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GEORGIA

Law and Practice

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1. State of the Restructuring Market

1.1 Market Trends and Changes

Georgia and the European Union

Georgia is trying hard to strengthen its relationship with the EU as envisaged by the EU-Georgia Association Agreement, but is facing several important economic and legal changes, with the focal point of harmonising the corresponding EU legal acquis into domestic legal culture. The changes associated with filling the legal gaps with country-specific modifications have affected almost all sectors, with labour, competition, corporate, insolvency, consumer protection, data protection, tax and financial regulations taking the lead.

Taking effect in early 2020, the VAT regulations were completely altered, to align the tax legislation with the EU VAT Directive. A new Law on Investment Funds has been established, which aims to create basic principles on the foundation of investment funds and asset management companies, and to define the operational capacities thereof. The Law of Georgia on Entrepreneurs came into force on 1 January 2022, creating a completely different and solid playing field for the establishment and operation of entrepreneurial entities in Georgia. It transposes regulations on conflicts of interest, the expulsion/departure of a partner and the reorganisation, dissolution and liquidation of a company, and grants higher protection standards to minority shareholders. It is noteworthy that joint stock company (JSC) rules are completely modernised, with the law setting a requirement for JSCs to have minimum authorised capital of GEL100,000 for establishment purposes.

Labour Code of Georgia

Important amendments have been introduced to the Labour Code of Georgia, including rules on discrimination, internships, contract forms and the termination thereof, night and day shift determination and working hour records, and employee accountability. The law also set out essential conditions for labour agreements. Considering the labour migration rates in Georgia, the regulations regarding their employment have been closely examined and utilised.

Competition Law

From a competition policy perspective, supplementary rules on concentration, sanctions, fines and enforcement have been laid down, making it possible to achieve the goal of reaching EU standards. A new Law on Consumer Rights Protection entered into force on 1 June 2022, focusing primarily on consumers and traders entering into civil-legal relationships with each other. The law regulates various consumer areas, including distance contracts, off-premises contracts, misleading advertising and commercial practice, and unfair contract terms. Law enforcement is supervised by the consumer protection department of the Georgian National Competition Agency, which will start operating from 1 November 2022.

The Banking Sector

It is also noteworthy that heightened regulations in the banking sector on borrowing standards and anti-money laundering policies have deeply affected the business environment. There have been some parliamentary discussions regarding the establishment of “micro banks”, which will appear in the financial market from next year under the supervision of the National Bank of Georgia. With the adoption of the draft law on micro banks, a medium-sized, stable business model and high-reputation financial institution

will be created in the financial sector, focusing on promoting credit facilities to small and medium-sized entrepreneurial and agricultural activities.

Law on Rehabilitation and Collective Satisfaction of Creditors

This new law came into force on 1 April 2021 and is playing a vital role in Georgia's legal modernisation. It contains completely new, modernised procedures for insolvency proceedings and develops entirely fresh policy standards. However, the business sector is struggling to align its policies with these new developments, specifically the emerging need for additional adaptability, time and expertise directly affecting the restructuring market. It is also noteworthy that the Insolvency Practitioners Association has become fully functional by involving authorised practitioners and developing a code of ethics to support the deployment of this profession.

COVID-19

Beyond legal implications, the economic restraints associated with the COVID-19 pandemic and the country's internal and external political fluctuations have exerted significant influence on the state of the restructuring market. The hospitality, tourism and aviation sectors had been severely affected by the COVID-19-related restrictions on economic activity, which also affected foreign direct investments and export opportunities.

With the end of the COVID-19 pandemic, however, Georgia's gross domestic product advanced by 7.1% year-on-year in the second quarter of 2022, following a 14.9% growth in the previous period. The country is now experiencing huge inflows of victims of the Russian aggression in Ukraine, which has exerted a great influence on real estate businesses, raised prices and created a high demand over the market. This has also encouraged a decrease in unemployment rates within the country and made Georgia a very appealing place for investments for business entities.

The depreciation of the national currency (GEL) is currently halted, but the distrust in the local currency created by the hyper-inflation period created remains unchanged. The great challenge for the country is the young labour force outflow, mainly to the EU, the UK and the US, in search for better labour conditions. This is especially relevant in the service, construction and agricultural industries.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of Laws and Statutory Regimes

The new Law on Rehabilitation and Collective Satisfaction of Creditors came into force on 1 April 2021, replacing the Law of Georgia on Insolvency Proceedings of 2007 and introducing a completely modernised restructuring policy in the country. The new law applies to cases that were commenced after its effective date, while the 2007 law remains applicable to ongoing cases launched before 1 April 2021.

The new law regulates the insolvency regimes of business entities, non-commercial legal entities, unregistered unions and partnerships. Unlike its predecessor, the new law excludes individual entrepreneurs from its scope and does not apply to insolvencies of physical persons, legal entities of public law, banks, non-banking deposit institutions and insurance companies, with the latter being subject to the Law of Georgia on

Commercial Bank Activities and the Organic Law of Georgia on the National Bank of Georgia.

2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership

There are two main regimes under which formal insolvency proceedings can be carried out in Georgia: rehabilitation and bankruptcy, with the former being prioritised over the latter. While these options are conducted under the direct supervision of the judiciary, granting it an active role in the process of recovery, the new law introduces a tool similar to a voluntary arrangement called a "regulated agreement", which is an agreement between a creditor and a debtor prior to any insolvency proceeding, directed towards the rehabilitation and remediation of the debtor.

2.3 Obligation to Commence Formal Insolvency Proceedings

Under the new law, a person authorised to manage and represent a debtor is obliged to file an application to initiate insolvency with the court no later than three weeks after the statutory criteria for insolvency are met. Failure to fulfil this obligation results in criminal liability under the Criminal Code of Georgia.

This duty is also reflected in the new Law of Georgia on Entrepreneurs.

2.4 Commencing Involuntary Proceedings

According to the new law, every creditor and debtor is entitled to commence involuntary proceedings if the statutory criteria for insolvency are met – ie, in the actual insolvency or expected insolvency of a company. Unlike its predecessor, the 2021 law introduces a presumption of insolvency that eases the burden of proof on creditors.

2.5 Requirement for Insolvency

While a debtor is generally regarded to be insolvent if they are unable to cover matured liabilities, the expected insolvency shall exist if there are reasonable grounds to presume that a debtor will become insolvent. The rationale behind insolvency presumption is that not every creditor could be aware of a debtor's actual financial distress, so filing an application becomes admittable if one of the criteria in the presumption test is met.

A debtor is presumed to be insolvent until the contrary is proved by the debtor. The criteria range from tax arrears to asset and liquidity tests, records in the Registry of Debtors and suspension of activities.

2.6 Specific Statutory Restructuring and Insolvency Regimes

The insolvency regimes for banks, non-banking deposit institutions and insurance companies are regulated by the Law of Georgia on Commercial Bank Activities and the Organic Law of Georgia on the National Bank of Georgia (NBG), as well as the decrees of the President of NBG that have recently been adopted, focusing on enhancing standards for the resolution framework according to EU laws. The applicability of substantially different rules is associated with financial stability and systemic risks of bank failure.

It is noteworthy that public entities are also subject to specific statutory requirements.

3. Out-of-Court Restructurings and Consensual Workouts

3.1 Consensual and Other Out-of-Court Workouts and Restructurings

The regulated agreement as a tool for consensual restructuring is a fresh concept in the Georgian restructuring framework. It entails a process of negotiations to reach an agreement in accordance with the procedure established by the law between an insolvent debtor or a debtor facing expected insolvency and its creditors. Under such agreement, each creditor shall receive at least the amount they would have received in the bankruptcy of the debtor, unless the creditor agrees to a different satisfaction under a regulated agreement. The purpose of a regulated agreement is to maintain a debtor as an operating undertaking, thereby excluding the liquidation thereof under such agreement, which can only be conducted under the direct supervision of the regulated agreement supervisor – an authorised insolvency practitioner.

This tool was introduced on 1 April 2021, and market participants seem to be reluctant to accept it as an outcome of insolvency. The initiation of a consensual restructuring is at the sole discretion of a debtor. No regulated agreement has yet been formed.

3.2 Consensual Restructuring and Workout Processes

Regulated Agreement

The debtor is eligible to commence the procedure for a regulated agreement. The first step is to make a proposal that includes a report on the activities of a debtor and its condition, a notice that a moratorium will be used, the personal attitude of the debtor regarding why the conclusion of a regulated agreement is desirable and appropriate, and the reason creditors are expected to support a regulated agreement. Specifically, the following must be referenced:

- ways to meet, modify, postpone or otherwise regulate the liabilities of an undertaking;
- measures to be taken against a creditor who is a person related to a debtor;
- information on whether the proposal envisages new monetary assets, credits and/or guarantees, and a description of the respective conditions, including whether or not a security measure will be used in respect of the property of a debtor;
- detailed information about the new sources of financing proposed to a debtor, and ways of meeting liabilities arising out of those sources;
- ways and methods to dispose of funds attracted to and/or intended for a regulated agreement, before said funds are distributed among the creditors;
- ways to pursue the activities and business of the debtor during the term of a regulated agreement; and
- the term of a regulated agreement and the procedures for the extension thereof.

The report may also include a debtor's security guarantees against the risk of and expenses for rescission if the debtor shifts to rehabilitation or the bankruptcy regime.

Supervisor's report

The proposal is examined by the insolvency practitioner, who decides on the feasibility thereof and submits a corresponding report within 30 days of receiving a notice from the debtor. The supervisor is entitled to request additional information from the debtor.

The supervisor's report could be positive or negative depending on whether or not it is likely

to be approved and fulfilled by the creditors, and on whether or not the debtor has sufficient monetary assets to carry on activities during the period of a moratorium.

Within five days of receiving a positive report, the debtor submits it and the proposal to the court, which decides on formal compliance with the requirements of an application and approves a moratorium for two months. If the creditors' meeting opts to prolong the negotiation to conclude an agreement, the court may extend the moratorium for this period, but for no longer than two months.

Creditors' meeting

Generally, the regulated agreement is approved by the creditors' meeting. An invitation shall be sent no later than 14 days before the date of this meeting. The support of at least 75% of attending creditors with voting rights (who are not persons related to a debtor) is required to approve a regulated agreement or an amendment thereto. However, no regulated agreement can be approved if it affects the rights of a secured creditor to enforce the provision of security, nor if a non-secured creditor is satisfied in a preferential manner compared to a preferential creditor, whereby a preferential creditor is satisfied in violation of the principle of proportionality compared to another preferential creditor, unless these are explicitly agreed between the parties.

The regulated agreement becomes binding on all creditors, except for a creditor who was not invited to the meeting due to the fact that the supervisor of a regulated agreement was not, or could not have been, aware of the existence of said creditor. Where such a creditor is identified after the approval of a regulated agreement, and where such creditor would have had a voting right if they had been invited to the creditors' meeting, the supervisor of a regulated agreement shall immediately notify the creditor of the right to submit their claim in writing as of the date of the approval of the regulated agreement. If a claim is not submitted within one month of the notification, the supervisor may exclude the creditor from the circle of creditors who are parties to the regulated agreement.

3.3 New Money

There are no specific rules addressing new money; the issue follows the general principles of insolvency proceedings and is subject to negotiations between the parties. However, new claims that arise during the insolvency proceedings are prioritised above the claims that arose before. This intrinsically creates additional guarantees for the protection of new money.

3.4 Duties on Creditors

While the law does not explicitly mention creditors' duties and the permissible scope in the workout strategies, there is a general doctrinal obligation to act in good faith, disclose all corresponding information to the negotiations and accept the standards set by the law ensuring collective satisfaction of creditors, including abiding with a non-discriminatory policy and a duty not to operate or vote in an oppressive manner.

Unless otherwise provided by the law, a creditor is deprived of the right to lodge a claim against a debtor or to initiate or pursue a dispute on the claim regulated by a regulated agreement, unless the regulated agreement is breached. Beyond that, the courts are empowered to order additional moratorium measures that oblige creditors to continue providing essential services to the debtor, so long as the debtor meets the current payments.

3.5 Out-of-Court Financial Restructuring or Workout

As no regulated agreement has yet been implemented in Georgia, the merits and effects of such agreements are difficult to assess. Theoretically, there are only three main requirements for the agreement to become feasible (see **3.2 Consensual Restructuring and Workout Processes**) and parties are free to negotiate for more by following the general principles of insolvency proceedings.

4. Secured Creditor Rights, Remedies and Priorities

4.1 Liens/Security

Two forms of security are widespread in Georgia.

- Mortgages are used over an immovable property – by holding a mortgage right, the creditor's (mortgagee's) claim is secured in case of breach of obligations.
- Pledges are used over a movable thing and/or intangible property. The pledgee acquires the right to satisfy their claim by selling or, if the parties so agree, by taking possession of the pledged property if the debtor does not fulfil their obligation or does so improperly.

A mortgage enters into legal force from the moment of registration in the Public Registry. If more than one mortgage right is attached to the immovable property, the extract from the Public Registry will reflect the rank of the registered mortgage rights according to the first registered principle.

The Civil Code of Georgia distinguishes between two types of pledges:

- a possessory pledge, whereby the pledged item is transferred into the possession of the pledgee or a third person designated by the pledgee; and
- a registered pledge, in which it is necessary to register the right of pledge in the public register, except for the pledge on vehicles, which shall be registered in the Service Agency of the Ministry of Internal Affairs of Georgia.

Pledges on financial collateral are also available, which are regulated pursuant to the Law of Georgia on Financial Collateral, Netting and Derivatives.

Intellectual property rights such as patents, trade marks and designs can also be subject to a pledge, which shall be registered at the National Intellectual Property Centre (*Sakpatenti*).

Interestingly, the new Law on Rehabilitation and Collective Satisfaction of Creditors explicitly provides that the term "secured creditor" means only those creditors whose claims are secured by a mortgage or pledge in accordance with the Civil Code of Georgia; the tax authority is no longer automatically deemed a secured creditor.

4.2 Rights and Remedies

Enforcement Procedures

Generally, if a debtor fails to fulfil its secured obligations, a creditor can commence enforcement proceedings to satisfy its claims. The procedure follows the Civil Code of Georgia and the applicable agreement signed between the parties. The following types of enforcement procedure are common:

- by auction;
- by directly transferring the mortgaged/pledged item into the ownership of the creditor;
- by the creditor selling the item; and
- based on a writ of execution issued by the notary.

Banks and microfinance organisations are the main sources for financing businesses in Georgia. Their claims are often secured, so they represent secured creditors in insolvency proceedings.

Prior to the entry into force of this law, a tax claim was also regarded as a secured claim if the tax authority issued a pledge/mortgage on the debtor's property in accordance with the tax legislation. Nowadays, a tax claim does not meet a standard of secured claim, unless a tax claim is restructured and becomes secured by a pledge or mortgage on the basis of a new contractual arrangement.

One of the novelties introduced by the new Law on Rehabilitation and Collective Satisfaction of Creditors is that secured creditors are better preserving the legal linkage with the secured item used for security during the rehabilitation process, making them authorised to request the rehabilitation manager/supervisor to release the item from moratorium and sell it independently if the item is not necessary for achieving the rehabilitation aim.

If the rehabilitation manager/supervisor rejects such a request, then the secured creditor can address the court, where the burden of proof that the item is necessary for rehabilitation lies with the rehabilitation manager/supervisor.

It is noteworthy that a secured creditor does not have a voting right in the process of endorsing a draft rehabilitation plan, unless the draft rehabilitation plan provides for a change of the terms and conditions of the agreement concluded between the debtor and the secured creditor. Moreover, a draft rehabilitation plan shall be put to the vote separately by secured creditors and non-secured creditors. Thus, the participation of both types of creditors is guaranteed in the process. Ultimately, the approval of a draft rehabilitation plan is subject to judicial control.

During bankruptcy proceedings, secured creditors of the first rank are authorised to request the bankruptcy manager to sell the secured property in accordance with the respective mortgage/pledge agreement. If the amount received from the sale exceeds the claim of a creditor of the first rank, the claims of creditors of each following rank registered for the item in question shall be satisfied by the excess amount, and any remaining amount shall be included in the insolvency estate.

The law directly prohibits the approval of a regulated agreement and/or amendment therein by the creditors' meeting if it affects the right of a secured creditor to enforce the provision of security, unless the secured creditor agrees to such.

4.3 Special Procedural Protections and Rights

Secured creditors enjoy advantageous positions in that they are empowered with a right of separate satisfaction (see **4.2 Rights and Remedies**).

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities

Secured creditors in both the rehabilitation and bankruptcy regimes are given special remedies to satisfy their claims by selling the secured item, except in the circumstances provided by law. With that logic, claims of secured creditors are not listed in the waterfall of claims.

Interestingly, the ranking, as such, is envisaged only for the bankruptcy regime, while in the rehabilitation regime the process is more flexible and subject to negotiation between the stakeholders. However, certain requirements must be fulfilled, such as:

- rehabilitation costs shall be satisfied preferentially, without prejudice to the rights of secured creditors; and
- the same applies to a new creditor's claims, which shall also be satisfied preferentially unless the creditor in question agrees to different satisfaction.

As a further point, judicial control over the approval of a rehabilitation plan ensures that important principles will be guaranteed.

5.2 Unsecured Trade Creditors

The law does not specifically address the term "unsecured trade creditors"; such creditors fall under the category of unsecured creditor and enjoy the same rights and remedies.

5.3 Rights and Remedies for Unsecured Creditors

Certain rights and remedies are available for unsecured creditors in Georgia, as follows:

- unsecured creditors can initiate insolvency proceedings against the debtor in both rehabilitation and bankruptcy;
- an unsecured creditor's participation in a creditors' meeting is guaranteed;
- any creditor (including unsecured) whose claim has been approved has the right to vote on the subject matter of the creditors' meeting, unless otherwise provided by the law;
- unsecured creditors have the right to vote in the process of endorsing a draft rehabilitation plan; and
- unsecured creditors have the right to file a private complaint against the ruling of the court in the insolvency process if the ruling has been delivered against them or relates directly to them.

5.4 Pre-judgment Attachments

Outside of insolvency proceedings, pre-judgment attachment is an available legal mechanism envisaged by the Civil Procedure Code of Georgia. The civil courts use pre-judgment attachment upon the request of the applicant.

In general, the following conditions should be met in order to use pre-judgment attachment:

- pre-judgment attachment should balance the interests of both parties;
- pre-judgment attachment should be necessary; and
- the enforcement of a future decision would become difficult or even impossible without pre-judgment attachment.

However, after opening an insolvency case, no new procedural security measures shall be applied, and already imposed procedural security measures shall be abolished.

5.5 Priority Claims in Restructuring and Insolvency Proceedings

During bankruptcy, an insolvency estate must be distributed in a strict order adopted by the law.

Firstly, the expenses of the bankruptcy regime should be covered – ie, court process expenses, remuneration of a bankruptcy manager, expenses deriving from labour relations during bankruptcy proceedings, the expenses of property management, and the expenses of various professional services purchased by the decision of a manager.

Secondly, new debts should be satisfied, including tax liabilities arising after the commencement of bankruptcy proceedings.

Thirdly, groups of creditors should be satisfied in the following order:

- preferential claims – which means three months' salaries and leave payable before a court declared an application for insolvency admissible (except for the expenses of salaries and leave of the directors of a debtor and members of a supervisory board, as well as their family members), as well as amounts payable due to occupational injury (for no more than GEL1,000 per creditor);
- preferential tax claims – which means indirect taxes (VAT, excise duties, income tax) provided by the Tax Code of Georgia, originating in the three tax years before a court declared an application for insolvency admissible;
- unsecured claims;
- claims arising as interest and fines accrued on the liabilities existing before declaring an application for insolvency admissible, administrative fines and other monetary liabilities deriving from administrative offences, and fines and penalties charged in accordance with the Tax Code of Georgia;
- non-preferential claims – which means a creditor claim, the satisfaction of which in a non-preferential manner was agreed between the debtor and the creditor in advance; and
- obligations arising from corporate relations (the payment of dividends, the redemption of shares and the return of contributions).

6. Statutory Restructuring, Rehabilitation and Reorganisation Proceedings

6.1 Statutory Process for a Financial Restructuring/Reorganisation

Rehabilitation Plan

The legislative purpose of the rehabilitation regime is to adopt a rehabilitation plan, which is a document aiming to achieve the survival of a debtor on the one hand, and the satisfaction of creditors' claims on the other.

The rehabilitation plan is generally prepared by the rehabilitation manager/supervisor. The new Law on Rehabilitation and Collective Satisfaction of Creditors details what the content of the rehabilitation plan should be – from technical information about the corporate structure of the company, creditors' claims, the name of the manager/supervisor, etc, to substantive issues such as a proposal for how rehabilitation must be achieved.

Creditors' endorsement

Firstly, the prepared rehabilitation plan is submitted to the creditors to obtain their endorsement; secured and unsecured creditors vote separately. In any case, the unsecured creditors enjoy voting rights, while the secured creditors have voting rights only if the draft rehabilitation plan

provides for a change of the terms and conditions of the agreement concluded between the debtor and the secured creditor.

The votes of those creditors that are affiliated to the debtor are not taken into consideration in endorsing the rehabilitation plan. Whether or not a creditor is affiliated with a debtor is reviewed by the rehabilitation manager/supervisor.

When one of the creditors is the tax authority, its consent is deemed to have been granted if a draft rehabilitation plan provides for the full payment of the principal amount of tax claims through the equal satisfaction of claims annually, no later than five years from the entry into force of the draft rehabilitation plan.

A draft rehabilitation plan shall be endorsed by a simple majority of votes of unsecured creditors and by a simple majority of votes of secured creditors with voting rights. The number of votes creditors have is determined according to the following rule: a claim for GEL1 equals one vote.

Court approval

Afterwards, the endorsed rehabilitation plan is submitted to the court for approval. The court approves the plan if certain procedural requirements have been duly executed. The court will not approve the plan if:

- the payment of preferential debts is envisaged in a way that does not mean the payment thereof in a prioritised manner as compared to non-preferential debts, unless there is consent from a relevant creditor;
- the principle of proportionality is violated in the groups of preferential creditors and non-secured creditors, unless there is consent from a relevant creditor;
- a creditor does not accept or does not maintain at least the value of their claim which they would have accepted on the basis of a ruling declaring an application for insolvency admissible and opening a bankruptcy regime, unless there is consent from said creditor;
- a secured creditor will receive less than they would have received from the sale of property used as collateral, unless there is consent from said creditor; and
- new creditors' claims are not protected in accordance with the procedure established by law.

If the creditors' meeting does not endorse the plan, the court is authorised – upon application from the rehabilitation manager/supervisor – to set aside the creditors' decision (rejection) and approve the plan if the following conditions are cumulatively met:

- a group of unsecured or secured creditors has endorsed the proposed draft rehabilitation plan by a majority; and
- a court considers that the draft rehabilitation plan will be implemented, and the rights of creditors are protected.

After it is approved, the rehabilitation plan becomes binding upon all parties and persons to whom said plan applies, and also upon the creditors whose claims have not been accepted, as well as the creditors who voted against the rehabilitation plan.

Deadlines

In insolvency proceedings, time has an even greater value, so deadlines are imposed by the law. The rehabilitation manager/supervisor has two months after opening the insolvency case to prepare the draft rehabilitation plan and submit

it to the creditors. This period can be prolonged by no more than one month.

Creditors have six months after opening the insolvency case in which to endorse the rehabilitation plan, which can be prolonged, on one occasion, by no more than three months.

Ultimately, the rehabilitation plan enters into force upon its approval by a court, unless the rehabilitation plan envisages a different date of entry into force, which shall be no later than one month after the court approval thereof.

6.2 Position of the Company

The opening of an insolvency case is associated with moratorium measures, which generally support the debtor to retain the status quo and operate the business.

Certain moratorium measures become automatically effective once the rehabilitation or bankruptcy regime is opened, including the measure that no new liabilities shall be assumed. However, the court is authorised to cancel this moratorium measure if it is necessary to attract additional financial resources in order to facilitate rehabilitation, and if the moratorium measure prevents or essentially impedes the achievement of this goal. In this case, the applicant must prove and substantiate that assuming new liabilities will not worsen the condition of the creditors.

After the opening of an insolvency case by way of the rehabilitation regime, the court initiates an automatic process to select an insolvency practitioner, who will engage in the process as a rehabilitation manager or rehabilitation supervisor.

If a debtor (its directorate) stays in charge, then the rehabilitation supervisor is appointed. In all other cases, the debtor's management body is kept apart and the rehabilitation manager is designated to lead both the company and the rehabilitation process.

6.3 Roles of Creditors

Creditors' decisions are made at the creditors' meeting, which is prepared and organised by the court. Any creditor attending a creditors' meeting may comment, express opinions and ask questions concerning the issues under review.

Any creditor whose claim is accepted has the right to vote at the creditors' meeting, except in the exceptional cases established by law. A creditors' meeting shall be duly constituted (authorised to adopt decisions) if it is attended or represented by more than 50% of the total votes of creditors. A creditors' meeting shall make decisions by a simple majority of votes of attending and present creditors, unless otherwise provided by law.

The endorsement of a rehabilitation plan is voted on separately by unsecured and secured creditors with voting rights.

Interestingly, a creditors' meeting shall not be called if a creditor who holds more than 50% of the votes consents to the issues to be reviewed through the electronic system. Such consent shall be equal to the minutes of the creditors' meeting, and shall be deemed to be a decision of the creditors' meeting.

Creditors have access to all information submitted in the electronic system during the insolvency proceedings, including the full financial situation of the debtor, the creditors' registry, etc, except for the debtor's commercial secret information.

6.4 Claims of Dissenting Creditors

If one group of creditors does not endorse the plan but another group does, the court may cram down the obstructive group and approve the plan if it considers that the draft rehabilitation plan will be implemented and the rights of creditors will be protected (see **6.1 Statutory Process for a Financial Restructuring/Reorganisation**).

6.5 Trading of Claims Against a Company

Georgian insolvency law does not restrict a claim being traded to another person, but the general requirements under civil law governing such transactions must be met.

An important practice has developed in court regarding an affiliated creditor and its voting rights. Despite the fact that the affiliated creditor alienated a claim to a third party, the court did not change the status of the claim in the creditor's registry and still deprived the creditor of voting rights. While such decisions are at the sole discretion of a court, they challenge the implementation of the law and need to be addressed on a solid legal basis.

In an insolvency context, notification from the rehabilitation manager/supervisor about the transaction must be supplied in order for the claims to be duly reflected in the creditors' registry.

6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group

This mechanism is not provided under Georgian insolvency law. The insolvency process is conducted individually toward the companies creating a corporate group.

6.7 Restrictions on a Company's Use of Its Assets

The debtor continues its business operation under the rehabilitation regime, and can be guided by the rehabilitation manager or debtor in management. It is noteworthy that a transaction that goes beyond the ordinary course of business of a debtor may be implemented by a rehabilitation manager with the consent of a creditors' meeting. Overall, the best interests of creditors should be taken into consideration while using the debtor's assets.

6.8 Asset Disposition and Related Procedures

The insolvency practitioner can sell or otherwise dispose of the debtor's assets via auction or through a contract. The rehabilitation manager is authorised to perform all activities necessary to sell the property of a debtor. There is no rule preventing existing creditors from taking part in an auction.

Following the release from a moratorium and the sale of property used as collateral, all the rights in rem to the property ranking after the satisfied creditor shall be annulled.

6.9 Secured Creditor Liens and Security Arrangements

The secured creditors hold a special right (see **4.1 Liens/Security**); if their claims are satisfied, then the mortgage/pledge over the item is lifted.

6.10 Priority New Money

The rehabilitation manager is authorised to conclude a loan agreement or to otherwise attract a new financial source. For that purpose, the rehabilitation manager can use the assets of the company as security. A general restriction applies whereby creditors' consent is necessary

if the transaction goes beyond the ordinary business operation of the debtor.

Pre-existing secured creditor liens/securities are still in force and every following lien or security will be appropriately ranked in the row.

6.11 Determining the Value of Claims and Creditors

Once insolvency proceedings are opened, the manager or the debtor in management is responsible for notifying the creditors of the commencement of the insolvency process and the amount of debt the debtor presents at that stage.

Afterwards, creditors shall provide their claims if they differ from the amount presented by the debtor. Ultimately, the manager/supervisor examines the claims and creates a creditors' registry, including only those claims that are well founded. The manager/supervisor has 60 days after opening an insolvency case to create a creditors' registry. The manager/supervisor is not authorised to accept the fine and undue percentage if both exceed the principal amount of debt by 10%.

As a next step, the manager/supervisor shall submit the creditors' registry to an electronic system. Within ten days of the registry being published, the debtor or the creditor is authorised to bring a complaint regarding the registry (eg, if the amount reflected in the registry is not satisfactory for them). This case shall be reviewed in an expedited manner. If the result of such complaint is negative for the complainant, then they can bring an individual claim against the debtor outside the insolvency case, provided that moratorium measures do not restrict such action.

6.12 Restructuring or Reorganisation Agreement

The rehabilitation plan requires final approval from the court. In certain cases, the court is authorised to reject the plan, even if it has been endorsed by creditors (see **6.1 Statutory Process for a Financial Restructuring/Reorganisation**).

The rehabilitation plan may include the following:

- the survival of a debtor as an operational undertaking, resulting in the full satisfaction of creditors' claims, unless a creditor whose claim is reduced agrees to the reduction; or
- the achievement of better results by a unity of creditors as a whole than would have been possible in the case of the immediate bankruptcy of the debtor, given that each creditor receives at least as much as they would have received in the immediate bankruptcy of the debtor. This might involve the survival of the debtor as an operational undertaking, as well as the full or essential alienation or management of its property for the purpose of the long-term satisfaction of creditors.

A rehabilitation plan prepared based on the first idea shall be given preference.

If all parties agree to withdraw the debtor from any contractual relationship and this understanding is covered in the rehabilitation plan, then an insolvency practitioner may disclaim or reject such contract.

6.13 Non-debtor Parties

Georgian insolvency law does not explicitly envisage a statutory procedure for releasing non-debtor parties from liabilities. The responsibility of the non-debtor party is determined by a separate agreement concluded with a creditor,

and release from liabilities is respectively regulated between them.

Practically speaking, the following types of non-debtor parties may affect insolvency proceedings:

- a guarantor;
- the owner of the mortgaged/pledged property; and
- the owner of the items subject to leasing.

The insolvency law gives these non-debtor parties the right to exempt their property from the insolvency estate. Property rights are recognised as being absolute towards the relationships arising out of security obligations; the procedure follows the general civil law requirements.

6.14 Rights of Set-Off

Creditors have a right to set-off mutual claims with the debtor, but this right can only be exercised when a respective claim shall be satisfied.

The law lists the following limitations under which set-off is prohibited:

- when the creditor's claim is not recorded in the creditors' registry;
- when the obligation of a creditor to a debtor arose within 90 days before the opening of the insolvency case and the creditor assumed this obligation for the purpose of setting-off the claims;
- when a creditor acquired a claim from another creditor within 90 days before the opening of the insolvency case or after the opening of the insolvency case; and
- when the claim of a creditor has arisen due to an action that is subject to dispute.

A decision on the set-off of mutual claims arising after the opening of the insolvency case shall be made by a manager or by a debtor in management, with the consent of a rehabilitation supervisor.

6.15 Failure to Observe the Terms of Agreements

If a rehabilitation plan is violated, a creditor may file an application for insolvency with a court requesting the opening of a bankruptcy regime in respect of a debtor, except in cases when the breach of a plan is minor by its nature.

6.16 Existing Equity Owners

The owners of the company (shareholders, partners, etc) retain their ownership rights in the capital of the company, but the interests of the creditors in terms of satisfaction prevail in the insolvency process.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Voluntary/Involuntary Proceedings

The new law openly prioritises the rehabilitation regime over bankruptcy – where the collective satisfaction of creditors' claims cannot be achieved through rehabilitation, it shall be achieved through the distribution of proceeds from the sale of an insolvency estate.

Application

Although they are subject to slightly different technical requirements, the insolvency proceedings under both regimes begin with the application of a creditor or a debtor. The insolvency practitioner is also eligible to file an application by requesting the conversion of regimes. Unlike its predecessor, the new law includes a require-

ment to indicate the choice of regimes at the very beginning. If a creditor asks to open insolvency proceedings against a debtor, the latter has seven days after receiving a notice from court to stipulate its position upon a creditor's application. The court may rule on the opening of insolvency proceedings only after hearing both parties' viewpoints. This development abolishes the conciliation board, which took decisions on insolvency regimes under the law of 2007.

It is also noteworthy that an application for insolvency and the accompanying information shall be confirmed by a statement of truth – ie, confirmation that the information submitted by an applicant is accurate and comprehensive, as far as is known to the applicant.

The court reviews the issue of declaring an application for insolvency admissible by holding an oral hearing. If the facts of the case are not disputed, a court may review this issue without an oral hearing. Where an application for insolvency is filed by a debtor, admissibility issues are decided within seven days of the filing; in the case of a creditor filing, they are decided within ten days of a document confirming the serving of a letter of a court on a debtor being submitted to the court. When the court rules on an application's admissibility, an insolvency practitioner is appointed and a moratorium imposed, thereby opening one of the regimes.

Refusal

It is also noteworthy that if the court considers that the debtor is not insolvent or is not facing expected insolvency, it shall refuse to declare an application for insolvency admissible. The same applicant is not eligible to initiate an insolvency case on the basis of essentially the same circumstances against the same entity within three months after such a refusal has been delivered.

Timeframes

Unlike the law of 2007, the new law does not specify the exact timeframe in which a proceeding must close, but this does not mean that insolvency proceedings may go on indefinitely – rather, it limits each activity period and defines more specific timeframes for actions, thereby accelerating the process.

Moratorium

The moratorium as a tool for stopping an activity for an agreed period to "freeze" the company's financial being and its assets and liabilities as they are at the time of opening insolvency, before the collective satisfaction of creditors, is highly modernised in the new law, distinguishing between legal and discretionary measures. As a rule, compulsory enforcement measures against the property of a debtor are ceased, and no new compulsory enforcement measures are initiated. The measures to secure enforcement as provided for by the Tax Code of Georgia (a tax lien, mortgage, etc) and the charging/payment of fines and default charges are also ceased.

The creditors are not eligible to satisfy claims by means of collateral, and no new procedural security measures shall be applied. Furthermore, no decisions shall be made regarding the distribution of dividends and the reorganisation/liquidation of an undertaking, no liabilities that arose before the initiation of insolvency proceedings shall be discharged, no new liabilities shall be assumed, and no new terms of payment shall be agreed and secured, except as provided by the law. It is also noteworthy that the payment of interest on the liabilities that arose before the initiation of insolvency proceedings will be ceased, although they will still be accrued and included in the claims of creditors. The charging and payment of penalties are also ceased. However, if the insolvency proceedings are terminated, it

shall be considered that penalties were being charged continuously.

Disputes Against Insolvency Estates

It should be noted that disputes against insolvency estates that had been initiated before the commencement of insolvency proceedings shall be ceased, and that no new disputes shall be initiated unless they involve the separation of a thing from the insolvency estate and cases provided by the law. It is also noteworthy that the court may rule on additional moratorium measures under the well-founded application of a creditor, debtor, insolvency practitioner or other interested persons. The additional moratorium measure can also establish a prohibition on contractors of the debtor terminating, suspending and/or impeding the provision of critical services to the debtor for reasons associated with the commencement of insolvency proceedings, provided that the debtor discharges to them those liabilities that arose after the application for insolvency was declared admissible.

Insolvency Practitioners

With the decision to open an insolvency regime against a company, the court also decides on the appointment of insolvency practitioners, depending on whether the rehabilitation or bankruptcy regime is adopted. The managers are selected by an electronic system and there is an option to deselect them under certain circumstances, with the decision of the creditors' meeting.

Upon the appointment of a manager, all persons authorised to manage and/or represent a debtor shall have such authority suspended. Regardless, the law also introduces a new concept of "a debtor in management", albeit only in the case of rehabilitation. There is still one restriction: actions directly conferred to an insolvency practitioner cannot be implemented by a debtor in management without the consent of a rehabilitation supervisor. The law distinguishes between rehabilitation manager and supervisor, with the latter being engaged only in the case of a debtor in management.

Insolvency practitioners are responsible for the following:

- making decisions on the debtor's business activities;
- performing all respective actions and signing any document on behalf of a debtor;
- taking custody of all documents, accounting entries and ledgers related to the activities of a debtor, including in electronic or other form;
- obtaining or regaining possession of the property owned by a debtor;
- collecting the property of a debtor, using the right of rescission;
- endorsing or terminating effective agreements and concluding new agreements; and
- selling or otherwise disposing of the property of a debtor at an auction or on the basis of an agreement, etc.

The law rules on a practitioner's actions in detail and distinguishes between the duties and obligations corresponding to the regime applied.

It is noteworthy that the formal insolvency regime is bound with a transparency requirement, which means that creditors should possess versatile information on a debtor's financial status and may act accordingly. Practically, it is the insolvency practitioner that collects and disseminates information on creditors. Creditors receive regular information on the status and developments of the bankruptcy proceedings through a periodical report, but certain information (eg, liability

actions to be carried out, at least before the filing) could be sealed for confidentiality purposes.

While a right of set-off can be guaranteed in contract, it cannot be implemented after the commencement of insolvency proceedings against the debtor. However, this restriction does not apply to a guarantor who later becomes a creditor with a conditional claim against the initial debtor. Using off-setting or netting options, it is up to the insolvency practitioner to decide on applicability and expediency.

Value Distribution

First, the expenses of the bankruptcy regime are paid out from the insolvency mass, followed by debts arising after the opening of a bankruptcy regime, including tax liabilities. Subsequent groups of creditors are then paid, in the following order:

- preferential claims;
- preferential tax claims;
- non-secured claims (including non-preferential tax claims – direct taxes such as profit and property taxes);
- claims arising as interest and fines accrued on the liabilities existing before declaring an application for insolvency admissible;
- administrative fines and other monetary liabilities deriving from administrative offences;
- fines and penalties charged in accordance with the Tax Code of Georgia;
- non-preferential claims; and
- obligations arising from corporate relations.

It is a novelty that secured creditors are not placed in the waterfall of claims, as they can satisfy their claims from selling the secured property.

7.2 Distressed Disposals

After the commencement of the insolvency regime, an insolvency practitioner assumes control of the company's activity. The director of the debtor can no longer engage in any legal activities unless a debtor in management is implemented (see **7.1 Types of Voluntary/Involuntary Proceedings**).

The bankruptcy manager focuses on realising assets and distributing the proceeds among creditors according to the waterfall of claims. A decision regarding the method of selling property shall be made by a bankruptcy manager, but creditors are free to offer an alternative method. Unless the recovery of a higher return is expected from selling property included in an insolvency estate in a different way, a bankruptcy manager sells the property through an auction. Since the auction is carried out through electronic means, any person may bid for company assets, including secured and unsecured creditors. Pre-negotiated sale transactions can be subject to the decisions of the insolvency manager.

It is also noteworthy that secured creditors of the first rank may request from the bankruptcy manager the sale of secured property in a manner provided by the pledge/mortgage agreement.

7.3 Organisation of Creditors or Committees

Unlike the law in effect before 2021, the new law obliges creditors to form a committee if the total value of a creditor's assets exceeds GEL10 million and their annual income exceeds GEL20 million. A creditors' committee shall be composed of three members, who are elected to facilitate the exercise of creditors' rights. One member of the creditors' committee is elected by secured creditors, while the other two members are elected by non-secured creditors. The

law imposes the requirements of impartiality and acting in accordance with the common interest on creditors' committees.

Remuneration for the activity of a member of a creditors' committee shall be decided by a court, no later than five days after a creditors' meeting elects a creditors' committee. The amount may be determined according to the time spent participating in the meetings of the creditors' committee, but it shall not exceed 20% of the remuneration determined for a manager. In specific cases, a court may adopt a different rate. Expenses related to remuneration are covered by the insolvency estate.

The law confers detailed tasks on the committee and introduces the opportunity to recall a member under special circumstances.

8. International/Cross-Border Issues and Processes

8.1 Recognition or Relief in Connection With Overseas Proceedings

If insolvency proceedings are ongoing in respect of a non-registered undertaking in the country of registration of that undertaking, the recognition of a decision opening insolvency proceedings in a foreign country does not exclude the possibility of opening separate insolvency proceedings in Georgia. Such proceedings can be launched based on the application of a non-registered undertaking or a creditor. In addition, where a debtor does not have a registered branch or address in Georgia, local proceedings may be opened based on an application from a creditor only if the creditor has a special interest in local insolvency proceedings – ie, if its condition is likely to worsen due to the insolvency proceedings ongoing in a foreign country. The obligation to substantiate a special interest rests with the applicant creditor.

8.2 Co-ordination in Cross-Border Cases

The Law of Georgia on Private International Law gives the courts the right to enter protocols or other arrangements. The legislation on insolvency proceedings does not contain any specific provision.

8.3 Rules, Standards and Guidelines

The main legal basis determining which jurisdiction's decision, rulings or laws shall govern is the Law of Georgia on Private International Law.

8.4 Foreign Creditors

Foreign creditors are entitled to the same rights and obligations as all other creditors, and their claims are subject to the same rules.

8.5 Recognition and Enforcement of Foreign Judgments

While the new law contains a chapter on international/cross-border insolvency, such proceedings are still subject to international private law. The decision of a competent authority on the opening of insolvency proceedings in a foreign country, relating to immovable property and/or creditors located in Georgia, shall be recognised by Georgia. Except for the general grounds established by the Law of Georgia on Private International Law, it is inadmissible to recognise a decision on opening insolvency proceedings in a foreign country if the consequences of such recognition are explicitly contrary to the fundamental goals and principles established for insolvency proceedings by the legislation of Georgia.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers

By introducing the new profession of insolvency practitioner, the new law distinguishes between rehabilitation supervisors (only in the case of a debtor in management), rehabilitation/bankruptcy managers and regulated agreement supervisors.

The law also recognises that both legal and natural persons can exercise the rights and obligations of an insolvency practitioner.

In general terms, insolvency practitioners advise on and commence appointments in all formal insolvency procedures. They are qualified and experienced persons from a professional body who act independently, impartially and in good faith, and can only be elected from the registry automatically at the time of opening an insolvency proceeding. Their authorisation rules and registry automation is based on the Decree of the Minister of Justice.

9.2 Statutory Roles, Rights and Responsibilities of Officers

The main responsibilities of an insolvency practitioner are to manage and represent the debtor. They are entitled to take all important decisions, and their duties range from preserving the insolvency estate to deciding on new agreements and arrangements for the debtor, steering the creditors' meetings and ensuring the collective satisfaction of creditors, depending on the regime. Their activities are assessed by the creditors' meeting, and their appointment could be recalled by a decision thereof.

An insolvency practitioner must hold professional insurance policy; failure to do so may be a reason to cancel authorisation.

9.3 Selection of Officers

Unlike the previous law, insolvency practitioners must only be authorised persons as defined by the law and the decree of the Minister of Justice in order to be elected as managers or supervisors. There is no restriction on professional affiliation but, practically speaking, mainly attorneys and economists serve as insolvency practitioners.

Their election is totally automated. The supervisor is appointed via an electronic system even in the case of a regulated agreement, as soon as the process is formally launched. Generally, the court may determine the necessity of appointing more than one manager due to the complexity of a case and where the annual turnover of a debtor exceeds GEL100 million.

The law also recognises a possibility to remove an automatically selected insolvency practitioner by a majority of two thirds of the attending creditors with voting rights. It is noteworthy that the new law also introduces rules on the disqualification/self-recusal of an insolvency practitioner, if such practitioner is:

- a party to the case or related to any party to the case with common rights or obligations;
- a relative of a party to the case or their representative; or
- personally interested, directly or indirectly, in the outcome of the case, or if there are other circumstances that cast doubt on their impartiality.

Remuneration is set directly by the law and calculated based on the time spent and the com-

plexity of the case, and is subject to final judicial control, which increases the independence and impartiality of insolvency practitioners.

10. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

10.1 Duties of Directors

As a fiduciary, a director is bound by the general civil law principle of good faith, and has two main responsibilities in the process of managing the company:

- a duty of care – the director must take such actions that an ordinary and reasonable person would take in a similar circumstance; and
- a duty of loyalty – the director must take actions to protect the interests of the company, and refrain from actions that are harmful to the interests of the company.

The obligations of the directors are defined by the legislation of Georgia, the charter of the company and the contracts concluded with them (if such exist). Violation of the obligations gives rise to the liability of directors. However, due to the presumption of the "business judgement rule", a director is protected from personal liability if they act in the belief that their decision was made in the best interests of the company and made an informed decision that they considered sufficient in the given circumstances.

If a rehabilitation manager is appointed during insolvency, they have a fiduciary duty towards the creditors. In that case, directors are obliged to co-operate with and assist the rehabilitation manager. It is up to the rehabilitation manager to decide whether directors maintain some of the tasks assigned to them, and what the remuneration for such services could be.

If a debtor remains in management, this means that the responsibilities of the rehabilitation manager are transferred to the debtor in management. Thus, it can be assumed that fiduciary duties toward the creditors are also assigned to them.

Directors have an obligation to apply to the court to commence insolvency proceedings within three weeks of the company becoming insolvent; failure to do so results in the criminal liability of the director.

Apart from criminal liability, directors' civil liability might arise if their actions caused harm to the creditors by not applying to the court or by delaying the commencement of the insolvency process in a timely manner.

10.2 Direct Fiduciary Breach Claims

Generally, court-appointed managers/supervisors are authorised to commence claims against disputed actions, but this process does not limit the application of legal remedies provided for by other laws, including the Civil Code of Georgia and the Law of Georgia on Entrepreneurs, to acts related to concealing or otherwise disposing of the property of a debtor in bad faith. In addition, if there are preconditions for voidness or for the compensation of damage, a respective dispute shall be reviewed in accordance with the procedure established by the applicable legislation.

11. Transfers/Transactions That May Be Set Aside

11.1 Historical Transactions

The following transactions preceding an insolvency process might become disputable:

- the intentional reduction of an insolvency estate – mainly acts aimed at reducing the insolvency estate;
- the devaluation of an insolvency estate – ie, the transfer of property free of charge or at a price lower than its market value, which took place before the occurrence of the insolvency of a debtor. The same conclusion might be achieved if such act resulted in the insolvency of a debtor or in the reduction of the value of the insolvency estate; and
- giving preference – these are the acts that prevent the satisfaction of creditors in accordance with the procedure established by the new Law on Insolvency. Acts that give preference to a creditor that would otherwise not have existed fall under this category, including the fulfilment of a creditor's claim that has not matured or providing the security of a creditor's claim, unless a security arrangement had been envisaged when concluding the main loan agreement.

11.2 Look-Back Period

An action may be disputed if it is performed within one year before the commencement of insolvency proceedings, or within two years if a party opposing rescission is a person related to a debtor.

The look-back period is lengthened to three years for those acts performed by a debtor that cause damage to a creditor.

11.3 Claims to Set Aside or Annul Transactions

Managers/supervisors are authorised to assert claims against disputed acts. Such claims can be brought in both the rehabilitation and bankruptcy regimes. Nevertheless, creditors of insolvency are not deprived of the right to bring claims on damage under general civil procedural law.

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Nodia, Urumashvili and Partners is one of the leading full-service law firms in Georgia, currently employing 13 law practitioners. The firm is renowned for its pre-eminent practices in banking and finance, real estate and construction, restructuring and insolvency, energy, intellectual property, corporate, competition and tax law, with outstanding expertise in each field, along with a well-established dispute resolution practice. It offers full legal support across a wide range of industries. The diverse client base includes leading companies from virtually all major sectors in Georgia. The firm has a particularly strong presence in the financial services, real estate and hospitality, energy and infrastructure, manufacturing, agriculture and retail sectors. It also has noteworthy experience and understanding of cryptocurrency and blockchain technology.

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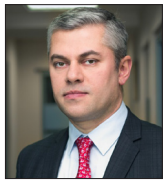

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