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NEWSLETTER

German Economic Team

GEORGIA

Georgia enacts modern insolvency law

On 1 April 2021, a new and modern insolvency law will come into force in Georgia, namely the law "On Rehabilitation and Collective Satisfaction of Creditors", which was adopted on 18 September 2020. This ends a long reform debate. The law brings a fundamental change in philosophy from the liquidation of the debtor company and the realisation of the insolvency estate to insolvency proceedings focused on the rehabilitation of the debtor and the preservation of jobs. The German Economic Team has supported the reform process for many years.

The arduous path to reform

The previous law "On Insolvency Proceedings" originally dates from 2007. The law was sharply criticised nationally and internationally by experts because of its lack of transparency, incompleteness and the one-sided preferential treatment of secured creditors. In addition, the state enforcement agency, the *National Enforcement Bureau* (NEB), had a dominant and partly monopolistic role in the liquidation of the debtor company. The position of insolvency practitioners was very weak under the previous law. The need for reform was also made clear by the fact that in the Doing Business Index, which shows excellent results for Georgia (2020: rank 7), the World Bank regularly gave the country the worst rating for the individual indicator *"Resolving Insolvency"* (2020: rank 64). Among others, the German Economic Team highlighted the weakness of the 2007 law and accompanied the reform process with policy advice for many years. The reform took place in a number of steps, also with the significant participation of the German GIZ. An internationally oriented law firm in Tbilisi speaks of the "culmination of a ten-year reform" in 2020.

Scope of the new insolvency act

The insolvency act applies to entrepreneurial activity in various legal forms, including non-commercial legal persons, unincorporated associations and cooperatives. However, it does not apply to individual entrepreneurs, physical persons and public law corporations. Foreign legal persons or other entities are also covered by the law if they have their main economic centre of interest in Georgia.

A special legislative measure of 2019 provides for separate treatment of bank insolvencies and insolvencies of certain investment firms. In this respect, Georgia follows the rules of the EU directive establishing a framework for the recovery and resolution of credit institutions and investment firms (2014/59/EU "BRRD"). There are also separate rules for insurance companies.

The new insolvency act applies to all insolvency applications filed on or after 1 April 2021. For earlier insolvency applications, the Insolvency Proceedings Act of 2007 will continue to apply.

Rehabilitation instead of liquidation

The change in philosophy can already be seen in the title of the law. The rehabilitation of the company is defined as the primary objective of the insolvency proceedings. If rehabilitation proves impossible, the insolvency estate is to be realised and the proceeds distributed to the creditors. Further objectives of the law are the speedy and consistent resolution of the debtor's financial problems, transparency and predictability of the proceedings, preservation and increase of the insolvency estate, promotion of the debtor's rehabilitation and equal treatment of creditors with comparable claims.

Reasons for insolvency and filing for insolvency

The grounds for insolvency are the debtor's insolvency and presumed insolvency. If the debtor's total liabilities, including contingent and future liabilities, exceed the total assets, over-indebtedness is assumed. This triggers the – albeit rebuttable – presumption of insolvency. In this case, insolvency does not arise only if there is a high probability that the debtor can continue its business activities and reduce its over-indebtedness.

The application for insolvency can be filed by the debtor, creditors or even insolvency practitioners as bankruptcy or rehabilitation managers or supervisors in regulated proceedings (see below). Earlier strongly restrictive regulations for filing an application no longer exist.

The new "regulated procedure"

The regulated procedure establishes an insolvency plan procedure that is carried out at the request of the debtor and under the supervision of a supervisor. The debtor can thus negotiate a debt restructuring and a continuation of business operations with the creditors in a less formalised manner. Accordingly, the goal is the continuation of the company as an operationally active entity. A central condition is that the creditors concerned are satisfied at least to the same extent as in bankruptcy proceedings. The role of the insolvency court is greatly reduced to reviewing the regularity of the proceedings. The regulated procedure requires a

resolution of the creditors' meeting with a 75% majority and excludes formal rehabilitation or bankruptcy proceedings in this case during its implementation.

Rehabilitation and bankruptcy proceedings

The two standard proceedings are the rehabilitation and the bankruptcy proceedings. The prerogative of the rehabilitation proceedings clearly results from the statutory objectives of the insolvency proceedings, the order of the provisions within the law and from the fact that a bankruptcy application can no longer be filed after an application for the opening of the rehabilitation proceedings has been filed. However, rehabilitation proceedings presuppose that the creditors as a whole can be expected to receive more than in the case of bankruptcy proceedings and that each individual creditor also receives more than in the case of the debtor's bankruptcy.

Legal acts prior to the opening of rehabilitation proceedings may be challenged if creditors are disadvantaged by the intentional weakening of the insolvency estate or if a disposition is made without or with inadequate compensation.

If the rehabilitation proves to be unsuccessful or if the rehabilitation plan is not approved, the rehabilitation proceedings are replaced by bankruptcy proceedings. The consequence is the realisation of the insolvency estate with the aim of collectively satisfying the creditors.

The profession of insolvency practitioners

The weak position of insolvency practitioners was a central point of criticism of the previous regime. This was accompanied by a dominant role of the NEB as trustee over the insolvent company, manager in many bankruptcy cases and auctioneer in the realisation of the insolvency estate. The new law greatly upgrades the insolvency practitioners. In future, the NEB will primarily act as a regulatory authority for the profession of insolvency practitioners.

Evaluation

With the new insolvency law, Georgia has taken a remarkable step and adopted a law that can be classified as modern and in line with international best practice. The decisive change is the shift in philosophy from liquidation to rehabilitation. This enables the debtor's owners to get a "second chance" and to reduce or avoid the stigma of insolvency. The strong preferential treatment of secured creditors and the tax authorities was considerably reduced. An insolvency plan procedure was introduced and the profession of private insolvency practitioners was strongly upgraded. As a result, the role of the state enforcement agency NEB is changing from a partly monopolistic, significant actor in insolvency proceedings to a regulator for insolvency practitioners.

Georgia's legislative approximation to EU legislation, which is a goal stated in the Association Agreement of 2014, has thus been followed by the country in the area of insolvency law. A further phase in the introduction of the new law must now take place, the phase of training all those involved in insolvency proceedings, not least the insolvency practitioners. Since insolvency law is developing very dynamically, attention is being drawn to areas that have been missing up to now. The creation of a consumer insolvency law is recommended and thought should also be given to an out-of-court and pre-insolvency rehabilitation framework for companies.

With the new insolvency law, Georgia has successfully completed a difficult reform process that has taken many years. The feared insolvency of the Georgian insolvency law has thus been remarkably averted.

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A thorough analysis of the new law is provided in Technical Note 06/2020. For a review of the previous law, see Policy Paper 01/2016.

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