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BILL ON REHABILITATION AND COLLECTIVE SATISFACTION OF CREDITORS –

the culmination of a decade-long reform in insolvency

Georgia's primary law governing the insolvency of enterprises in Georgia [the Law of Georgia on Insolvency Proceedings] has long failed to meet both modern standards for insolvency legislation as well as the economic reality of Georgia.

The reasons behind this are numerous, and include but are not limited to: preferential treatment of secured creditors' interests, the monopoly of the National Bureau of Enforcement (NBE) to act as a trustee at the opening stage of the insolvency process, the inability of the judicial system to handle insolvency matters in a timely and efficient manner, excessive costs related to opening a case and fees to be paid to the trustee, rigidity of the law in the foreclosing of the insolvency estate, heavy reliance on court-administered auction and a lack of predictability for the involved parties.

Due to the above shortcomings in the law, the existing insolvency legislation has been subject to criticism by a number of international organizations (USAID's Governing for Growth Initiative, GIZ, European Bank for Reconstruction and Development, the World Bank, to name a few), which have prepared a series of research papers and organized a number of conferences, workshops and awareness raising campaigns to advocate for legislative changes.

As a result, the Georgian government initiated the drafting process of a completely new piece of legislation.

The Bill on Rehabilitation and Collective Satisfaction of Creditors was sent to the floor in March 2020. The working group that drafted the law was comprised of representatives of both the public and private sectors, amongst them was one of the partners of BLC Law Office.

This resulted in procedures and mechanisms with a unique understanding of the practice and sensitivities surrounding the insolvency proceedings. The following are the highlights of the bill:

- The bill abolishes the monopoly of the NBE to act as a trustee and introduces the profession of an insolvency practitioner, which will be licensed and supervised by the Ministry of Justice. However, insolvency practitioners will be representatives of the private sector with required experiences and qualifications for distress business management
- The bill introduces the concept of 'Company Voluntary Arrangement', a quasi-judicial and less formalistic procedure that enables the debtor to negotiate debt restructuring with its creditors and give them the comfort of having the arrangement approved by the court. If the CVA is not complied with, the process will automatically convert into bankruptcy or rehabilitation
- Secured creditors will no longer hold unnecessary privileges similar to approval of a rehabilitation plan. Their interests are mostly safeguarded through giving them the ability to foreclose over the collateral prior to completion of the insolvency process subject to the rehabilitation manager's right to suspend such foreclosure if the asset in question is necessary for archiving the rehabilitation. Should the rehabilitation manager exercise this right, then the debtor becomes liable to continue contractual payments to the secured creditors, as originally agreed under the relevant agreements

- The bill entirely changes the principles for the ranking of creditors. First and foremost, the waterfall included in the law applies in the case of bankruptcy only, while creditors have the freedom to determine the relevant ranking in the rehabilitation plan. In addition, the new law creates the notion of 'preferential claims' for employee claims and abolishes unconditional preferences of all tax claims reinforcing that only indirect taxes accrued over the period of 2 years immediately preceding the opening of insolvency regime shall be entitled to take precedence over the claims of unsecured creditors
- Historically, the number of rehabilitations were hurtled due to the inability of the Revenue Service to negotiate reduction of budget debts. The new law suggests that the creditors may approve the rehabilitation plan without the consent of the Revenue Service of Georgia if the rehabilitation plan provides for satisfaction of the principal amount of the relevant tax debts over a 5 year period. Notably, the law also tries to address private party troublemakers and introduces the notion of 'bankruptcy minimum'. This concept implies that certain creditors may be compelled to agree to rehabilitation and reduction of their claims if the amount they will recover as a result of rehabilitation plan is more than they would have received in case of the company bankruptcy. In calculating the bankruptcy minimum, the law takes the time value of money into consideration
- Court administered formalities are reduced to the maximum extent possible. Convocation of the creditors' meeting, preparing the creditors registry and similar tasks are now within the competence of the insolvency practitioner. Judiciary is left with the constitutional mandate to consider and resolve contentious matters only
- The new law provides for the possibility of debtor's management to remain in control, subject to the supervision of the rehabilitation supervisor. However, this must be approved by company creditors
- And last but not least, the law provides for the possibility of direct sale of assets, private tender and other forms of asset sale, as opposed to the court mandated public auction, which is the only realization mechanism under the existing law and which often proved to be the most ill fitted tool for the sale of a distressed business.

Historically, insolvency proceedings have not been used very often in Georgia, including, among other reasons, due to the cultural stigma attached. When the business community became more or less acquainted with this instrument, practice has shown that often it was abused by the parties involved. In most cases, the law failed to deter such abuses, since it lacked necessary procedures and statutory guidance. And without proper legislative guidance and the law being silent on critical issues, courts failed to achieve fairness of proceedings, as well as that of an outcome. The bill is an ambitious legislative initiative aimed at creating robust business rehabilitation and asset recovery framework. It has the ambition of procedural fairness, as well as equipping parties with the tools for equitable business solutions.

In these troubled times when the world is in economic recession, sound insolvency framework can give businesses distressed due to Covid-19 pandemic additional room to breathe. This is evidenced by the practice of more developed economies where insolvency is considered as one of the major tools for combating the hardships associated with economic recession. The existing Law on Insolvency Proceedings is simply unable to achieve the same result. Each day of delay is another lost opportunity for another business in Georgia. The ball is now in the hands of the Georgian Parliament to create the most important legacy for economic law making in modern Georgia.

Please apply for the professional advice prior to relying on the information given in this article. BLC and its team shall be ready and pleased to provide any information, legal advice and specific recommendations regarding the issues covered herein.

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