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# Legal Newsletter

Author: Gvantsa Saneblidze

April 15, 2021



# Review of new provisions enacted under the Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors

The law of Georgia on Rehabilitation and Collective Satisfaction of Creditors became effective on April 1, 2021, succeeding the previous law of Georgia on Insolvency Proceedings and introducing fundamentally new approaches and principles from the previous one. Unlike the previous law of Georgia on Insolvency Proceedings, the current law seeks to collectively satisfy the creditors' claims primarily through rehabilitation rather than the bankruptcy of enterprise for which it provides fundamental principles of insolvency proceedings. This review aims to summarize the key developments provided by the new law.

## Purpose and Principles

Unlike the previous law, which sought to protect the interests of both the debtor and the creditor equally, the current law seeks to collectively satisfy the creditors' claims through the achievement of rehabilitation, and where the rehabilitation cannot be achieved, through the allocation of proceeds from the disposal of an insolvency estate. Therefore, the primary objective of the new law is the collective satisfaction of the creditors through the rehabilitation of companies rather than declaring them bankrupt. The new law aims to accomplish this objective by incorporating new insolvency standards, including the following:

- the careful administration of an insolvent debtor's operations and insolvency estate;
- the timely and phased settlement of an insolvent debtor's financial difficulties;
- the transparency and predictability of insolvency proceedings;
- preserving and increasing the profitability of insolvency estate and company as far as possible;
- the facilitation of an insolvent debtor's rehabilitation;
- the equal treatment of creditors of the same rights.

## Insolvency Application

An insolvency declaration is a way of performing insolvency proceedings against the debtor under the court jurisdiction, in which the creditor requests that the court begins rehabilitation or bankruptcy proceedings against the debtor.

The debtor, any creditor, regulated agreement supervisor, and rehabilitation and bankruptcy manager (only with the request of the regime conversion) have the authority to file insolvency claims in court.

The previous law did not provide for the debtor to receive a creditor's filing for insolvency or to communicate a position to the court regarding its actual or expected insolvency. According to the current law, the debtor is invited to provide its views to the court on its ongoing or potential insolvency and the initiation of a rehabilitation or bankruptcy regime within 7 days of receiving the court notification, which represents a significant legislative novelty since the rights of both the creditor and the debtor to communicate their positions on the debtor's current or expected insolvency are equally safeguarded.

The new law strikes a balance between creditors' and debtors' procedural interests during the insolvency proceedings at court, and it promotes the time efficiency for the proceeding, which significantly enhances the debtor's rehabilitation capability.

The new law refers to the debtor's property as the "Insolvency Estate" and distinguishes property rights on certain assets included therein.

The court decides the admissibility of an insolvency application without an oral hearing, which facilitates the resolution of the debtor's financial difficulties in a timely manner. However, this does not exclude the court from discussing the matter during the oral hearing if it assumes that the given approach serves to further clarify the facts of the case.

Additionally, it provides an immediate and prompt resolution to the debtor's financial difficulties by allowing the claimant to provide a motion to initiate the applicable regime in the insolvency application. As a result, in addition to deciding on the admissibility of the application, the court further decides on the establishment of a rehabilitation or bankruptcy regime.

## Insolvency Estate

The previous law applied to the debtor's property as "Trust Property", while the current law renamed and referred it to as an "Insolvency Estate". The term "Insolvency Estate" applies to all property owned by the debtor at the time of admissibility judgement of insolvency application, as well as property acquired, received or generated since then.

The current law distinguishes property rights on certain assets included in the insolvency estate. It specifically excludes from the insolvency estate any property of conditional ownership or leasing that the debtor is entitled to purchase. The manager/supervisor may authorize the debtor to have possession and use of such property if it is required for rehabilitation or bankruptcy purposes.

## Opening of Rehabilitation or Bankruptcy Regime

The new law authorizes the court to determine whether to open a rehabilitation or bankruptcy regime. Such authority was previously granted to the Conciliation Board.

According to the new law, a judge can decide whether to open a probation or bankruptcy regime without an oral trial unless the facts of the case are disputed. By authorizing the court to decide on opening rehabilitation and bankruptcy regime, the current legislation eliminates a legal gap created by the previous law, which delegated such decision-making authority to the conciliation board.

The court further appoints the rehabilitation regime manager/supervisor or the bankruptcy regime manager (insolvency practitioner) as it rules on the initiation of the rehabilitation or bankruptcy regime.

The given court judgement should also provide a detailed description of the moratorium which seeks to preserve and secure the insolvency estate while also protecting the collective interests of creditors from either debtor or individual creditor's specific actions.

## Disputed Acts

The new statute regulates "Disputed Acts" which were formerly referred to as "Actions Harmful to Creditors". Given the possibility that the debtor may intentionally minimize and/or reduce the insolvency estate or prioritize any creditor, the manager/rehabilitation supervisor has the authority to declare them as disputed acts.

An act can be disputed if it was committed within one year from the start of insolvency proceedings and within two years if the party opposing such rescission is in any form related to the debtor. Furthermore, a debtor's act intended to inflict harm to a creditor shall be disputed if it occurred within three years of the date on which an application for insolvency was deemed admissible.

The period of limitation for exercising the right of rescission shall be one year, beginning on the day on which a decision declaring an insolvency application admissible and opening a rehabilitation or bankruptcy regime was issued.

Provided that the right of rescission is meant to preserve the debtor's insolvency estate in favour of creditors interests, its legal effect is of restorative nature, requiring that the debtor's insolvency estate be replenished and restored to a state in which disputed acts would not have occurred. Therefore, the results following such acts are governed by the provisions on compensation for damage and unjust enrichment determined under the Civil Code of Georgia.

Under the new law, actions that are detrimental to creditors are referred to as "Disputed Acts." Additionally, it defines the time span within which acts become disputed and the period of limitation for exercising the right of rescission towards such acts.

## Debtor in Management

The new law establishes a new form of management in the rehabilitation regime, called "Debtor in Management". Such a possibility offered by the new law serves as an incentive mechanism to address the rehabilitation regime in the insolvency proceedings. Additionally, the new law specifies the grounds upon which a court can refuse to retain the debtor in management.

The primary goal of the new law is to secure a debtor by rehabilitation, and to that end, it establishes a new form of management in the rehabilitation regime, called "Debtor in Management." In such an event, the debtor's operations and property are managed by the debtor itself under the supervision of the rehabilitation supervisor within the scope of the rehabilitation regime. The court determines whether or not to retain the debtor in management during the rehabilitation regime. The court will not keep the debtor in management if it enters the rehabilitation regime from the regulated regime which ended unsuccessfully or if it acted in bad faith during the management of its company and generally towards its insolvency.

Except for the rights and duties of the rehabilitation supervisor and the right to revoke the acts and transactions conducted by the debtor's former or current director or any other persons authorized to administer and represent it, the debtor in management retains all of the rights and obligations of rehabilitation supervisor set forth under the new law.

## Right to Separate Satisfaction

Right to Separate Satisfaction represents the right of secured creditor to appeal to the court for the cancellation of moratorium measures on the encumbered property.

The secured creditor has the right to appeal to the court for the cancellation of moratorium measures on the encumbered property, although he must prove to the court that he has suffered substantial damage as a consequence of the moratorium measure and that his interests outweigh the statutory purpose of collective satisfaction of creditors. If the rehabilitation supervisor does not agree to the cancellation of the moratorium on the encumbered property, then he/she carries a burden of proof to demonstrate that maintaining the moratorium on such property is essential for rehabilitation purposes.

The new law determines the framework to preserve and secure the insolvency estate while also protecting the collective interests of creditors by statutory and discretionary moratorium measures.

The new law further regulates the prospect of converting the bankruptcy regime into a rehabilitation regime, which will significantly encourage legal entities to get involved in insolvency proceedings.

## Moratorium

The key objective of the moratorium is to preserve and secure the insolvency estate while also protecting the collective interests of creditors from either debtor or individual creditor's specific actions. The current law determines statutory and discretionary moratorium measures. The statutory moratorium measures become effective immediately once the court declares the insolvency application admissible and issues an order for the opening of a rehabilitation or bankruptcy regime. Furthermore, the court may impose additional moratorium measures at its sole discretion based on the valid request of the creditor, debtor, manager or any other interested person.

## Conversion

The new law provides the opportunity of regime conversion which can be viewed as an incentive tool for the parties to address insolvency proceedings. Notably, the new law permits not only the conversion of the rehabilitation regime into a bankruptcy regime but also to convert the bankruptcy regime back to the rehabilitation regime.

If the rehabilitation plan is not approved in accordance with the law, the rehabilitation regime converts to the bankruptcy regime and the court appoints the bankruptcy manager. The rehabilitation supervisor/manager is entitled to file a conversion request to the court at any time prior to the rehabilitation plan gets approved if he/she deems that there are no reasonable grounds for achieving the rehabilitation goal.

As in the conversion of the rehabilitation regime into the bankruptcy regime, the bankruptcy manager has the authority to submit a motion requesting the conversion of the bankruptcy regime to the rehabilitation regime. If the court approves of such a motion, it will follow the statutory procedure of establishing and opening the rehabilitation regime and may also rule on moratorium-related issues.

## The Order of Creditor Satisfaction and the Disposition of Remaining Property after the Completion of Bankruptcy Regime

The new law defines the place of primary satisfaction of new creditors' claims and preferential claims in the creditors list. Additionally the new law resolves constitutional issues regarding the standard governing the debtor's remaining property following the bankruptcy.

The primary satisfaction of new creditor claims arising since the declaration of the admissibility of the insolvency application is a significant reform in the order of creditor satisfaction. Besides, the new law determines so-called "Preferential Claims" which shall be satisfied right after the new creditor claims are satisfied. Preferential claims refer to costs such as three-month salaries and leave (except for the expenses of the debtor's directors and members of the supervisory board, as well as their family members' salaries and leave expenses), as well as sums payable due to occupation purposes (of not more than GEL 1 000 per creditor).

The previous law transferred the property remaining after the sale of insolvency estate to state ownership, raising concerns over the constitutionality of the norm. The current law addresses this shortcoming, and all the remaining property surviving the bankruptcy of enterprise are dispersed proportionately to the debtor's partners unless otherwise agreed between the parties under the relevant charter or the agreement.

## The Sale of Insolvency Estate

Under the new law, creditors have the right to offer the bankruptcy manager an alternative way of selling the debtor's property, while the bankruptcy manager is authorized to select the most optimal method of selling the insolvency estate that best protects the creditor's interests.

According to the new law, the bankruptcy manager is allowed to sell the insolvency estate in any manner permissible by law, whether as a single complex or in parts, under the principles of maximising the chances of receiving larger funds. Within 7 days of the release of a report on the form of property sale, the creditor is authorized to offer the bankruptcy manager a more profitable option of the property sale. The final decision on the form of the property sale shall be made by the bankruptcy manager. Therefore, the proposed regulatory novelty authorizes the bankruptcy manager to evaluate and select the most suitable method for selling the insolvency estate in a way that better safeguards the creditor's interests.

## Debtor with a Status of a Special Regime

The new law introduces the concept of the Debtor with a Status of a Special Regime and determines a different approach to the sale of its property. If the suspension or termination of the debtor's business operations significantly damages the state and/or public interest, the court can grant such debtor the status of a special regime. The property of such Debtor shall be sold as a single complex or in any other manner that does not affect the continuity of its operation. Due to the high public interest, it is impermissible for the purchaser of such debtor's property to alter the nature of the debtor's business activity. Therefore, the purchaser undertakes to maintain the activity previously carried out by the bankrupt debtor.

## Regulated Agreement (Extrajudicial Trial)

The new law provides an effective method for insolvency parties to end insolvency proceedings with rehabilitation. It is a negotiation process within a legal framework between the insolvency parties which allows the debtor to reach rehabilitation on a more expeditious and cost-effective basis. Only the debtor may initiate a regulated agreement. Unless the creditor agrees to a different satisfaction under the regulated arrangement, each creditor will receive at least as much as he/she would have received in the event of the debtor's bankruptcy under this agreement.

The main objective of the regulated agreement is to sustain the debtor's business operations, which precludes its liquidation under this agreement. Its conclusion and execution are only achievable with the involvement of a regulated agreement supervisor (insolvency practitioner).

The new law governs the concept of a Debtor with a Status of a Special Regime and determines a different approach to the sale of its property.

The new law provides the parties of insolvency proceedings with the option of extrajudicial trial - "Regulated Agreement" which aims to keep the debtor's business operations running and to support the parties to reach the negotiation on a more expeditious and cost-effective basis, within a mutually compromising and legislative framework.



Under the new term “Insolvency Practitioner” the new law unites the rehabilitation/bankruptcy manager and the rehabilitation/regulated agreement supervisor. The insolvency practitioner who will lead the insolvency proceedings is an individual or legal entity with appropriate credentials and experience, representing professional sectors and for each insolvency proceeding is selected automatically, with the principle of random allocation through the relevant electronic selection system.

The current law introduces and further regulates the fees of insolvency proceedings.

## Insolvency Practitioner

Under the new law, a rehabilitation/bankruptcy manager, as well as a rehabilitation/regulated agreement supervisor shall only be an Insolvency Practitioner. Representatives of this regulated profession shall be individuals or legal entities with appropriate credentials and experience, representing professional sectors, who should lead the insolvency proceedings independently, impartially, and in good faith.

The insolvency practitioner for each insolvency proceeding is selected automatically, with the principle of random allocation through the relevant electronic selection system. If such an electronic system is suspended temporarily, the new law allows for the option of selecting the insolvency practitioner in sequence.

## Insolvency Proceeding Fees

The current law introduces a new way of regulating the fees of insolvency proceedings. The state fee payable upon the submission of an application for the commencement of insolvency proceedings shall be 3% of insolvency estate value, but not less than GEL 500 and not more than GEL 10,000. If the applicant of initiating insolvency proceedings is a creditor, the state fee payable upon the submission of the application shall be 3% of the value of its claim, but not less than GEL 500 and not more than GEL 5 000 if the applicant is a natural person, and not more than GEL 10 000 if the applicant is a legal entity.

# Thank you for Attention!

**Gvantsa Saneblidze**

Junior Associate

[gvantsa.saneblidze@conse.ge](mailto:gvantsa.saneblidze@conse.ge)

[www.conse.ge](http://www.conse.ge)

