The Georgian Insolvency Law is on the move

Nana Amisulashvili reviews the recent changes in Georgia, expected to completely change the system

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Georgia's insolvency system is facing significant changes today. The new draft law is ready to be enforced and will completely change the system.

The current Insolvency Law of 2007 is appreciated as primarily oriented towards a rapid liquidation of insolvent corporate and private entrepreneurs' businesses with the subsequent distribution of remaining assets amongst the creditors. The number of insolvency cases dealt with by the local courts is fairly limited, most probably due to insufficient assets to cover the costs of the insolvency procedure. The law left many aspects of insolvency procedures either unclear or unregulated.

The need for reform

In 2016, an Insolvency Reform Sustainment Plan (hereinafter – the "Plan") was created within the framework of the project named Insolvency Reform Advocacy Campaign, implemented by The Association of Law Firms of Georgia (ALFG) and supported by The United State's Agency of International Development (USAID) project, named "Governing for Growth" (G4G).

The "Plan" provided an overview of the most significant problems and gave recommendations.

The most significant problems were:

- unreasonably high standards for commencement of proceedings;
- unusual long period before commencement of rehabilitation/reorganisation or bankruptcy/liquidation proceedings governed by the National Bureau of Enforcement, leaving no real chance for business;
- collateral issues, such as mortgage and pledge negated because all secured creditors, notwithstanding the ranking of their security right, were placed within the same rank, horizontally;
- no provisions for the rules of realisation of assets that have short shelf lives, are easily perishable or need to be sold immediately for any other objective reason, because the realisation of the assets was feasible only through public auction, which, in certain scenarios, diminished the recoverable amount and damaged the interests of creditors; and
- the rehabilitation plan could only be approved by the secured creditors, with 100% of votes.

> **THE NEW DRAFT LAW OFFERS MANY INCENTIVES FOR BUSINESS, WITH FLEXIBLE AND FAIR MECHANISMS MEANT TO ENCOURAGE EARLY APPLICATION**

The new draft law, developed on the initiative of the Ministry of Justice of Georgia, offers many incentives for business, with flexible and fair mechanisms meant to encourage early application. It also contains several truly bold new recommendations.

Commencement

Significant changes have been made regarding the commencement of insolvency proceedings. Due to the fact that the transitional period (trusteeship) appeared to be an obstruction, the new draft law will make rehabilitation/reorganisation or bankruptcy/liquidation proceedings accessible directly, without any such period. Also, procedures for opening the proceedings have become simpler and more easily accessible to creditors.

Secured creditors' rights

The mechanism of collateral will work in compliance with the principles and regulations of the Civil Code, meaning that the content of the right will not be materially altered due to the opening of the insolvency proceedings. Thus, the rights of secured creditors will be protected. In parallel, insolvency assets have been divided into two pools, thus creating an independent pool for unsecured creditors from assets that are not the object of security.

Approval of the rehabilitation plan

All unsecured creditors will have the right to vote. Secured creditors shall not have voting rights, except where, according to the rehabilitation plan, conditions of the agreement between debtor and secured creditor are to be changed. Nonetheless, secured and unsecured creditors are to vote on the rehabilitation plan separately. Also, a new cram-down mechanism has been inserted in the draft, which is a novelty for the Georgian insolvency system. Moreover, the court shall approve the rehabilitation plan, considering different circumstances and also the fact of whether compliance with the legal procedure for calling the creditors' meeting has been respected.

Deadline for and effect of the approval of the rehabilitation plan

The draft law strictly provides a maximum 12-month period for approving the rehabilitation plan. The automatic liquidation procedure will be initiated if the set deadline has been missed. This mechanism aims to motivate every participant and especially those in charge of the effectiveness of the rehabilitation plans. When the rehabilitation plan has been approved the official insolvency proceedings are closed. Under the current law, the formal insolvency procedure covers not only the improvement of the plan, but also the whole period of implementation.

Realisation of assets

The draft law provides a variety of mechanisms for the realisation of assets. In parallel, it contains safeguards for ensuring that the right to choose will not be abused in the process.

Trustees

A very dynamic political decision was made regarding the management of insolvent businesses. According to the draft law, this will be wholly entrusted to an experienced business manager (an insolvency practitioner) from the outset. As a result of this approach in the draft law, the first professional body of insolvency practitioners was founded by leading experts in this field. The Business Rehabilitation and Insolvency Practitioners Association's (BRIPA) purposes are to play the leading role in the regulation of profession, to promote the development of practice and to keep high professional standards in the insolvency system.

Ranking

The draft law offers a completely new ranking, in which the Revenue Service as a creditor is relegated to a lower priority so as to give a new chance to the business.

A new voluntary arrangement procedure

This is the most important change offered by the draft law, a new third procedure within the insolvency system, quite similar to pre-insolvency restructuring schemes. A voluntary arrangement is an agreement between the insolvent-to-be or already insolvent debtor and the creditors. The legal consequence of a voluntary arrangement is the full and irrevocable discharge of all liabilities of the debtor existing as at the moment of approving the voluntary arrangement and included in the arrangement. The procedure also includes a special moratorium. For the voluntary arrangement, it is not mandatory to meet the following conditions.

(a) To adhere to the proportionality principle throughout a distribution among non-secured creditors, in respect of those non-secured creditors who agreed to the voluntary arrangement, if the voluntary arrangement provides for a distribution;
(b) To identify creditors' claims and create a list of creditors in accordance with the rules established by the law. For the purposes of a voluntary arrangement, the debtor and the nominee of the voluntary arrangement can compile a list of creditors with simplified rules, which will fully allow the creditors to submit their claims.

A voluntary arrangement will be approved through a 75% majority of votes of voting creditors present at the meeting, provided they are not parties related to the debtor. A voluntary arrangement or a modification thereto may not be approved if:

(a) it affects the secured creditor's right of enforcement, except in cases when that creditor agrees to such a provision;
(b) a non-secured creditor is satisfied earlier than a preferential creditor, unless the preferential creditor agrees to such a provision; or
(c) a preferential creditor, in comparison to other preferential creditor(s), is satisfied in violation of the principle of proportionality, unless such satisfaction is approved by the relevant creditor.

Summary

These reforms are very welcome. Handing over insolvency management to private practitioners together with removing the transitional period for commencement and deadlines for approval of the rehabilitation plan are all measures that will drastically reduce the time and expense of insolvency proceedings. The new procedures and ranking system should serve as incentives for businesses to apply earlier for rescue. Thus, this brand new and innovative law will likely play a significant role in the development of the Georgian economy. ■

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