussion that, Mr. Bakhtadze because of borrowing money back has put his own interest above the company is wrong. In my point of view, good faith of the director in the part of prevailing company's interest has not been violated.

Additional discussions were provided for ascertaining the price of the transaction, which the court has discussed in the section of good faith. Initially, the partners meeting of LTD Talant has afforded the price of real estate, which was much lower rather than its market price. Despite this document, there were expert reports, which evaluated real property with a higher value. However, there were mutually exclusive documents Mr. Bakhtadzehas sold the real property for a price it was afforded by the partners, but the court held that, director had obligation to act in the best interest of the company and not in accordance with the partners' decision.

Selling the real property in a lower price caused financial damages to the company. Besides, it was found out that, director has not even paid the price of transaction. LTD Talant has not received gains, but on the contrary, it appeared detrimental for the company. According to the Article 9 (4) of the Law on Entrepreneurs and Article 54 of the Civil Code of Georgia the court held that, Mr. Bakhtadze, intentionally acted against the interest of company and it was reasonable enough to void the transaction.

Ultimately, I agree with the court decision. Except aforementioned circumstances, my position is supported by the fact that, after acquisition Mr. Bakhtadze had no plan and was not going to restore debts for the remaining creditors. He even did not know what the full debt of the company was. Mr. Bakhtadze's intentions were not provided through the fairness.

Therefore, court's decision was a logical invalidation in order to protect the company from the financial losses occurred through the conflict of interest transaction.

11. My "Perfect" Legal Regulations

As the Supreme Law of the country the Georgian Constitution guarantees economic freedom.[137]Economic freedom indirectly promotes right-wing ideology with non-intervention in business and such approach stimulates the development of the free market. Particularly, free market with its self-regulatory characteristics generates appropriate solutions on an individual basis. Everything is connected like a chain.

In my point of view, I strongly appreciate the principles that give entrepreneurs more possibilities freely operate on the free market and gradually develop themselves. However, sometimes situations become uncontrolled. Therefore, certain kind or regulations seems relevant for me.

I think, when an interested party is involved in self-dealing transaction and respectively raises conflicting interest transaction, he should explicitly be liablefor full disclosure under the law. Fully disclosure should reveal the substantial interest why interested party has involved in transaction and what kind of profits is he waiting from either for himself and for the corporation, also. Definitely disclosure shall be defined to be made before when the contract is not still concluded due to the ability for the remaining disinterested parties to evaluate the risks or gains that may derive from that transaction.

To be honest, approval or ratification process of those transactions I consider suspiciously. There are several arguments for that. Initially, when we talk about the approval of conflicting interest transactions it means that certain amount of disinterested directors, shareholders or both of them shall take decision on approval. Respectively it raises question, how many remaining parties' vote would be enough for approval? If we say that, more than a half of disinterested parties' voice is enough for that, then what will happen to their opinions that have refused ratification for different views? If these people claim for that transaction in court and if court would void transaction, what kind of responsibilities shall be imposed on them who have approved that transaction? Many questions are posed, but my answer is to rule out ratification as an obligatory requirement. It creates more problems for corporation rather than guarantees their protection.

On the other hand if weprevail the majority of the minority approval, it means that decision shall be made within the remaining parties and all of them should vote for transaction, evenif they represent only 1% of disinterested parties in corporation.Hence, decision shall

[137]Constitution of Georgia, (introduction of the law expressing the will of Georgian citizens)

be made by hundred percent of one percent. I strongly believe that, rising decision-making power in minorities hands contain the risks of devastation for corporation, due to their intention receive more gains, rather than expected from transaction.

As for the interested party involvement in approval of transaction in which he/she has self-interest it shall be ruled out directly to avoid any kind of negative influences or partiality in ratification process.

All these arguments give me good reasons completely rule out approval or ratification process through conflicting interest transactions and be satisfied only with the concept of full disclosure use for conflicting interest transactions validity. Confidently, the main solutions are full disclosure and the good faith defined through the fairness of an interested party.

11.1 Article 16^1 for Non-Listed Corporations

Georgia as a democratic country always recognizedand tried to get closer to the European standards in different directions, with the aim to become its worthy member state. Association Agreement with EU could be prescribed, as the greatest expression of this process.[138]Therefore, before Georgia becomes one of the members of the union, country should try not to break up European standards significantly, but on the contrary every kind of changes, especially amendments taken in Georgian legislation should come in accordance with EU standards and regulations.

Related party transactions, which is the same situation as self-dealing transactions in non-listed companies have never been regulated under the EU legislation. European practice prevailed non-intervention policy in business. The only act, which was established after 2012 in Union was the Directive related only to the listed companies, as it is in the Georgian Law on Stock Market.According to the Article 26 of the Directive EU member states shall ensure through adequate safeguards that related party transactions does not conflict with the company's best interests.[139]

[138]Association Agreement between Georgia and European Union, 2014
[139]Directive 2012/30/EU of the European Parliament and of the Council, 2012, article 25

Comparatively to the Georgian Law on Stock Market, Article 16[1]shall be prescribed exactly as the adequate safeguards for publicly held corporations and its shareholders. Investors who do not have enough experience and information operating in stock exchange, government stimulates with more guarantees and protects them from the risks, which may appear in conflicting interest transactions.

In my opinion, in respect of non-listed companies policy should not be changed. Investors who purchase shares in non-listed companies upon the Law on Entrepreneurs understand the risks, which may be applied. Therefore, government with its general conservative policy has no obligation or aim make interventions in independent companies and "protect" investors from financial risks.

Conclusion

This thesis has demonstrated that, self-dealing transactions are not illegal acts. Discussed cases and court interpretations gave me confidence that, mostly judges, legislatures or even businesspeople gradually become assured in advantageous nature of conflicting interest transactions.

The most significant intention of thesis was to have created legal framework, which could approve that, conflict of interest transactions are not automatically void, but in most situations it could rescue many investors and even big corporations from financial crisis. Fortunately, Georgian legislation and court practices also follow this belief.

Many elements were defined, which could be used for control and it is normal, because if concluded self-interested transaction adversary effects on the rights of shareholders, which could have negative effect on the development and growth of the corporation such a transaction should be eliminated immediately.

Georgia follows up international practices and reacts due time with efficient tendencies. Finally, positive changes should create legal structure to attract more investments in the country and give both legal and economical guarantees under the Georgian laws.

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