"Anchoring sustainable development by rule of law"

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ISET

Regulatory Impact Assessment (RIA) of the selected topics under the Draft Law on Rehabilitation and Collective Satisfaction of Creditors

Final Report

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I. Executive Summary

Policy Context Reaching European and international standards of insolvency proceedings is considered as one of the most important priorities of the Georgian authorities[1] [2] and its international partners for creating enabling business environment and fostering sustainable growth and jobs creation in the country.

Fundamental piece of legislation that governs relationship between parties in insolvency proceedings, Law on Insolvency Proceeding, was enacted in 2007. Number of amendments have been made to the 2007 law with an attempt to align with international best practices, however existing legislation and practice fails to fulfill its function as evidenced by international rankings and assessments. In 2014, GIZ, European Bank for Reconstruction and Development (EBRD) and Governing for Growth in Georgia (G4G) have assessed insolvency regime in Georgia and provided recommendations to alter both the law and the overall insolvency system.

In close cooperation with the Ministry of Justice of Georgia and the National Bureau of Enforcement, GIZ established a working group that started to work on the new law on insolvency proceedings. The working group was composed of the representatives of the Ministry of Justice of Georgia, the National Bureau of Enforcement, the Ministry of Economy and Sustainable Development of Georgia and the Ministry of Finance of Georgia, four prominent lawyers with extensive experience in handling insolvency cases, representative of the Investors Council and German experts, who have provided recommendations for a policy change and a reform proposal. In June, 2018, the working group finalized elaboration of the draft – Law on Rehabilitation and Collective Satisfaction of Creditors (the "Draft Law"), and launched consultation phase. Key stakeholders have been invited to present their concerns and assessments of the proposed piece of legislation.

The key challenge for the Draft Law is To improve efficiency of the insolvency framework by increasing opportunities for viable firms to be rescued and by fostering equitability, transparency and predictability in the distribution of the debtors' assets when firm rescue is not feasible.

a. Increase the value of a firm's assets and recoveries by creditors;

b. Improve efficiency in liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;

c. Foster business enabling environment;

The options considered in this RIA:

Option 1

In the "No policy change" option the acting law is not changed and therefore, the trends associated with the current formulation of the law are unaltered. This implies that economic and social trends are expected to continue evolving as they are doing currently, in absence of the reform. The

[1] SME Development Strategy of Georgia 2016-2020

[2] Social-economic Development Strategy of Georgia "GEORGIA 2020"

regulatory framework will continue to fail on its stated functions and objectives, compromising country's reputation for its business enabling environment. On the other hand, any additional burden on public and private sector associated with the new regulations will be avoided.

Proposed policy intervention, Option 2 measure/evaluate net benefits (qualitative and quantitative, where feasible) of such interventions.

Option 2

Option 2 is a policy scenario in which all key provisions from the Draft Law, as envisioned by the authors, are adopted.

In summary, compared to the current regulation of the insolvency the Draft Law provides following changes:

i. Compared to the Current Law, the Draft Law provides different allocation of the competences between the actors involved in the insolvency proceedings. For example, the bankruptcy or rehabilitation of the distressed company is made by the judge, not by the Conciliation Council as envisaged under the Current Law.

ii. The Draft Law introduces the concept of the insolvency practitioner by which the person may assume the role of the bankruptcy or the rehabilitation manager if he meets certain qualification criteria.

iii. The Draft Law amends the current ranking of the creditors. In particular, according to the Draft Law, the Revenue Service, even if it applies the tax security measures (such as tax pledge and tax mortgage) available under the tax legislation will not rank as the secured creditor. Moreover, the Draft Law singles out a new class of the creditors: the preferential creditors, which amongst others, includes the employees of the distressed company whose claims from the employment take precedence over the claims of the secured and unsecured creditors.

iv. Within the bankruptcy proceedings, the Draft Law provides the satisfaction of the secured creditors only to the extent of the realized value of the secured assets. The part of the claims which are not be satisfied from the value of the secured assets, will be transferred to the pool of the claims of the unsecured creditors.

v. The Draft Law provides more neat criteria based on which the rehabilitation plan of the distressed company shall be prepared and then approved by the court. Such criteria shall ensure that the rehabilitation plan is not approved in the detriment of the creditors.

vi. The Draft Law enables the unsecured creditors to prevail in approval of the rehabilitation plan even if the secured creditors are against such plan. Notably, in order the unsecured creditors to prevail, the rehabilitation plan shall meet the criteria which are further elaborated below.

vii. The Draft Law sets out the maximum thresholds for remuneration of the bankruptcy and rehabilitation manager. Subject to the substantiated grounds, the court may increase the fee above these thresholds.

Comparison of Options using Multi-Criteria Analysis

EVALUATION CRITERIA	OPTION 1	OPTION 2
Effectiveness	+	++
Feasibility / Ease to comply	++	+
Minimization of Potential Risks	++	+
Maximization of Potential Benefits	+	++
Distributional impacts	+	++

Ranking of options

According to the analysis, both options have some merits; We do not attribute specific weights to the criteria; If all the criteria are weighted equally by the policy-maker Option 2 will dominate Option 1 and should be preferred option. However, if Feasibility/Ease to Comply and Minimization of Potential Risks criteria receive very high priority that is, are weighted higher than other criteria, the preferred option should be Option 1.

Approach

The RIA team, acknowledging its share of responsibility in the implementation of the UN 2030 Agenda, took special care to conduct the RIA exercise in accordance with the five principles (see below) in all stages of the study. An integrative approach towards analyzing the impacts of the suggested policy, engaging a comprehensive set of stakeholders, including the marginalized groups has been taken. Participatory consultation process involved public and private sector, academia, business associations, and civil society, which ensured promotion of transparency in decision-making, triggering dialogue and opening-up governance. Criteria for options ranking has been developed in a way that maximizes synergies between three dimensions of sustainability: economic, social and environmental, and addresses trade-offs between goals and targets. Moreover, the study suggests a set of measurable indicators to track progress in implementation of the Draft Law in light of the 2030 Agenda that encompass all three dimensions.

PRINCIPLES OF AGENDA 2030
Universality: the SDGs apply to all countries: low, middle and high income countries alike. All countries need to cooperate to achieve global goals. To this end, each country needs to define and alight its national policies to the 2030 Agenda.
Integrated Approach: addressing the three dimensions of sustainable development (economic, social and environmental) taking into account the interlinkages and interactions between the three dimensions.

Shared responsibility: existing challenges cannot be overcome by governments alone. The 2030 Agenda calls for all actors – governments, sub-national levels, civil society, private sector, and academia - to assume responsibility for implementation, according to their capabilities.
Leave no one behind: in order to achieve sustainable development, no one shall be left behind. This principle focuses on the least favorable, marginalized groups when implementing the 2030 Agenda and suggests to take inclusive approaches to allow disadvantages populations to be reached.
Accountability / Monitoring und Review: for 2030 Agenda to be successful, progress in implementation should be monitored and reviewed, and should enable mutual learning in order to effectively design policies. To measure progress, high quality, accessible and desegregated data is required on the national level.

Georgia has undertaken active measures to adjust Sustainable Development Goals (SDGs) agenda and its targets to the national circumstances and to advance their implementation with due consideration of its five principles. Implementation of sustainable development goals are seen as one of the core national priorities, that underpin each political and strategic level and hence laws and political documents alike. Translation of SDGs into the national setting in Georgia resulted in the development of the National SDG Matrix, which acts as the main reference to measure regulations and policies against country's commitments under the 2030 Agenda.

II. Problem Definition

A. Policy Context

Reaching European and international standards of insolvency proceedings is considered as one of the most important priorities of the Georgian authorities[3] [4] and its international partners for creating enabling business environment and fostering sustainable growth and jobs creation in the country.

Fundamental piece of legislation that governs relationship between parties in insolvency proceedings, Law on Insolvency Proceeding, was enacted in 2007. Number of amendments have been made to the 2007 law with an attempt to align with international best practices, however existing legislation and practice fails to fulfill its function as evidenced by international rankings and assessments. In 2014, GIZ, European Bank for Reconstruction and Development (EBRD) and Governing for Growth in Georgia (G4G) have assessed insolvency regime in Georgia and provided recommendations to alter both the law and the overall insolvency system.

According to the assessment report produced by USAID project, "Governing for Growth (G4G) in Georgia," the current "law adversely affects the rights of senior secured creditors, largely ignores the rights of unsecured creditors, and does not provide a flexible enough framework for "rehabilitation" to be a useful strategy for either debtors and creditors." The German Economic Team assessment identifies two key aspects in which the Georgian framework fails to conform to international best practices. The first key aspect is that its main focus is on liquidation of insolvent companies, rather than on rehabilitation. The second aspect concerns the limited institutional capacity to manage insolvency cases, such as an absence of an established profession of private insolvency office holders (temporary management while the company is engaged in insolvency proceedings).

In close cooperation with the Ministry of Justice of Georgia and the National Bureau of Enforcement, GIZ established a working group that started to work on the new law on insolvency proceedings. The working group was composed of the representatives of the Ministry of Justice of Georgia, the National Bureau of Enforcement, the Ministry of Economy and Sustainable Development of Georgia and the Ministry of Finance of Georgia, four prominent lawyers with extensive experience in handling insolvency cases, representative of the Investors Council and German experts, who have provided recommendations for a policy change and a reform proposal. In June, 2018, the working group finalized elaboration of the draft – Law on Rehabilitation and Collective Satisfaction of Creditors (the "Draft Law"), and launched consultation phase. Key stakeholders have been invited to present their concerns and assessments of the proposed piece of legislation.

[3] SME Development Strategy of Georgia 2016-2020

[4] Social-economic Development Strategy of Georgia "GEORGIA 2020"

B. Rationale for Intervention

Insolvency law guides the relationship between debtors such as entrepreneurs and shareholders, and creditors, such as banks and other institutions which lend in cash or in-kind, when debtors for some reason are unable to meet their obligations. The legal framework governing this relationship is instrumental to efficient, that is fast and cheap, reallocation of productive resources to its best use when the business ends up in financial crises. Evidence illustrating a positive correlation between the strength of a country's insolvency framework and economic outcomes is abundant[5] (La Porta et al (1997), Djankov et al. (2008), Araujo et al (2012), Ferrando et al (2015), etc), but an optimal insolvency framework depends on the legal background and other specificities of the country. 2016 Nobel Prize laureate in Economics, Oliver Hart, recognized for his contribution to contract theory, argues that while there are no one-size-fits-all insolvency laws, there are general principles that every law should satisfy. He identifies three specific goals the law should try to accomplish.

Goal 1. Ceteris Paribus, a good insolvency procedure should deliver an ex-post efficient outcome.

In other words, the efficient outcome of an insolvency procedure is achieved when viable firms reorganize, while unviable firms exit the market. High recovery rates for creditors and low costs in terms of financial and time expenses of insolvency proceedings are also important. High insolvency costs discourage liquidation of inefficient firms and diverting freed-up resources into a productive use. Letting ailing firms exit increases the robustness of the economy, benefiting the whole society.

Claessens & Klapper (2005) study determinants of the usage of formal bankruptcy procedures. The authors use data of actual bankruptcy filings in 35 countries to investigate how the filings relate to country's specific creditor rights and judicial efficiency. The authors find that bankruptcies are more frequent in countries with better-functioning judicial systems, meaning that the higher is the chance that a creditor can effectively satisfy requirements using the court, more likely creditors are to use formal bankruptcy proceedings in the case of default. Richer countries are found to have higher use of bankruptcy, suggesting that more economic development is related with more court usage.

Goal 2. A good insolvency procedure should preserve the bonding role of debt by penalizing managers and shareholders adequately in insolvency states.

Insolvency regime is a tool to achieve financial discipline and legal certainty. Lenient insolvency procedures increase the risk of investors in case things go awry. Therefore, only high-risk investors will be willing to invest in countries with weak insolvency regimes. Lower downside risks would encourage a higher variety of investors to engage in entrepreneurial activities, and therefore stimulate the economy.

According to the International Monetary Fund's Orderly and Effective Insolvency Procedures Guidelines, the degree to which insolvency law is perceived as pro-creditor or pro-debtor is irrelevant. What matters is the extent to which these rules are effectively implemented by a strong

[5] Section V below briefly summarizes this literature

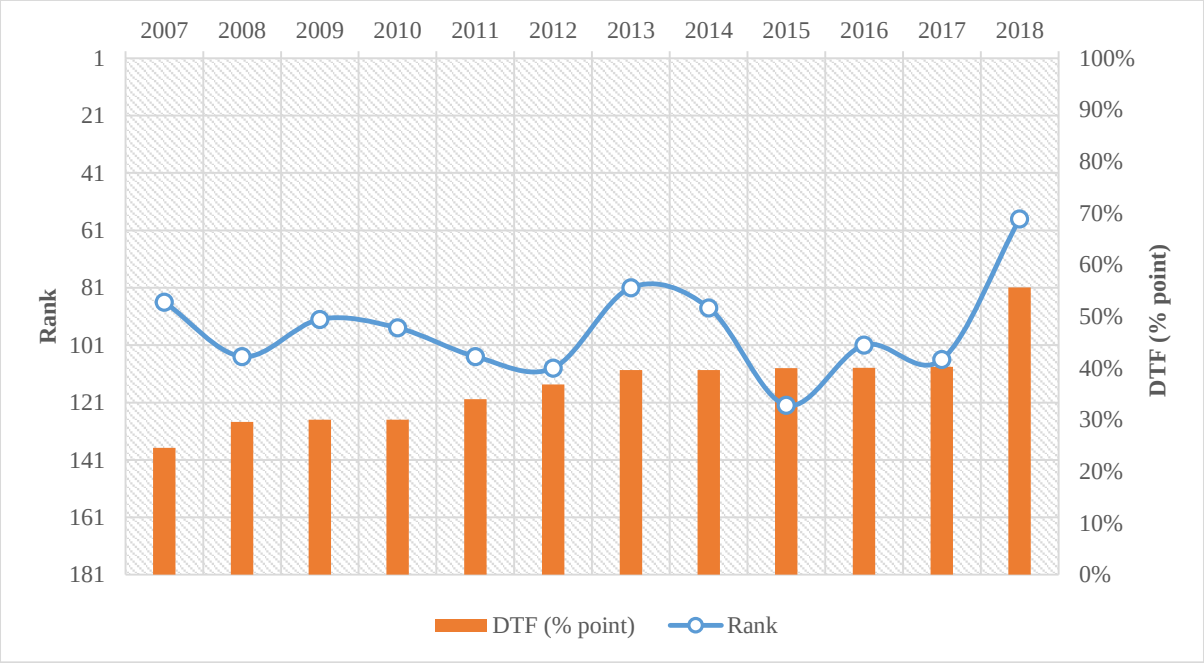
institutional infrastructure[6]. A pro-debtor law that is applied effectively and consistently will generate greater confidence in financial markets than an unpredictable pro-creditor law.

Goal 3. A good insolvency procedure should preserve the absolute priority of claims, except that some portion of value should possibly be reserved for shareholders.

Reserving a portion of value for shareholders decreases the incentives for high risk-taking on behalf of shareholders in order to avoid insolvency or delay an insolvency filing.

Congruent with these general principles, the Doing Business Resolving Insolvency indicator evaluates insolvency regimes around the world in terms of their ability to secure the most efficient outcomes. Georgia's performance is comparable to the developing countries in Europe and Central Asia (ECA) region (excluding OECD high income countries), but significantly lags behind OECD high income countries on indicators such as: the recovery rate, which measures how many cents were collected out of the dollar by secured creditors from an insolvent firm at the end of the insolvency proceedings; time needed for creditors to recover their credit, recorded in calendar years; and, the cost of the proceedings, recorded as a percentage of the value of the debtor's estate. The outcome of an insolvency proceeding is most likely to be a piecemeal sale, rather than sale as a going concern, which adversely affects the recovery rate.

Figure 1. Doing Business Resolving Insolvency in Georgia Ranking



Source: World Bank Doing Business Publications

[6] this, in itself aligns with the Goal 16 of the 2030 Agenda, committing countries to promote rule of law and develop effective, accountable and transparent institutions to meet the needs of business for stability and predictability and to stimulate growth and opportunities

Table 1. Doing Business Resolving Insolvency in Georgia Indicators

Indicator	Georgia	Europe & Central Asia	OECD high income
Recovery rate (cents on the dollar)	39.4	38	71.2
Time (years)	2	2.3	1.7
Cost (% of estate)	10	13.1	9.1
Outcome (0 as piecemeal sale and 1 as going concern)	0		
Questions		**Answer**	**Score**
Strength of insolvency framework index (0-16)			**11**
Commencement of proceedings index (0-3)			**2.5**
What procedures are available to a DEBTOR when commencing insolvency proceedings?		(a) Debtor may file for both liquidation and reorganization	1
Does the insolvency framework allow a CREDITOR to file for insolvency of the debtor?		(b) Yes, but a creditor may file for liquidation only	0.5
What basis for commencement of the insolvency proceedings is allowed under the insolvency framework?		(a) Debtor is generally unable to pay its debts as they mature	1
Management of debtor's assets index (0-6)			**5.5**
Does the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor?		Yes	1
Does the insolvency framework allow the rejection by the debtor of overly burdensome contracts?		Yes	1
Does the insolvency framework allow avoidance of preferential transactions?		Yes	1
Does the insolvency framework allow avoidance of undervalued transactions?		Yes	1
Does the insolvency framework provide for the possibility of the debtor obtaining credit after commencement of insolvency proceedings?		Yes	1
Does the insolvency framework assign priority to post-commencement credit?		(a) Yes over all pre-commencement creditors, secured or unsecured	0.5
Reorganization proceedings index (0-3)			**0**
Which creditors vote on the proposed reorganization plan?		(c) Other	0
Does the insolvency framework require that dissenting creditors in reorganization receive at least as much as what they would obtain in a liquidation?		No	0
Are the creditors divided into classes for the purposes of voting on the reorganization plan, does each class vote separately and are creditors in the same class treated equally?		No	0
Creditor participation index (0-4)			**3**
Does the insolvency framework require approval by the creditors for selection or appointment of the insolvency representative?		Yes	1
Does the insolvency framework require approval by the creditors for sale of substantial assets of the debtor?		No	0
Does the insolvency framework provide that a creditor has the right to request information from the insolvency representative?		Yes	1
Does the insolvency framework provide that a creditor has the right to object to decisions accepting or rejecting creditors' claims?		Yes	1

Source: World Bank Doing Business 2018

The in-depth assessment of current mechanisms and procedures commissioned by G4G/USAID identified number of structural deficiencies in the insolvency framework[7]. The findings in these studies are supported by stakeholder consultation and number of additional studies conducted prior and after the 2015 assessment as well as international rankings such as EBRD Assessment of Insolvency Office Holders.

One of the key challenges to efficiency of the insolvency framework comes from frequent and significant delays in its implementation. The statistics on duration of insolvency proceeding is not available publicly[8], however the data presented in the assessment report[9] as well as Doing Business Indicator indicates that it could take more than two years to fully administer the proceeding. This is due to the several factors altogether: gaps in the existing law e.g. there is no deadline for formation of the Conciliation Council; Overloaded Courts, and burdensome requirements on judges e.g. verification of creditor registry, appointment of third member of Conciliation Council if creditors cannot make a decision on this, etc.

Costs of the proceeding are prohibitively high, especially for small and medium sized enterprises (SMEs). The costs consist of court fees, NBE fees, the cost of legal service, etc. All these sum up to the significant share of the total claims. Furthermore, the law stipulates the undistributed amount of assets after the bankruptcy procedures to be transferred to the NBE. Therefore, it is clear that the company does not have incentive to apply to the court in a timely manner, when it is still possible to rescue the company.

Significant shortcomings have been identified in the management of the insolvency case. Insolvency Office Holder duties, responsibilities and authorities as well as the governance structure of the IOH as an institute the key mandate of which is to maximize the value of the insolvent debtor's tangible and intangible assets for the sake of the pre-insolvency creditors remains the key challenge to be addressed.

The law is completely silent about the qualifications of the IOH needed to make sure that competent and experienced people are put in charge of managing a business in crises. EBRD (2014) Assessment of Insolvency Office Holders in the countries where it invests also names Georgia along with Egypt, Morocco and Turkey as having the weakest overall framework for IOHs out of twenty-seven assessed countries. Absence of licensing and registration systems for insolvency office holders as well as any standards on qualification and training requirements for insolvency office holders are reflected in the relevant scores (Table 2).

Mandatory auction as the only option in bankruptcy has also been named as one of the significant hindrance to efficient resolution of the case.

Significant flaws of the Current Law are related to its violation and/or inadequate protection of creditors' rights. Grouping all secured creditors into a single rank, exclusion of unsecured creditors from the decision making on rehabilitation plan, requirement to divert all remaining assets to NBE after auction, rights assumed by Revenue Service, etc. increase uncertainty and unpredictability for

[7] Executive summary of the report can be seen in APPENDIX I

[8] Official response to the data request submitted to the Tbilisi City Court states that this type of analysis is not being conducted and submitted in the database for public disclosure

[9] It took 43 months and 27 months to close the case in 2013 and 2014, respectively

all parties involved. Revenue Service often is the largest creditor, treating the government as a secured or senior unsecured creditor, decreases the rate of recovery for junior unsecured creditors.

Table 2.EBRD (2014) Assessment Indicators for Georgia[10]

Indicator Name	Score/100
Development of the insolvency office holder profession	**48**
Development of licensing and registration systems for insolvency office holders	25
Development of qualification and training requirements for insolvency office holders	25
Framework for insolvency office holder standards and ethics	31
Framework for regulation, supervision and discipline of insolvency office holders	50
Statutory framework for insolvency office holder legal powers and duties	58
Remuneration of insolvency office holder	69
Development of insolvency office holder appointment systems	83

Source: EBRD (2014)

Protracted and costly procedures with inadequate decision-making mechanisms, overprotection of state interests hamper and distort the fairness of the insolvency process, and fail to deliver on its functions as described above, these in turn lead to low rate of filing for insolvency, low rate of rehabilitation, loss in economic value of assets, low recovery rate for creditors, weakening of country's reputation for attractive business environment and financial instability. In addition to economic outcomes weak insolvency framework leads to deterioration is social variables due to the number of jobs lost while the insolvent company is stuck in state of legal uncertainty. Moreover the Current Law treats company employees as unsecured creditors who most of the time end up receiving no payment for their services when the company goes bankrupt. This, on the other hand, incentivizes employees to leave the business in financial difficulties as fast as possible when their participation is most crucial for survival of the company.

Table 3. Distribution of Firms by Legal Status, 2018

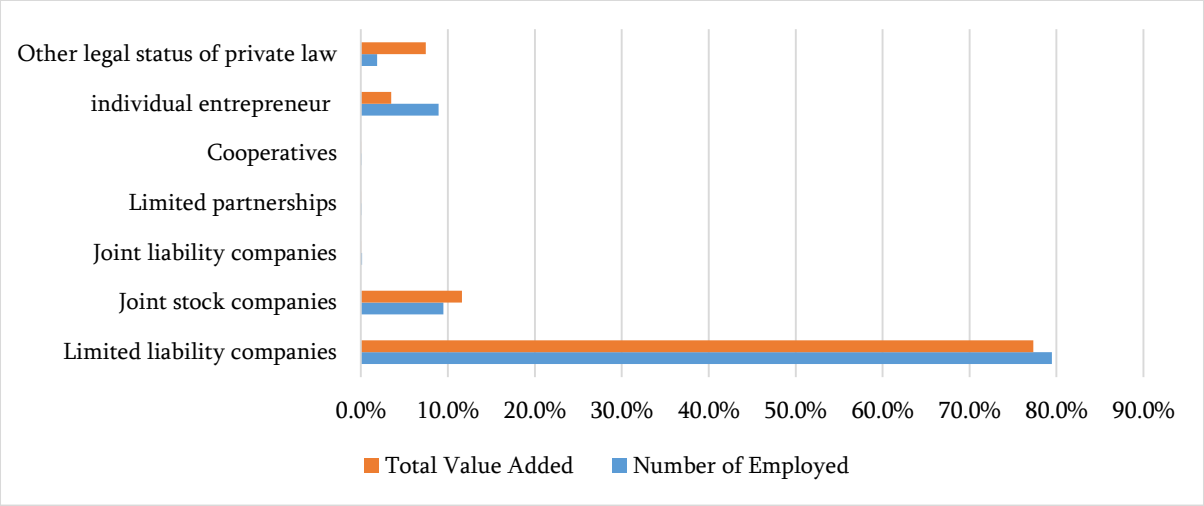
Legal Status	Number of entities	Active	% of Active
TOTAL	709729	184660	100
Commercial legal persons	244919	80975	43.9%
Joint liability companies	2759	271	0.1%
Limited partnerships	186	26	0.0%
Limited liability companies	234240	79423	43.0%
Joint stock companies	2527	907	0.5%
Cooperatives	5207	348	0.2%
Non-commercial legal persons	26316	3795	2.1%
Individual entrepreneur	427035	95994	52.0%
Other	5627	1216	0.7%
Entities of public law	5832	2680	1.5%

Source: Geostat

[10] The score ranges between 0 and 100, higher values representing better assessment.

Significant social costs are also borne due to absence of legal framework which governs effectively bankruptcy of natural persons, including individual entrepreneurs[11], which represent majority of active firms in the economy (see table 3). As a consequence, there are in excess of 260,000 individuals (7% of total population) listed in the debtors' registry[12] who are excluded from formal economy leading to adverse social outcomes in the country[13] .

Figure 2. Value added and Number of Employed by legal form, 2016



Source: Geostat

In June 2014, the EU and Georgia signed an Association Agreement (AA), which entered into force on July 1 2016. There is no explicit requirement in the AA to reform legal framework governing insolvency proceedings, however to be able fully capitalize on the opportunities that AA has to offer the country needs to modernize its legal framework creating favorable environment for cross-border investments. In 2016 European Commission commissioned a study[14] to define the existence and the magnitude of problems in the area of capital flows, economic growth and job creation associated with discrepancies in insolvency regimes across EU and to propose policy options on minimum standards in insolvency and restructuring law. The study estimates costs of discrepancies at the EU 28 level of over EUR 70 million per year, majority of which is borne by SMEs.

Insolvency framework which fails to deliver on its objectives prevents the Georgian Government to deliver on its 2030 Agenda commitments. The Agenda and the SDGs suggest that countries achieve sustainable development by setting 17 Goals spanning economic, social and environmental dimensions. Goal 16 calls for just, peaceful and inclusive societies. Commitment is to promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels. Building effective institutions,

[11] Even if Current Law does not prohibit commencement of insolvency proceedings with rehabilitation or bankruptcy regime for individual entrepreneurs there has been no instance of such case

[12] https://debt.reestri.gov.ge/main.php?s=1

[13] 2030 Agenda – Principle of Leave No One Behind (LNOB), where the current insolvency framework fails to count the interests of natural persons and individual entrepreneurs

[14] European Commission, 2016, Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law

which are accountable and transparent is one of the key targets of the Goal measured through World Bank Governance Indicators (WGIs): Rule of Law[15], Voice and Accountability[16], Government Effectiveness[17], Control of Corruption[18], Regulatory Quality[19]. Comparing to Europe and Central Asia averages (Figure 3) Georgia exceeds its peers in performance on Regulatory Quality, Government Effectiveness and Control of Corruption, but significantly lags behind on Voice and Accountability and insignificantly on Rule of Law indicators; however benchmarking against selected group of comparable countries such as Estonia, Lithuania, and Latvia shows that Georgia has a considerable political and financial investments to make in its institutions to be able to catch up with its peers.

Figure 3. World Bank Governance Indicators for Georgia, 2017

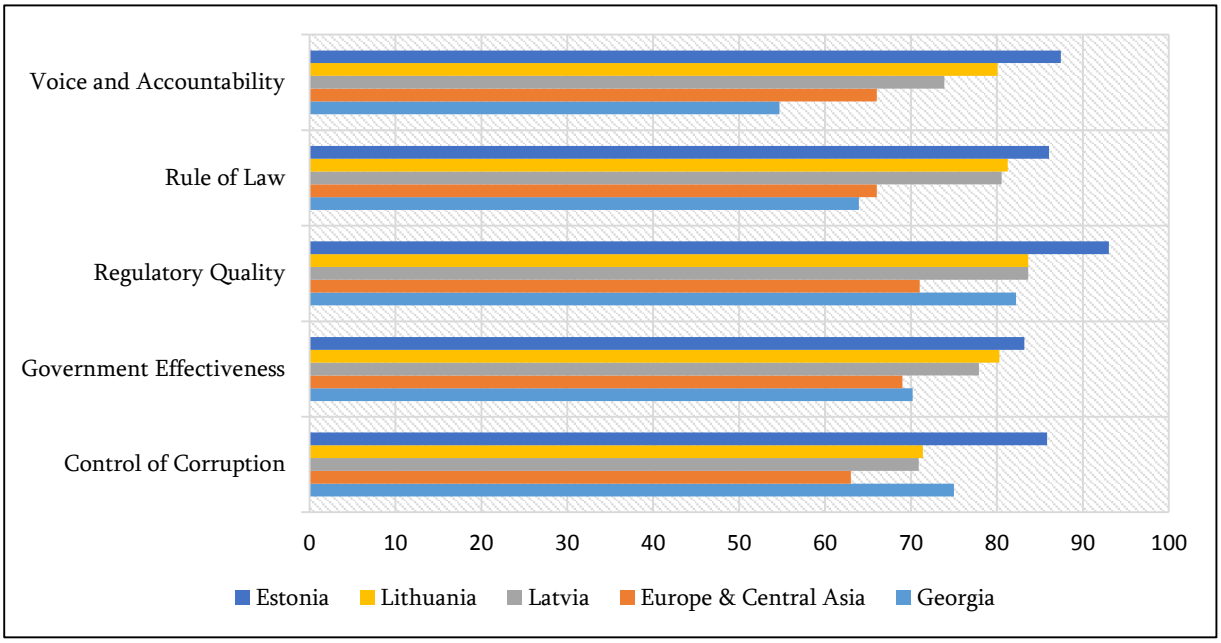


Table 4 below also illustrates strong correlation between selected WGIs and WB Resolving Insolvency Distance to Frontier indicator. In other words, countries that perform well on WGI indicators also tend to have more robust regal framework governing insolvency proceedings.

[15] Rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

[16] Voice and accountability captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

[17] Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies

[18] Control of corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

[19] Regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

Table 4. Correlation Coefficients for Selected Variables

	Control of Corruption	Government Effectiveness	Regulatory Quality	Rule of Law	Voice and Accountability	Distance To Frontier
Control of Corruption	1.000					
Government Effectiveness	0.897	1.000				
Regulatory Quality	0.858	0.937	1.000			
Rule of Law	0.944	0.928	0.913	1.000		
Voice and Accountability	0.782	0.702	0.728	0.783	1.000	
Distance to Frontier	0.587	0.724	0.748	0.641	0.532	1.000

Source: World Bank and Authors' Calculations

III. Objectives

A. General and Specific Objectives

1. Improve efficiency of the insolvency framework by increasing opportunities for viable firms to be rescued and by fostering equitability, transparency and predictability in the distribution of the debtors' assets when firm rescue is not feasible.

    a. Increase the value of a firm's assets and recoveries by creditors;

    b. Improve efficiency in liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;

    c. Foster business enabling environment;

B. Operational Objectives

a. Reduce length of insolvency proceedings;

b. Reduce costs of insolvency proceedings;

c. Improve Insolvency Office Holder practice;

d. Introduce options for realization of insolvent debtors' assets;

e. Provide for equitable treatment of similarly situated creditors;

f. Reinforce creditor rights, priority of claims and participation of all creditors in the insolvency process;

g. Introduce early restructuring opportunities for distressed companies and natural persons.

Table 5. Summary of objectives

OBJECTIVE	INDICATOR	RESPONSIBILITY	TIMING
Increase the value of a firm's assets and recoveries by creditors;	-Recovery rate by secured and unsecured creditors (%) -Value of post insolvency proceedings assets relative to insolvency mass (%)	Ministry of Justice of Georgia	TBD
Improve efficiency in liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;	-Duration of insolvency proceeding, by regime (# of months) -Cost of insolvency proceeding, by regime (% of insolvency mass) -Share of rehabilitation versus bankruptcy in total insolvency resolutions (%)	National Bureau of Enforcement	TBD
Improve business enabling environment;	-Doing Business Resolving Insolvency Score and Ranking - World Bank Governance Indicators (**SDG 16.6**) -Number of insolvency applications (#)	Ministry of Economy and Sustainable Development	TBD

IV. Policy Options

The section outlines the policy options selected after consulting with stakeholders, identifying the nature of the problem to be solved and defining the objectives policy options should help achieve.

Option 1

In the "No policy change" option the acting law is not changed and therefore, the trends associated with the current formulation of the law are unaltered. This implies that economic and social trends are expected to continue evolving as they are doing currently, in absence of the reform. The regulatory framework will continue to fail on its stated functions and objectives, compromising country's reputation for its business enabling environment. On the other hand, any additional burden on public and private sector associated with the new regulations will be avoided.

Proposed policy intervention, Option 2 measure/evaluate net benefits (qualitative and quantitative, where feasible) of such interventions.

Option 2

Option 2 is a policy scenario in which all key provisions from the Draft Law, as envisioned by the authors, are adopted.

In summary, compared to the current regulation of the insolvency the Draft Law provides following changes:

i. Compared to the Current Law, the Draft Law provides different allocation of the competences between the actors involved in the insolvency proceedings. For example, the bankruptcy or rehabilitation of the distressed company is made by the judge, not by the Conciliation Council as envisaged under the Current Law.[20]

ii. The Draft Law introduces the concept of the insolvency practitioner by which the person may assume the role of the bankruptcy or the rehabilitation manager if he meets certain qualification criteria (more about the insolvency practitioner is provided in the Section B below).

iii. The Draft Law amends the current ranking of the creditors. In particular, according to the Draft Law, the Revenue Service, even if it applies the tax security measures (such as tax pledge and tax mortgage) available under the tax legislation will not rank as the secured creditor. Moreover, the Draft Law singles out a new class of the creditors: the preferential creditors, which amongst others, includes the employees of the distressed company whose claims from the employment take precedence over the claims of the secured and unsecured creditors (more information of the creditors' ranking is provided in Section C below).[21]

iv. Within the bankruptcy proceedings, the Draft Law provides the satisfaction of the secured creditors only to the extent of the realized value of the secured assets. The part of the claims

[20] Shared responsibility principle under the 2030 Agenda. See the actors in the insolvency proceedings below: chapter V - Qualitative Analysis, sub-chapter "a" – Actors in the Insolvency Proceedings.

[21] Leave No One Behind Principle under the 2030 Agenda. Furthermore it relates to SDG 8 in terms of ensuring stability of work.

which are not be satisfied from the value of the secured assets, will be transferred to the pool of the claims of the unsecured creditors.

v. The Draft Law provides more neat criteria based on which the rehabilitation plan of the distressed company shall be prepared and then approved by the court.[22] Such criteria shall ensure that the rehabilitation plan is not approved in the detriment of the creditors.

vi. The Draft Law enables the unsecured creditors to prevail in approval of the rehabilitation plan even if the secured creditors are against such plan. Notably, in order the unsecured creditors to prevail, the rehabilitation plan shall meet the criteria which are further elaborated below.

vii. The Draft Law sets out the maximum thresholds for remuneration of the bankruptcy and rehabilitation manager. Subject to the substantiated grounds, the court may increase the fee above these thresholds.

The main risks associated with this option are[23]:

- Frictions in implementation and enforcement of the Draft Law due to capacity constraints at the NBE and Courts further deteriorating efficiency of public institutions
- Inadequate trust of secured creditors in the insolvency legal framework.
- Preparedness of private enterprises to make use of early restructuring options or redesigned formal insolvency procedures.

Ways to minimize these risks would be:

- supporting a gradual implementation of the reform, allowing a transition period to increase awareness on the new legislation, allowing creditors and enterprises to develop a greater understanding of the potential benefits associated with the reform;
- Engaging with key stakeholders including NBE, judges, secured and unsecured creditors from the early phases of reform design, and implementation.
- Developing inclusive and transparent system for monitoring and evaluation with clear assignment of duties and responsibilities as well indicators of success.

[22] Preparation and approval of the rehabilitation plan promotes economic activity of the company and thus contributes to generating income in the country and meeting the SD Goal 9.

[23] More extended analysis of risks and mitigation strategies can be found in APPENDIX II

V. Analysis of Impacts

A. Qualitative Analysis

This section of the report presents qualitative impact analysis of the proposed legislative interventions. Analysis consists of three main parts. First part analyzes in more details proposed changes from legal perspective. The second part describes outcomes in insolvency case and third part discusses anticorruption impacts of the Draft Law.

a. Actors in the Insolvency Proceedings

The Draft Law provides with three types of the actors involved in the insolvency proceedings:

(i) The Court;
(ii) The Insolvency Supervisor, which is the National Agency of the Enforcement Bureau of Georgia (the "Enforcement Bureau");
(iii) The Rehabilitation Manager or the Rehabilitation Supervisor appointed in case the debtor continues to manage the insolvent company; and
(iv) The Bankruptcy Manager.

The insolvency supervisor is involved at the early stage of the insolvency and from the moment when the court admits that the company is insolvent and opens the insolvency proceedings. The insolvency procedure is under the direction of the insolvency supervisor, however, under the Draft Law his powers are rather limited. In particular, the insolvency supervisor's main function is to carry out the basic actions for the reservation of the assets of the debtor, preparation of the initial report of the debtor, registering of the creditors claim and approvals of the major transactions to be carried out by the debtor. The operation of the insolvency supervisor is also limited in time. According to the Draft Law, the insolvency supervisor shall cease its operations as soon as the court approves the bankruptcy or rehabilitation of the debtor which shall be adopted within 1 month from the initiation of the insolvency (i.e. from the date when the insolvency supervisor is appointed to supervise the insolvent company). In sum, the role of the insolvency supervisor is mostly related to the preservation and safeguard of the insolvent company and preparation of the sufficient information for the court to resolve on actual insolvency of the company. This complies with the recommendations of World Bank Principles (C8.2) by which after the commencement of the insolvency proceedings the court or insolvency representative shall take measures "to preserve and protect the insolvency assets and debtor's business".

The Draft Law requires that the insolvency office holders (i.e. person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the rehabilitation or bankruptcy of the insolvent person's assets or affairs) set out under sections (ii) and (iii) are authorized to take appointments if they are the licensed insolvency practitioners (the "**Insolvency Practitioner**"). The goal of the Insolvency Practitioner is to be uniquely well qualified to advise businesses in financial difficulties and ensure such advice is properly qualified. Therefore, the Insolvency Practitioner should have some fundamental qualifications, which includes general ability and intelligence, experience and professional knowledge.

According to the Draft Law, the Insolvency Practitioner shall be elected by a random selection and upon that selection to be appointed by the court. Although a random selection system may have certain disadvantage (for example, it may not ensure that the particulars of the case is matched by

the appropriate qualification of the selected practitioner), we understand that such random selection is pursuing the goal to ensure that the Insolvency Practitioner possesses important personal qualities, such as integrity, impartiality and independence and that the selection is not influenced by the creditors and as a result avoid the potential conflict of interest.[24] Thus, the selection is made without the involvement of the court or of creditors/debtor. The appointment of the Insolvency Practitioner can be reversed/challenged if the selected Insolvency Practitioner has conflict of interest with either party involved in the insolvency or later once instituted, at the request of the creditor or the debtor by the court, if the Insolvency Practitioner has abused its powers.

The powers of an Insolvency Practitioner are tailored to specific proceedings, but in as far as they relate to the debtor's assets they are generally broad, e.g. to manage the debtor's business, enter into new contracts on its behalf, sell its assets, collect outstanding claims of the debtor, preserve all rights and claims of the debtor, decide on pending lawsuits or payment of creditors and carry out daily operations of the debtor. While implementing its duties, the Insolvency Practitioner, though bound by the fiduciary duties and by the same standard of conduct as applicable to the directors under the Law on Entrepreneurs, acts within his discretion. Apart from the certain cases, the Insolvency Practitioner does not need any approval for its actions. At the same time, the Insolvency Practitioner is bound by the instructions submitted by the court and its decisions can be challenged by the creditors or the shareholders of the debtor before the court.

In sum, although the court remains the major supervisor of the Insolvency Practitioner, it remains rather distant. Its role is: (i) to approve the major issues related to the insolvency, including the approval of the Rehabilitation Plan or approval of the costs associated with the Insolvency Practitioner; and (ii) mostly to deal with issues of a legal nature and disputes (conflicts with creditors, hearings, termination of a practitioners' appointment or converting a rehabilitation into the bankruptcy and vice versa). The court is not otherwise involved. Thus, the standard insolvency procedure is under the direction of an insolvency professional, even if the proceedings aim at bankruptcy, and his powers are broad. For example, within the bankruptcy decision the Bankruptcy Manager is entitled to make a decision on the form of the divestment of the distressed assets, as well as decide on whether to divest the assets as going concern on piecemeal basis.

Extension of board powers to the Insolvency Practitioner, who acts as the "master of the proceedings", necessitates that the Insolvency Practitioner meets a high standard of professionalism. However, it is not clear yet how the legislation will regulate licensing of the Insolvency Practitioner. Further regulations shall be adopted which shall set out professional requirements and eligibility criteria for the Insolvency Practitioner and ultimately, which body (whether the private or state) shall be authorized to issue license to the Insolvency Practitioner. In sum, the introduction of the Insolvency Practitioner is in line with the tendencies of major EU jurisdictions which already introduced such concept.[25] At the same time, additional regulations

[24] In this respect, see World Bank Principles (C6.2), by which "supervision of management is undertaken by an impartial and independent insolvency representative or supervisor". Likewise, according to the UNCITRAL Legislative Guide on Insolvency Law (2005), "it may also be desirable for the insolvency representative to possess certain personal qualities, such as integrity, impartiality, independence and good management skills". Moreover, the UNCITRAL Legislative Guide on Insolvency Law (2005) envisages a possibility of selection of the insolvency practitioner on a basis of rotation system. This further contributes to SD Goal 16 to establish transparent institutions.

[25] See also UNCITRAL Legislative Guide on Insolvency Law (2005), Section 2 (Qualifications) and its recommendations 115 and 116

shall be adopted in order to provide a transparent and predictable process of appointment of the Insolvency Practitioner as well as set out the requirements as to the impartiality, independence and competence of the Insolvency Practitioner. It highly desirable for the insolvency representative to be appropriately qualified, with knowledge not only in the law but most importantly, to have adequate experience in commercial and financial matters, including accounting. If more specialized qualification is required in a particular case (based on the specifications or particularities of the industry in which the distressed company is involved), it can always be provided by hired experts.

The Draft Law provides new rules for the remuneration of the Insolvency Practitioner. According to the Current Law, the remuneration of the insolvency office holder was determined by the creditors. The Draft Law takes a different approach, by which it sets out the maximum rates for the remuneration of the Insolvency Practitioner. In particular, the remuneration is set as the variable percentage varying according to the value of the insolvency assets. Ultimately, the final determination, as to the remuneration which the Insolvency Practitioner may charge is in the hands of a court, which is allowed to decrease the remuneration below the provided threshold or increase above the threshold if the Insolvency Practitioner proves that the costs in excess of the threshold was incurred on a legitimate basis. At the same time, the Draft Law maintains the priority payment of the remuneration of the Insolvency Practitioner.[26] In sum, the Draft Law sets out a fixed percentage for the remuneration, at the same time, allowing increase or decrease of the fee depending upon the particular case. The imposition of the remuneration thresholds and the court's control over the determination of the remuneration will ensure the remuneration is not inflated and is not distributed in an unfair manner. It is likely that by moving away from the creditors' based remuneration envisaged under the Current law, the Draft Law intends to avoid a situation where ability of the creditors to determine the final remuneration can be used as a leverage to unduly influence the conduct of the Insolvency Practitioner and subsequently a course of the proceedings.

While overall logic of the Insolvency Practitioners' remuneration can be assessed positively, additional analysis to determine payment scale needs to be conducted before the Draft Law is enforced. One should make sure that the remuneration package stipulated in the law is competitive and reflects market's changing environment. This is critical to attract highly qualified human resources. Moreover, it is crucial to design a payment scale is such a way which incentivizes Insolvency Practitioner to maximize value of debtors' assets.

b. Rights of Creditors and Ranking of Claims

The creditors' ranking is relevant in the bankruptcy proceedings, where the proceeds from the divestment of the assets shall be distributed among the creditors of the debtor. Likewise, the creditors ranking is also relevant is the rehabilitation proceedings in several aspects. For example, according to the Draft Law, the rehabilitation shall ensure that the creditors will receive at least more than they could receive under the bankruptcy and in this case regard shall be made to the satisfaction of the creditors according to the ranking set out under the Draft Law.

The Draft Law distinguishes rules of satisfaction of secured and non-secured claims. Notably, the unsecured creditors form a part of the registry creditors and they are satisfied from the insolvency assets (i.e. all assets of the debtor excluding the secured assets), while the secured creditors are not

[26] This is in the UNCITRAL Legislative Guide on Insolvency Law (2005) and its recommendation 119, which recommends to prioritize a payment of the fees of the Insolvency Practitioner over other payments under the insolvency assets.

part of the registry and they are satisfied from the proceeds of the secured assets. A main implication of this difference is as following:

- The secured creditors are satisfied primarily from the divestment of the secured assets in which that particular secured creditor holds the security interest. If the proceeds from the divestment of the secured assets do not fully cover the claim of the secured creditor, the unsatisfied part of this claim may be placed in the category of the unsecured claims (see Section 3(c) below);

- Unless otherwise agreed between the creditors, unsecured creditors have a recourse only to: (i) unsecured assets of the debtor; and (ii) any surplus, which has been left from the distribution of the proceeds received from the divestment of the secured assets.

Notably, compared to the Current Law, the Draft Law introduced the limited concept of the secured creditors. In particular, only those creditors holding the security rights as envisaged under the Civil Code of Georgia (the "**Civil Code**") will qualify for the class of the secured creditors. As a result, the Revenue Service, which is entitled to impose the security measures (such as tax pledge/mortgage, which from legal perspective are not viewed as the security rights of the Civil Code) for securing the tax liabilities, will not fall under the ranking of the secured creditor and its claims (except some exceptions such as preferred tax claims defined below in Section 3(b)) will have *pari passu* standing together with any unsecured claims (see Section 3(c) below). However, it is not clear a standing of the tax security interest in case such interest is created before the security interest envisaged under the Civil Code. Although the Draft Law provides no clear answer, we assume that in this case that the tax security interest will take a precedence over other security interest.

(a) Unsecured Creditors and Cost of the Proceedings

The order of satisfaction of the creditors from the value of the realization of the property is the following:

1. First rank: the costs associated with bankruptcy regime including the remuneration of the Bankruptcy Manager and the cost of the court proceedings in the order as set out under the Draft Law;

2. Second rank: the Company's debts created after the Insolvency Admissibility Decision, including tax liabilities;

3. Third rank: the creditors in the following order:

(a) preferential claims existing before the Insolvency Admissibility Decision, which are limited to a maximum of 3 months' salary/vacation expenses/injuries for the employees, however no more than GEL 1,000 per one creditor;

(b) preferential tax claim – amount of indirect taxes (VAT, excise duty and import duty) accrued to the debtor prior to one year of the Insolvency Admissibility Decision;

(c) unsecured claims, including amongst others, taxes accrued prior to the date of submission of the insolvency application to the court;

(d) the claims in the penalties and interests (including administrative fines and tax penalties) accrued to the liabilities existing before the Insolvency Admissibility Decision;

(e) non-privileged claim – i.e. the claim, which pursuant to the agreement of the creditor and the debtor will be satisfied on an unprivileged basis; and

(f) the claims from the corporate relationships (payment related to dividend distributions, share buy-outs, capital decreases).

Note that the tax claims, which are secured by the Revenue Service through the tax security measures (such as tax mortgage/pledge) and provided that such measures were imposed and created after the security interest of the secured creditors, will fall under the unsecured claims (see section 3(c) above).[27]

Distribution is based on the principle of proportionality. After distribution, the Bankruptcy Manager issues the distribution report that shall be submitted to the creditors and to the court and finally, approved by the court.

(b) Secured Creditors

The secured creditors (e.g. the Bank) do not form the part of registry creditors. They are to be satisfied from the secured property in which they hold the security rights and may ask realization of the secured property.

The Bankruptcy Manager shall make realization of the secured property in accordance with the request of the Secured Creditors, if otherwise cannot be reached more profitable result. 7% shall be deducted from the amount received from the realization of the secured property, which will be included in the insolvency asset.

The Secured Creditors shall be satisfied from the sale of the relevant secured property in accordance with the order as established by the Civil Code of Georgia. If value of the divested property is less than the secured claims and if the secured creditors agree, the unsatisfied part of the secured claims may be placed in the category of the unsecured claims (see section 3(c) above). If the value of the realization of the property exceeds the claim of secured creditor(s), the amount beyond the secured creditor's claim shall become a part of the insolvency asset. In compliance with the World Bank Principles (2016), Principle C12.2. The Draft Law ensures prompt distributions to secured creditors, who are satisfied primarily from the divestment of the secured assets in which that particular they hold the security interest.

In addition, by introducing a separate divestment rules for secured and unsecured creditors, as well as the rules for the preferential creditors (with exception of preferential tax claim, which is further discussed below), the Draft Law ensures UNICITRAL *principle of equitable treatment*,[28] which requires that in collective proceedings equal creditors with similar legal rights should be treated fairly, receiving a distribution on their claim in conformity with their ranking and interests.

Apart from it, in general, UNICITRAL *principle of clear rules for the ranking of creditors* is partially guaranteed. The Draft Law provides clear terms for the creditors' ranking, hence, provides predictability to creditors,[29] but reflects certain fiscal (public) interest and determines preferential rank of certain tax claims (i.e. the preferential tax claim, which are amount of indirect taxes accrued to the debtor prior to one year of the Insolvency Admissibility Decision), which have the potential to distort the outcome of insolvency. It has to be admitted that abovementioned principle, as well as World Bank Principle (2016), C12.3 requires minimization of prioritizations.[30]

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[27] As mentioned above, although it is not clear from the Draft Law, the tax security interest created before any other security interest will take a precedence.

[28] According to the UNICITRAL *principle of equitable treatment*: "all creditors do not need to be treated identically, but in a manner that reflects the different bargains they have struck with the debtor. This is less relevant as a defining factor where there is no specific debt contract with the debtor, such as in the case of damage claimants (e.g. for environmental damage) and tax authorities. Even though the principle of equitable treatment may be modified by social policy on priorities and give way to the prerogatives pertaining to holders of claims or interests that arise, for example, by operation of law, it retains its significance by ensuring that the priority accorded to the claims of a similar class affects all members of the class in the same manner."

[29] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 13; "consistent application of the rules, confidence in the proceedings and that all participants are able to adopt appropriate measures to manage risk";

[30] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 13;

The Draft Law as a first is ensures payment of insolvency expenses, such as court fees and expenses for insolvency officer, supervisor, assets management and preferential rank is given to claims from the workforces with specific limitations.[31] This is progressive change in comparison to the Current Law, which also complies with the World Bank Principles (2016), Principle C12.4, which requires that the claims from labor to be given priority with "careful consideration" for "balancing the rights of employees with those of other creditors".[32]

The preferential employment entitlements are followed by preferential tax claim, i.e. the amount of indirect taxes (such as VAT, import tax and excise duties) generated prior to one year of the Insolvency Admissibility Decision. Afterwards, comes unsecured claims, including other tax debts, followed by the claims in the penalties and interests accrued to the liabilities existing before the Insolvency Admissibility Decision, creditor's non-privileged claim agreed as such by the Company and respective creditor; In compliance with the World Bank Principles (2016), Principle C12.5 the claims from the corporate relationships are satisfied as a last class, after full repayment of all creditors.

Though, the Draft law envisages and ensures most guiding principles as mentioned above, it should be admitted that the certain tax claims in second and third rank are given preference over the unsecured claims. Hence, the public interests are given precedence over private rights that is not in conformity with the World Bank Principles (2016), Principle C12.3, which states that "Public interests generally should not be given precedence over private rights". It is suggested that the tax claims should be treated the same as other claims.[33] However, it should be emphasized that in comparison to Current Law, which provided unconditional preference of secured tax claims over the other unsecured claims, in general a preference of the secured tax claims is limited under the Draft Law.

In contrast to Current Law, the Draft Law introduces the *Deduction Rule*[34]. The secured creditors contribute to cover costs in the manner that 7% will be deduced from the amount received from the realization of the secured property and will be included in the insolvency asset. The goal hereby is to ensure that upon the divestment of the secured assets, a certain portion of the funds is retained from the divestment which shall cover certain unsecured claims and costs of proceedings.

c. Time Limits and Deadlines

The key question analyzed here is the timeline of the insolvency processes and duration of subsequent bankruptcy/rehabilitation. In general, the Draft Law tends to set out the specific deadlines for the various actions and phases of the insolvency to ensure that the period related to potential bankruptcy or rehabilitation of the debtor is foreseeable and certain. Such intention generally complies with the standard requirement that the insolvency should be addressed and resolved in an orderly, quick and efficient manner.[35]

The Draft Law provides the following time limits in the course of the insolvency proceedings:

[31] A certain preference of the preferential claims is also in compliance with the report "Rescue of Business in Insolvency Law" of the European Law Institute:
https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf

[32] Principle C12.4;

[33] European Law Institute, the report "Rescue of Business in Insolvency Law", Recommendation 4.04 states that no additional general preferences shall be given to specific groups of creditors for protection of social interests; giving preference to fiscal interests shall be analyzed thoroughly (including it shall be determined their general impact on rescue efforts).

[34] European Law Institute, the report "Rescue of Business in Insolvency Law", Recommendation 4.03 *Deduction rule*: "While no assets cases should be financed by public funds, secured creditors should contribute to cover costs in other cases by introducing a clear and predictable deduction rule, e.g. a general deduction up to 10 per cent."

[35] See UNCITRAL Legislative Guide on Insolvency Law (2005)

Insolvency Review

In the first phase, the court conducts the inquiry proceedings to determine whether the debtor is actually is insolvent. This inquiry requires a certain insolvency test and according to the Draft Law, an insolvency review at the court may not exceed 10 days.

Bankruptcy/Rehabilitation Review

If the court declares the debtor insolvent, under the following phase it shall determine whether the debtor is subject to the bankruptcy or its financial situation can be remedied through the rehabilitation. In either case, the bankruptcy/rehabilitation review by the court is limited to 30 days from the date when the court approves the insolvency of the debtor and qualifies the company as insolvent. In sum, the Draft Law provides clearer cut deadlines as to resolution of the bankruptcy or rehabilitation of the debtor compared to the Current Law, which does not set out the specific period during which the Conciliation Council shall adopt the decision on bankruptcy or the rehabilitation.

Such strict deadline is in compliance with the accepted standards, by which a court is required to make a decision as to commencement of the insolvency and subsequent bankruptcy/rehabilitation in a timely manner to ensure the efficient conduct of the proceedings without delay.[36]

Approval of the Rehabilitation Plan

If the court opts for the rehabilitation of the debtor, the Rehabilitation Manager, appointed by the court by virtue of the rehabilitation decision, is limited in time to strike a consensus with the creditors over the proposed Rehabilitation Plan. In particular, according to the Draft Law, the rehabilitation plan shall be approved by the creditors no later than 9 months from the date when the debtor is declared insolvent by the court. The prolongation of this period is not allowed and failure to obtain the creditors' consent within this period will automatically convert the rehabilitation proceedings into the bankruptcy proceedings. At the same time, we note that the Draft Law sets out no timeline during which the court shall approve the rehabilitation plan which has been approved by the courts and submitted by the Rehabilitation Manager to the court for the final approval. An absence of the time limitation on the court to accept the rehabilitation plan, does not enable to foresee the exact timeline required for the final adoption of the rehabilitation plan. Therefore, it is recommended the Draft Law to set out the certain time limit for the court to approve the rehabilitation plan which is approved by the creditors

Timeline of the Bankruptcy

The Draft Law provides no time limits for the process of the bankruptcy and related divestment of the assets of the debtor. In particular, the Bankruptcy Manager is not limited in time to decide on the form of the divestment of the debtor's asset. Likewise, in case the Bankruptcy Manager opts for the direct sale, no period is prescribed for the Bankruptcy Manager to finalize such sale. Though, the Draft Law provides the time limitations if the distressed assets are to be divested though the auction subscribing exact period for the conduct of each round of auction.

[36] See UNCITRAL Legislative Guide on Insolvency Law (2005), page 58

In sum, compared to the Current Law, the Draft Law tends to fix time limits for most of the insolvency actions or milestones, apparently providing certainty and transparency for both the debtor and creditors. At the same time, fixed time period may not be flexible to take account of the circumstances of the particular case. It may also prove difficult to ensure that the court or the other participants of the proceedings adheres to the established limit. This particularly applies for the rehabilitation plan which, according to the Draft Law, shall be approved by the creditors within 9 months from the date the debtor is declared insolvent by the court. The rationale of the Draft Law is clear as it aims to restrict a misuse of the insolvency regime by debtors who are seeking to obtain only the benefits of the moratorium. However, in complex cases, where the several rounds of consultation may be required with the creditors, limitation of the approval process of the rehabilitation plan to 9 months, may not be a flexible option.

d. Consumer Bankruptcy

Current regulation

The Current Law does not regulate the issue of insolvency of natural persons. Pursuant to Article 2.2(a) of the Current Law, its scope does not extend to natural persons except for individual entrepreneurs against which the Current Law does not prohibit commencement of insolvency proceedings with rehabilitation or bankruptcy regime.

Proposed Regulation

Compared to the Current Law, a scope of the Draft Law extends to natural persons, however, only by way of using the voluntary agreement.[37]

A voluntary agreement represents a novelty introduced by the Draft Law and is defined as an agreement reached between a debtor and a creditor within which each creditor receives the minimum amount of money that they would have received should the debtor have gone bankrupt, except the case when the creditor agrees to the satisfaction of its claim in a different manner.[38] In case of a natural person, the goal of the voluntary agreement is to release the natural persons from the outstanding debts.[39]

A voluntary agreement may be proposed to the creditor only by a debtor natural person. Such proposal and its conditions shall be sent to a supervisor of a voluntary agreement, which shall be an insolvency practitioner. Within 30 calendar days from the date of receipt of the proposal, the supervisor shall prepare a report. In case of a positive feedback, a debtor shall present such report to the court along with the proposal.

After having established compliance of the proposal and the report with all formal requirements by the court, the supervisor shall convene a creditors meeting which shall confirm and approve the voluntary agreement within no later than 2 months.

After approving the voluntary agreement, unless otherwise determined by such voluntary agreement, creditors are not entitled to initiate or continue any disputes against the debtor related

[37] See Articles 4.2 and 4.3 of the Draft Law

[38] See Article 18.1 of the Draft Law

[39] See Article 18.3 of the Draft Law

to the claims that are regulated by the voluntary agreement, unless the agreement has been breached.

In case of natural persons, the voluntary agreement might be terminated by: (a) fulfilment of such voluntary agreement or (b) premature termination, including due to breach of the agreement.

As to the costs associated with the voluntary agreement, the state fee for registering the application on voluntary agreement is GEL 500 which shall be paid by the applicant (debtor) upon submitting the application. Noteworthy, it is not that clear how the costs of the supervisor (insolvency practitioner) shall be reimbursed. Pursuant to the Draft Law, the rules concerning compensation of such practitioners is only applied to calculate the amount of compensation for insolvency practitioners only when they serve as rehabilitation / bankruptcy managers. Therefore, the amount of compensation of the supervisor, in case of the voluntary agreement, shall be determined by the court and be paid by the debtor.

Assessment of the Proposed Regulation

As already mentioned, the Current Law is not familiar with insolvency proceedings of natural persons. In light of this, introduction of voluntary agreement in relation to natural persons by the Draft Law is noteworthy. Naturally, pros and cons of such institute will be more visible in practice, however, at this stage, it could be said that operation of such institute will most likely be wholly dependent on the activities and willingness of debtors. Grounds for such conclusion are as follows:

- A voluntary agreement does not represent any regime of the insolvency proceedings;
- Since it is prohibited to engage the natural person debtors into rehabilitation or bankruptcy regimes, transformation of such regimes into voluntary agreement is not possible.

Taking these two considerations into account, proposing a voluntary agreement to creditors is solely a voluntary act of the debtor (natural person). Naturally, a natural person will only choose this option if the potential benefits outweighs potential costs.

With respect to the fact that the procedure of the voluntary agreement requires an intensive involvement of the debtor (preparation of the proposal, including, business report, its terms and conditions; submission to the supervisor; obtaining a positive report from the supervisor and further communication with the court), a conclusion and finalization of the voluntary agreement will require sufficiently qualified legal assistance for the debtor. The latter will result in additional expenses of the debtor.

An instant benefit of the voluntary agreement is an imposition of the moratorium that suspends the enforcement and foreclosure measures against the debtor, halts current disputes and accrual of the interest to the outstanding debt. On the other hand, nowadays, in case of unsecured obligations, the best "weapon" of debtors is to hide from their creditors.

It should be noted that the attitude of the court towards the penalties and reduction of such penalties to minimum, results in a reality where the debtor is only required to pay the principal amount of the debt. To put it simply, instead of trying to reach the voluntary agreement with the creditor, the debtor prefers to extend the dispute (a) to avoid fulfilment of its obligations during the dispute; and (b) because it is aware of the court practice with respect to reduction of the penalties,

by which the debtor will be exempted from the accrued interest even if he is in delay with payment of the debt.

After prolonged court proceedings, when the creditor wins the case and the debtor is obliged to fulfil the decision, the stage of enforcement proceedings commences with two potential scenarios:

1) In case the debtor does not own any property, does not have any official income or bank account with money, the debtor tries not to engage in the process since the debtor is aware that the creditors will not have any recourse to the assets. In such cases, it is typical that the debtors simply "hide". Therefore, it is often necessary to find them through the police in order to present them before the enforcement manager. Moreover, even if such debtor is found, if he does not have any official income or property, it is impossible to enforce the decision and satisfy the claims. Therefore, such disputes are suspended for years hoping that someday the debtor will acquire property or receive official income which will further be used as a source for satisfying the claims of the creditors; or

2) in case the debtor owns property or has an official income, as a rule, the debtor either pays the debt voluntarily and promptly or proposes to the creditor to divide the payable sum. However, in light of the existing regulations, it is prohibited to divide (extend) such payables into more than 12 months. Due to this time limitation, this might become a burden for the debtor, since he has to agree on a division that is impossible to fulfil within the proposed timeline and, again, the debtor may face potential default and subsequent inability to pay the outstanding sums.

Based on the above, the strategy of the debtor, as usual, is simple – the debtor does not commence fulfilment of the obligation until the very last moment. In those cases, when the debtor does not have any enforceable assets, he does not even consider fulfilment of the obligations.

Having such a simple strategy, the voluntary agreement and mainly the moratorium in which it results, may become yet another weapon for the debtor to satisfy the creditors' claims. At the same time, it is unlikely the debtor to initiate the procedures on the voluntary agreement and incurred subsequent costs associated with the voluntary agreement, when under a current legal regime, the debtor has availability of certain weapons (as set out above) to bypass or protract the payment of the debts without incurring any substantial costs.

It shall be mentioned that the Law of Georgia on Enforcement Proceedings envisages so called simplified proceedings related to claims of reimbursement of monetary obligations, which has certain similarities with the institute of the voluntary agreement. Such simplified proceedings enable the debtor and the creditor to strike the settlement by which the debtor will be able to pay the debt in instalment or extend the period for the debt payment. In sum, the outcome of the proceedings is wholly dependent on the debtor and its willingness to cooperate with the creditor.

Despite certain similarities, there is one big difference between the simplified proceedings and voluntary agreements, and particularly in terms of their results. In particular, in the first instance, the enforceable act is being issued which represents the prerequisite for commencement of enforcement proceedings and in the second instance, the creditor is obliged to renew the suspended dispute or initiate the standard dispute resolution mechanisms. Therefore, naturally, the creditors will prefer to choose a simplified proceedings.

Conclusion

As demonstrated above, existing judicial system is formed in a manner that the debtor prefers to postpone payment of the debt until the last minute and refrain from engagement in the debt restructuring process with the creditors. It is true that in such case the costs incurred by the creditor have to be paid by the debtor, however, the time gained by the debtor is worth the costs.

Based on the considerations above and with respect to the fact that the voluntary agreement is a voluntary act of the debtor, it is unlikely that the debtors who are natural persons, will actively use the voluntary agreement, especially in those cases where the outstanding amount is not too much and/or the debtor is reluctant to the fact that he/she might be recorded in the Debtor Registry and/or exposed to other restrictions.

UNCITRAL Legislative Guide on Insolvency Law (the "**Legislative Guide**") does not address issues specific to the insolvency of individuals who are not engaged in economic activities, such as consumers. It notes that policies applicable to individual or personal debt and insolvency often evidence cultural attitudes that are not as relevant to debtors engaged in economic activity. Despite availability of different tests for determining differences between interests of natural persons involved in economic activity and those of consumer debtors, it remains difficult to separate an individual's personal indebtedness from their business indebtedness for the purposes of determining how they should be treated in insolvency. Therefore, the Legislative Guide focuses on the conduct of economic activities by both legal and natural persons, irrespective of the legal structure through which those activities are conducted and whether or not they are conducted for profit and does not provides special considerations with respect to the consumer insolvency.[40]

However, when addressing the insolvency of the natural persons engaged in a business undertaking and considering difficulties in separating the debts accrued for the business and personal purposes, the Legislative Guide suggests not to adopt rules on the business debts of natural persons that differ from the rules applicable to consumer debts.[41]

As it was emphasized above, the Draft Law extends its scope on natural persons for purposes of voluntary agreement that in no event will be transformed in any of insolvency regimes: bankruptcy or rehabilitation. Therefore, its application to natural persons is considerably limited. This is contrary to the recommendations set out in the Legislative Guide[42] which stresses an importance of adopting such insolvency law that should govern insolvency proceedings against all debtors (both natural and legal persons) that are engaged in economic activities.

Voluntary agreement, considering its voluntary nature, is very similar to so called Voluntary Restructuring Negotiations, which is broadly used in some jurisdictions and is developed by the banking sector, as an alternative to formal reorganization proceedings under respective insolvency law, with limited applicability in cases of corporate financial difficulty or insolvency in which there is a significant amount of debt owed to banks and financiers.[43] The Legislative Guide mentions that

[40] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 41

[41] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 284

[42] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 44

[43] UNCITRAL Legislative Guide on Insolvency Law (2005), p. 21

in order the Voluntary Restructuring Negotiations to be effective, the respective legislative framework shall enable the insolvency proceedings of the natural person.

Considering current over-indebtedness of natural persons, we are of the view that the Draft Law shall extend its scope to natural persons beyond voluntary agreement and adopt rules enabling insolvency procedure, either bankruptcy or rehabilitation, as a case may be, to apply to individuals. The protection of natural persons is also accepted by the World Bank Principles for Effective Insolvency and Creditor / Debtor Regimes, which underlines importance of adopting clear exemptions to allow individuals to retain household goods and those assets indispensable to the debtor's profession or job as well as the subsistence of the debtor and his/her family. According to IMF[44], there are five aspects that personal insolvency law should take into account as to be economically efficient:

1. Allocate risks among parties in a fair and equitable manner;
2. Provide a fresh start through discharge of financially responsible individuals from the liabilities at the end of insolvency proceedings (typically after 3-5 years);
3. Establish appropriate filing criteria to make insolvency procedures accessible to individual debtors while minimizing abuse;
4. Impose automatic and temporary stay on enforcement actions with adequate safeguards of creditor interests;
5. Set repayment terms that accurately reflect the debtor's capacity to repay to ensure an effective fresh start;

Therefore, we are of the view that the issue of the insolvency of the natural person is not sufficiently addressed under the Draft Law and additional regulations shall be introduced in this respect.[45]

e. Case Study Analysis

This section of the report presents results of a case study which has been adopted from Doing Business Resolving Insolvency indicator methodology, but has been modified to account for number of additional circumstances that can arise in a typical insolvency proceeding. The main goal of the section is to understand cost and time implications of the Draft Law and compare them against current legislative framework. In addition, the analysis tries to identify gaps in the Draft Law which could hamper effective implementation of the Draft Law. First, we study the case on the basis of the Current Law. The analysis is then extended to the Draft Law.

Assumptions about the business

The business:

- Is a limited liability company.
- Operates in the economy's largest business city.

[44] IMF, 2013, Dealing with private debt distress in the wake of the financial crisis

[45] This will further ensure compliance with the Leave No One Behind Principle under the 2030 Agenda.

- Has downtown real estate, where it runs a hotel, as its major asset. Other assets include the movable property and the inventory (such as food, products utility inventories) used for the daily operation of the hotel.
- Has a professional general manager.
- Has 201 employees and 50 suppliers, each of which is owed money for the last delivery.
- Has a 10-year loan agreement with a domestic bank secured by a mortgage over the hotel's entire real estate property.
- One of the shareholders of the company (the "**Shareholder**") also extended the loan to the company (the "**Shareholder Loan**"), which is secured by a pledge with respect to all movable property and inventory of the company which are used for the hotel operations, except the vehicles of the Company which are not subject to any encumbrance.
- Has observed the payment schedule and all other conditions of the loan up to now.
- Has a market value, operating as a going concern, of $200,000. The market value of the company's assets, if sold piecemeal, is 70% of the market value of the business, i.e. $140,000, out of which the hotel's entire real estate property value would be $120,000.

Assumptions about the case

The business is experiencing liquidity problems. The company's loss in 2016 reduced its net worth to a negative figure. It is January 1, 2017. There is no cash to pay the bank interest or principal in full, due the next day, January 2. The business will therefore default on its loan. Management believes that losses will be incurred in 2017 and 2018 as well. But it expects 2017 cash flow to cover all operating expenses, including supplier payments, salaries, maintenance costs and taxes, though not principal or interest payments to the bank. On 15 January 2017, the VAT and other payable taxes were accrued to the company in the amount of $40,000, which the company could not pay. Thus, it resulted in imposition of the tax mortgage/pledge over the entire assets of the company.

The amount outstanding under the loan agreement is equal to $170,000. The company's further creditors include:

- The Revenue Service with respect to $40,000 taxes payable by the company
- The company's shareholder's loan in the amount of $50,000;
- Other creditors (suppliers, employees and utility companies) in the amount of $60,000, out of which the payroll payment amounts to $20,000.

The company has too many creditors to negotiate an informal out-of-court workout. The following options are available: a judicial procedure aimed at the rehabilitation or reorganization of the company to permit its continued operation; a judicial procedure aimed at the liquidation or winding-up of the company; or a judicial debt enforcement procedure (foreclosure or receivership) against the company.

Assumptions about the parties

The bank wants to recover as much as possible of its loan, as quickly and cheaply as possible. The unsecured creditors will do everything permitted under the applicable laws to avoid a piecemeal sale of the assets. The majority shareholder wants to keep the company operating and under his control. Management wants to keep the company operating and preserve its employees' jobs. All the parties are local entities or citizens; no foreign parties are involved.

Other Assumptions

- The bankruptcy and/or rehabilitation proceeding is due and runs without complications;
- The court as well as other parties to the process take maximum time as determined by relevant law;
- All the calculations are made in USD; The currency exchange rate with regard to GEL is fixed as 2.7;
- Attorney fees are not envisaged in calculations;
- Rehabilitation manager fee is not envisaged in the scenarios as per Current Law, however, is assumed to be comparable to the amount stipulated in the Draft Law;
- The fee for enforcement bureau, as a supervisor of the process, before the bankruptcy/rehabilitation manager is appointed, as well as a fee for bankruptcy manager with respect to the current law is taken from the Order of the Minister of Justice #144.

- The scenarios of bankruptcy and rehabilitation pursuant to the Law on Insolvency (the "Current Law")

Rehabilitation pursuant to the Current Law

For the purpose of the below report the Bank, the Revenue Service and the Shareholder are referred to as the "**Secured Creditor**", while other creditors are referred to as the "**Unsecured Creditors**".

The Unsecured Creditors want to recover the Company and therefore, they submit the application of the debtor's insolvency (the "**Insolvency Application**") to the court on 1 February 2017 and deposits GEL 5,000 in the court.

The court has 5 days to consider the Insolvency Application.[46] In certain cases, the court may prolong this period by additional 10 days.[47] In addition, if the Insolvency Application has gaps, the court may also prolong the period for admissibility review by additional 5 working days.[48] If court satisfies the Insolvency Application, the court will adopt the decision (the "**Insolvency Decision**") and open the insolvency proceedings (the "**Insolvency Proceedings**"). The court will publish the Insolvency Decision in the electronic system/to the web-page www.matsne.gov.ge in order to inform creditors of the Company.[49]

To sum: if the Insolvency Application is filed on 1 February 2017, the court will satisfy the Insolvency Application on 6 February 2017 (in certain cases by 16 February 2017) and opens the

[46] See Article 19.1 of the Current Law

[47] See Article 22.2 of the Current Law

[48] See Article 20.1 of the Current Law

[49] See Article 20.5 of the Current Law

Insolvency Proceedings. In this case, we assume that the court adopts the Insolvency Decision on 16 February 2017.

Appointment of the Insolvency Trustee

Upon the commencing of the Insolvency Proceedings, the insolvency trustee (the "**Trustee**") will undertake a control of the Company. In particular, the debtor cannot make any decision without the consent of the Trustee or the court.[50] The Enforcement Bureau will act as the Trustee[51]. The authority of the Trustee will cease once the court approves the decision on appointment of the Rehabilitation Manager (as defined below).

Call to the Creditors

Within 20 days from the Insolvency Decision, the person authorized to manage the Company (e.g. the debtor) shall provide the Trustee with information on the Company.[52] Within the same period, the creditors of the Company shall submit their claims.[53]

The court and the Trustee will call the creditors meeting (the "**Creditors Meeting**"), which shall be created and convened from 30 up to 40 days from the Insolvency Decision.[54] The duration of the first Creditors Meeting shall be no more than 7 working days.[55]

In sum: the first Creditors Meeting shall take place no later than 27 March 2017. If the first Creditors Meeting is held on 27 March 2017 then it shall be finished no later than 6 April 2017. However, we note that in practice and in particular in complex cases the first Creditors Meeting usually takes more than 7 working days.

The creditors' claims are examined by the court at the first Creditors Meeting.[56] After the creditors' claims are examined, the Conciliation Council (the "**Conciliation Council**") is created.[57] The Conciliation Council has three members: one member is elected by the debtor, one by the creditors with the simple majority votes and one member by the representatives of the creditors and the Company (if they could not agree, then the court will appoint the third member).[58] The Current Law provides no timeline for the election of the members of the Conciliation Council, as well as, for the appointment of the third member of the Conciliation Council by the court in case the creditors and the debtor cannot agree on such member.

To sum: since the Conciliation Council shall be created at the first Creditors Meeting, we assume that the such committee is set up on 6 April 2017 (the last day of the first Creditors Meeting).

The Bank, having the majority votes in the Creditors Meeting, will appoint one member of the Conciliation Council. It is most likely that the the creditors and the debtor will not be able to agree

[50] See Article 21.2(a) of the Current Law

[51] See Article 26.1 of the Current Law

[52] See Article 24.1 of the Current Law

[53] See Article 29.1 of the Current Law

[54] See Article 21.1(b) of the Current Law

[55] See Article 27.22 of the Current Law

[56] See Article 27.23 of the Current Law

[57] See Article 27.23 of the Current Law

[58] It is an often case that the third member of the Conciliation Council is not selected at the first Creditors Meeting

on the third member of the conciliation council. Thus, it will rest on the court to appoint the third member.

Rehabilitation Decision

Within 15 days from its creation the Conciliation Council shall discuss whether the Company shall be subject to bankruptcy or the rehabilitation.[59] The Current Law does not set out the period during which the Conciliation Council shall adopt the decision on bankruptcy or the rehabilitation as it only says that the Conciliation Council shall discuss (review) the issue within 15 days from its creation.

Provided that the Conciliation Council agrees to the rehabilitation, it shall submit the proposal for the rehabilitation to the court.[60] If the latter agrees to the rehabilitation, then the court adopts the rehabilitation decision (the "**Rehabilitation Decision**"). Within 3 days from the Rehabilitation Plan, the creditors will elect the rehabilitation manager (the "**Rehabilitation Manager**") which shall approved by the court.[61]

In sum: the Current Law provides no timeline for the Conciliation Council to resolve on rehabilitation of the Company. Neither, the Current Law sets out any period during which the court shall adopt the Rehabilitation Decision if the Conciliation Council proposes the rehabilitation. Moreover, we are of the view that under the Current Law, the court is not able to reverse the decision of the Conciliation Council. Moreover, the Current Law provides no criteria based on which the Conciliation Council shall adopt its decision.

Based on the practice the adoption of the rehabilitation proposal by the Conciliation Council and subsequent adoption of the Rehabilitation Decision may take up to 30 days from the establishment of the Conciliation Council. Therefore, we assume that the court adopts the Rehabilitation Decision by 7 May 2017.

Rehabilitation Plan

The preparation of the rehabilitation plan (the "**Rehabilitation Plan**") shall be commenced from the date of the Rehabilitation Decision.[62] The preparation period shall not exceed 60 days (unless otherwise decided by the majority of the creditors)[63] and during this period shall be submitted to the Conciliation Council for the approval. Once submitted, the Conciliation Council has 10 days to consider and approve the draft Rehabilitation Plan.[64] Upon approval by the Conciliation Council, the draft Rehabilitation Plan shall be submitted to the Secured Creditors which shall approve it within 7 days from the submission. All Secured Creditors shall approve the Rehabilitation Plan.[65] At the same time, the Current Law does not deal with situation if the Conciliation Council does not agree with the draft Rehabilitation Plan and whether it can demand any changes into the plan, which will result in the prolongation of the process for the approval of the Rehabilitation Plan. It

[59] See Article 33.1 of the Current Law

[60] See Article 33 of the Current Law

[61] See Article 44.2 of the Current Law

[62] See Article 43.1 of the Current Law

[63] See Article 43.2 of the Current Law

[64] See Article 46.6 of the Current Law

[65] See Article 47.1 of the Current Law

is not also clear what will be procedures and period for the approval if not all Secured Creditors approve the Rehabilitation Plan.

In Sum: the draft of the Rehabilitation Plan shall be prepared and submitted to the Conciliation Council for the approval no later than 8 August 2017 and the Conciliation Council shall approve it no later 18 August 2017, while the Secured Creditors shall approve the Rehabilitation Plan by 25 August 2017.

At the same time, the Bank will have substantial leverage to control the adoption of the Rehabilitation Plan as according to the Current Law, the draft Rehabilitation Plan shall be approved by all Secured Creditors. Therefore, the Bank will not have any incentive to approve the Rehabilitation Plan if it sees that it cannot recover the loan through the realization of the secured assets (e.g. through the bankruptcy)

Costs

According to the Draft Law, there are three major costs related to the rehabilitation process:

1. The court fee in the amount of GEL 5,000 (approximately USD 1,852);
2. The cost of the Trustee. According to the Order of the Ministry of Justice, the fee of the Trustee will amount to 6% of debtors' assets, around USD 18,519.[66]
3. The cost of the Rehabilitation Manager, which however is not set out by the legislation and depends on the decision of the creditors. Thus, such costs vary according to the case. For illustration purposes, we assume that this cost amounts to the value stipulated in the Draft Law, USD 21,296.

Position of the Bank and probability of the Rehabilitation

We note that the Bank, as the secured creditor and as the majority holder of votes at the Creditors Meeting will have substantial ownership over the insolvency process.

First, the Bank will be able to appoint one member to the Conciliation Council, which ultimately shall approve whether the Company will be rehabilitated. Second, the draft Rehabilitation Plan shall be approved by the Secured Creditor, including the Bank. Thus, if the Bank sees the ability to recover the loan through the realization of the secured assets (i.e. through the bankruptcy), then it is most likely that the Bank will reject the Rehabilitation Plan and force the bankruptcy of the Company.

Summary

As to the timing, according to the Current Law, the minimum period for the approval of the Rehabilitation Plan may take up to 7 months from the date of the Insolvency Application. However, in complex cases the process may be protracted due to various reasons. For example, in most cases the examination of the creditors' claims at the first Creditor Meeting may take more than 7 working days.

[66] See Article 9.1(b.c) of the Order of the Minister of Justice

As to the costs, the approximate cost of the rehabilitation will be $41,667. This however, does not include the cost of the attorneys.

Bankruptcy pursuant to the Current Law

The sections 1, 2 and 3 as set out above for the rehabilitation will apply for the bankruptcy.

Since the Conciliation Council shall be created at the first Creditors Meeting, we assume that such committee is set up on 6 April 2017 (the last day of the first Creditors Meeting).

The Bank, having the majority votes in the Creditors Meeting, will appoint one member of the Conciliation Council. It is most likely that the creditors and the debtor will not be able to agree on the third member of the Conciliation Council. Thus, it will rest on the court to appoint the third member.

Bankruptcy Decision

Within 15 days from its creation, the Conciliation Council shall discuss whether the Company shall be subject to bankruptcy or the rehabilitation. The Current Law does not set out the period during which the Conciliation Council shall adopt the decision on bankruptcy or the rehabilitation as it only says that the Conciliation Council shall discuss (review) the issue within 15 days from its creation. We assume that the Conciliation Council has discussed and took decision on the debtor's bankruptcy within the same 15 days from its creation, i.e. on 21 April, 2017.[67] The decision is approved by the court decision (the "**Bankruptcy Decision**").[68] Within 3 days from the Bankruptcy Decision, the creditors shall appoint the bankruptcy manager (the "**Bankruptcy Manager**"), i.e. not later than 24 April 2017 the Bankruptcy Manager is appointed by the Creditors. If the Bankruptcy Manager is not selected by the creditors, then the court will appoint the Enforcement Bureau as the Bankruptcy Manager.[69]

To sum: the Current Law provides no timeline for the Conciliation Council to resolve on bankruptcy of the Company. Neither, the Current Law sets out any period during which the court shall adopt the Bankruptcy Decision if the Conciliation Council proposes the bankruptcy. Moreover, we are of the view that under the Current Law, the court is not able to reverse the decision of the Conciliation Council. Moreover, the Current Law provides no criteria based on which the Conciliation Council shall adopt its decision.

Auction

In the bankruptcy proceedings, the insolvency property is sold in the auction.[70] The duration of auction shall be 7 up to 10 days.[71] From the appointment of the Bankruptcy Manager within 25 days, the Bankruptcy Manager shall apply to the Enforcement Bureau for conducting the auction.[72] In exchange, certain fee shall be paid to the Enforcement Bureau for the auction services, which is determined by the Minister of Justice[73].

[67] See Article 33.3 of the Current Law
[68] See Article 36.1of the Current Law
[69] See Article 37.2 of the Current Law

[70] See Article 38.1 of the Current Law

[71] See Article 38.4 of the Current Law
[72] See Article 38.5 of the Current Law
[73] See Article 38.5 of the Current Law

The first auction shall be conducted within 40 days from the appointment of the Bankruptcy Manager.[74] The insolvency property shall be sold out as a whole and at 50% of the market value of the property (i.e. USD 100,000 in our case).[75]

To sum: the first auction shall be conducted no later than 3 May 2017. In such case, the first auction shall be completed by 14 May 2017.

If the property is not sold out during the first auction, the second auction shall be conducted no earlier than 10 days but no later than 40 days from the end of the first auction.

To sum: the second auction shall be conducted no earlier than 24 May 2017 but no later than 24 June 2017.

If the property is not sold out during the second auction, the third auction shall be conducted within 40 days from the end of the second auction.

To sum: the third auction shall be conducted no later than 3 August 2017 and end not later than 13 August, 2017.

Scenario 1: Ideal scenario, during the first auction, if the business is sold as a going concern for USD 200,000. Insolvency expenses amounts to USD 31,852, the rest amount goes to the secured creditors in proportion to their claims. As a result of such distribution, USD 109,944 goes to the Bank (65.385% recovery rate of the claim), USD 25,701 goes to the Revenue Service (15.385% recovery rate of the claim), and USD 32,337 goes to secured shareholders' (19.231% recovery rate of the claim).

Scenario 2: If the business is sold piecemeal for USD 140,000. Insolvency expenses amounts to USD 27,052, USD 73,850.6 goes to the Bank, USD 17,376.62 goes to Revenue Service and USD 21,720.77 to the secured shareholders'. .

Scenario 3: The first auction ends without success. The bank pursuant to Article 38 (10) of the Current Law takes the property and pays insolvency expenses as well as Revenue Service and secured shareholders' debt in full. All the other creditors in lower ranking remain without recovery.

Costs

According to the Current Law, there are major costs related to the bankruptcy process:

- The court fee in the amount of GEL 5,000 (approximately $1,852);
- The cost of the Trustee. According to the Order of the Ministry of Justice, the fee of the Trustee will amount to 6% of realized value of assets.
- The cost of auction, 1% of the market price of the property being under management of the Trustee.
- The cost of the Bankruptcy Manager (in case of NBE) 7% of debtors' insolvency assets.

[74] See Article 38.9 of the Current Law
[75] See Article 38.9 of the Current Law

Table 6. Recovery Rates under Different Scenarios[76]

	Scenario 1	*Recovery rate %*	*Scenario 2*	*Recovery rate %*
Sold for		$200,000.00		$140,000.00
Secured Creditors - BANK	$109,944	65,385%	$73,850.6	65,385%
Secured Creditors - Shareholders	$32,337	19.231%	$21,720.77	19.231%
Secured Creditors - Revenue	$*25,701*	15.385%	$17,376.62	15.385%
Unsecured	$-	0	$-	0
Other unsecured	$-	0	$-	0
Bankruptcy Costs	$31,852	100%	$27,052	100%

Source: Authors' Calculations

Summary

As to the timing, according to the Current Law, the minimum period for the finalization of the bankruptcy from the moment of creation of Conciliation Council may take up to 4 months and one week. However, in complex cases the process may be protracted due to various reasons, as mentioned above.

As to the costs, the minimum cost of the rehabilitation will be around 19% of debtors' assets, assuming NBE remains as a Bankruptcy Manager.

- The scenarios of bankruptcy and rehabilitation pursuant to the Draft Law

Rehabilitation pursuant to the Draft Law

The Nature of the Rehabilitation

The idea of the rehabilitation is that the distressed company (the "**Company**") is managed by: (i) the debtor (e.g. the existing management of the Company) or the rehabilitation manager with an ultimate goal to ensure going concern standing of the Company and satisfaction of the creditors' claims.

Initiation of Rehabilitation

The rehabilitation proceedings shall be commenced through filing the insolvency application (the "**Insolvency Application**") to the court. By the Insolvency Application, the applicant shall specify that (i) the Company is insolvent or is expected to become insolvent; and (ii) it seeks for the

[76] However this does not include time value of money, i.e. has not been discounted to take into the consideration opportunity costs to the creditors.

rehabilitation of the Company and it is reasonable to achieve the rehabilitation of the Company.[77] The Insolvency Application requesting the rehabilitation shall meet the particulars set out in Article 42 of the Draft Law, while the Insolvency Application requesting the bankruptcy shall meet the particulars set out in Article 43 of the Draft. Together with the Rehabilitation Application, the Unsecured Creditors shall pay the fee in proportion of their claim pursuant to Article 121 of the Draft Law. Here, we assume that maximum amount has been paid by Unsecured Creditors GEL 5,000 (the "**Fee**").[78]

Before satisfying the Insolvency Application, the court first shall assess whether the Company is insolvent. Only after such assessment, the court will resolve, whether to admit Insolvency Application and thus commence the rehabilitation proceedings. The admissibility review shall take 10 days from the date of filing the Insolvency Application and if admitted the court shall issue the insolvency admissibility decision (the "**Insolvency Admissibility Decision**").[79] If the Insolvency Application has any errors the court will set 5 days for the applicant to correct and remedy the errors.[80] The Insolvency Admissibility Decision shall be published and immediately sent to the National Agency of the Public Registry (the "**Public Registry**") and National Enforcement Bureau (the "**Enforcement Bureau**").

The Insolvency Admissibility Decision (requesting rehabilitation) will halt initiation of the Insolvency Application requesting a bankruptcy of the Company, or if Insolvency Application requesting the bankruptcy is admitted then it shall be suspended until the court adopts the decision on the rehabilitation of the Company.[81]

Simultaneously with the Insolvency Admissibility Decision, the court appoints the insolvency supervisor (the "**Insolvency Supervisor**"), which shall be in charge of supervision of the Company until the court adopts the decision of rehabilitation or bankruptcy of the Company. The Enforcement Bureau will act as the Insolvency Supervisor and shall approve certain transactions of the Company, as well as prepare the initial creditors' registry.[82]

To sum: the period from the Insolvency Application until the Insolvency Admissibility Decision may take up to 10 days. Thus, if the Other Unsecured Creditors file the Insolvency Application on 1 February 2017, the court will adopt the Insolvency Admissibility Decision by 11 February 2017.

Moratorium

The adoption of the Insolvency Admissibility Decision will trigger the moratorium measures as set out in Article 56 of the Draft Law. The measures under the moratorium, amongst others, include a prohibition to divest the secured assets where the security interest is owned by the Secured Creditors.[83] The moratorium measures may be changed or altered based on specific needs.[84] In

[77] See Articles 41 and 42 the Draft Law

[78] See Article 121 of the Draft Law

[79] See Articles 45.1 and 45.3 of the Draft Law

[80] See Article 46.1 of the Draft Law

[81] See Article 47.1 of the Draft Law

[82] See Articles 48.1 and 48.2 of the Draft Law

[83] See Article 56(c) of the Draft Law

[84] See Article 59 of the Draft Law

general, the moratorium shall cease with the termination or completion of the rehabilitation regime.[85]

Rehabilitation Decision

Within 25 days from the date of the Insolvency Admissibility Decision, the Insolvency Supervisor shall prepare and submit to the court the insolvency report which shall set out, amongst others, information on the assets of the Company, the initial creditors' registry and other relevant information.[86] The court shall review the insolvency report within 5 days from its submission and resolve whether to initiate the rehabilitation or terminate the insolvency proceedings.

If the court approves the rehabilitation regime, it will issue a decision on commencement of the rehabilitation (the "**Rehabilitation Decision**").[87]

The Rehabilitation Decision will keep the moratorium in place, which will also concern the suspension of the payment under the current obligations towards the Secured Creditors.

To sum: the period from the Insolvency Admissibility Decision until the Rehabilitation Decision may take up to 30 days. Thus, if the Insolvency Admissibility Decision is made by 11 February 2017, the Rehabilitation Decision shall be made by 11 March 2017.

Managers of the Rehabilitation Process

Simultaneously with adopting the Rehabilitation Decision, the court will determine the person to be in charge of the rehabilitation, i.e. the rehabilitation manager(s) (the "**Rehabilitation Manager**"). If the rehabilitation is requested by the Company (i.e. debtor), the court may appoint the debtor as the Rehabilitation Manager. If rehabilitation/insolvency is requested by the creditors, the court may appoint the Rehabilitation Manager, which is not the debtor unless the creditors agree that the debtor may continue with the management of the Company.[88] If the debtor remains in the management, the court will also appoint the rehabilitation supervisor (the "**Rehabilitation Supervisor**"), which controls the activities of the debtor as the Rehabilitation Manager.[89]

The Rehabilitation Manager shall create the creditors' registry within 2 months from the date of the Rehabilitation Admissibility Decision.[90]

The fact on who is the Rehabilitation Manager may have the cost implication of the rehabilitation as follows:

1. The costs if the debtor remains the Rehabilitation Manager the costs will be as follows:

    a. the compensation of the Rehabilitation Supervisor. The debtor, as the Rehabilitation Manager, is not entitled to the compensation as generally provided for the Rehabilitation Manager;[91]

[85] See Article 60.1 of the Draft Law

[86] See Article 51 of the Draft Law

[87] See Articles 64.1 and 65 of the Draft Law

[88] See Article 66.1 of the Draft Law

[89] See Article 66.3 of the Draft Law. The Rehabilitation Supervisor shall the person holding the status of the insolvency practitioner.

[90] See Article 54 of the Draft Law

[91] See Article 75.1 of the Draft Law

2. If the third party acts as the Rehabilitation Manager, the cost will be as follows:

    a. the compensation of the Rehabilitation Manager, which in our case shall be maximum $21,296
    b. the cost of the director of the Company, who shall assist the Rehabilitation Manager and whose compensation shall be reasonable and approved by the Rehabilitation Manager.[92]

One of the main objectives of the Rehabilitation Manager is to prepare the report on the activities of the Company (the "**Company Report**").[93]

Rehabilitation Regime and its Criteria

Unlike the Current Law, the Draft Law sets out the goals of the rehabilitation, which are as follows: (a) the survival of the debtor, in which case the creditors' claims are fully discharged; and (b) achieving better results for all creditors, than what could be achieved through immediate bankruptcy. The priority shall be given to the goal set out under paragraph (a), unless the Rehabilitation Manager will decide that such goal is not viable to achieve. [94] To sum: with respect to the fact that the management "expects 2017 cash flow to cover all operating expenses, including supplier payments, salaries, maintenance costs and taxes, though not principal or interest payments to the bank" and the Company had projected to continue this performance into the future (although it experienced an unexpected operating loss due to worsened industry conditions), we assume that the rehabilitation goals can be met for the purposes of this part of the report.

Rehabilitation Plan

Based on the Company Report and the creditors' registry, the Rehabilitation Manager shall prepare the rehabilitation plan (the "**Draft Rehabilitation Plan**") within 2 months from the date of the Rehabilitation Decision. This period can be extended by one more month subject to the consent of the court and such extension shall be substantiated by the Rehabilitation Manager. In this case, the period for the submission of the Draft Rehabilitation Plan to the creditors will be 3 months from the date of the Rehabilitation Decision. The Draft Rehabilitation Plan shall be submitted to the Creditors' Meeting.

To sum: the period from the starting date of the preparation of the Draft Rehabilitation Plan until its submission to the Creditors' Meeting may take 3 months. Thus, if the Rehabilitation Decision is adopted on 11 March 2017, the Draft Rehabilitation Plan shall be prepared and submitted to the Creditors' Meeting shall no later than 11 June 2017.

The Draft Rehabilitation Plan shall be approved by the creditors within 6 months from the date of the Rehabilitation Decision subject to such period extension by maximum of three months, however provided that the Draft Rehabilitation Plan shall be approved no later than 9 months from

[92] See Article 74.1 of the Draft Law

[93] See Article 80 of the Draft Law

[94] See Articles 71.2 and 71.3 of the Draft Law

the date of the Rehabilitation Decision.[95] If the Draft Rehabilitation Plan is not approved, the court will adopt the bankruptcy decision.[96]

To sum: if the Rehabilitation Decision is adopted on 11 March 2017, the Draft Rehabilitation Plan shall be approved by the Creditors' Meeting no later than 11 December 2017.

Only Unsecured Creditors may participate in the adoption of the Rehabilitation Plan. The Secured Creditors do not have voting rights as to the approval of the Rehabilitation Plan unless the rehabilitation plan modifies agreement between the secured creditors and the debtor.[97]

At the Creditors' Meeting, the voting rights will be allocated to:

- All unsecured creditors, except those who are related party to the Company. At the same time, the consent of the Revenue Services is deemed to be issued if the Draft Rehabilitation Plan contemplates the that the claims of the Revenue Service will be fully satisfied during 5 years from the approval of the Rehabilitation Plan by the court;[98] and
- the secured creditors, except those who are related to the Company.[99]

Note that for the purpose of the approval of the Rehabilitation Plan, the secured creditors and unsecured creditors are voting separately.[100]

Once approved and within 5 days from the approval of the Creditors' Meeting, the Rehabilitation Plan shall be submitted to the court for the final approval.

While reviewing the Rehabilitation Plan, the court shall be bound by the following criteria: (a) the procedures related to the convocation and voting the Creditors' Meeting shall be duly complied with; (b) the Rehabilitation Plan shall not be approved if: (i) the creditor would receive less than it would receive in the bankruptcy proceedings; or (ii) the secured creditor would receive less than it would receive upon the realization of the secured assets.[101]

If the Creditors' Meeting does not approve the Draft Rehabilitation Plan, upon the request of the Rehabilitation Manager, the court may still approve the Draft Rehabilitation Plan if:

(i) at least majority of the secured creditors or unsecured creditors vote for the Draft Rehabilitation Plan;
(ii) the court considers that the Draft Rehabilitation Plan is viable to be implemented and the rights of the creditors will be protected pursuant to Article 85 of the Draft Law (the criteria set out above); and
(iii) the obligations of the secured creditors, from the terminated agreements, will be performed in accordance with annuity rules.[102]

[95] See Article 84.1 of the Draft Law
[96] See Article 84.2 of the Draft Law
[97] See Article 84.6 of the Draft Law
[98] See Article 84.11 of the Draft Law
[99] See Article 84.9 of the Draft Law
[100] See Article 84.7 of the Draft Law
[101] See Article 85 of the Draft Law
[102] See Article 86 of the Draft Law

To sum: the period from the Insolvency Admissibility Decision until the adoption of the Rehabilitation Plan by the creditors may take maximum 9 months. Thus if the Rehabilitation Decision is adopted on 11 March 2017, the Draft Rehabilitation Plan shall be approved by the Creditors' Meeting no later than 11 December 2017. However, the Draft Law does not specify the period during which the court shall approve the Draft Rehabilitation Plan submitted by the Rehabilitation Manager.

The Bank and the Shareholder, as the secured creditors, will not hold any voting rights at the Creditors' Meeting. Therefore, even if the Secured Creditors reject the plan, the Unsecured Creditors can still adopt the Draft Rehabilitation Plan and enforce its implementation, however provided that the court finds that the Draft Rehabilitation Plan meets the relevant criteria set out in Article 86 of the Draft Law.

Implementation of the Rehabilitation Plan

During the implementation of the Rehabilitation Plan, the moratorium measures (including a ban on realization of the secured assets) will remain in force and thus the secured assets shall stay intact from the foreclosure measures. At the same time, the Secured Creditors may still have a recourse to the secured assets if the Company fails to meet the current obligations towards the Secured Creditor two times in a row. Then in this case, the Secured Creditor may demand that the secured assets are lifted from moratorium and the Secured Creditor may foreclose these assets.[103]

Role and Standing of the Bank

The Bank will have incentive to agree to the rehabilitation if realization of its secured assets (including a realization in the bankruptcy proceedings) will not enable Bank to cover the outstanding loan issued to the Company. Based on the analysis below (see below section *Order of Satisfaction of Claims*), the Bank's recovery rate in case of sale of the Company is at most 71%. Thus, it can be assumed that the Bank can be interested to agree to the rehabilitation.

At the same time, the Bank has no full control over the rehabilitation process and may not prevent the rehabilitation in case it wants to proceed with quick realization of assets via bankruptcy. Provided that the Bank does not agree to the rehabilitation and votes against the draft Rehabilitation Plan, it still may be dragged into the rehabilitation if the Unsecured Creditors approve the Rehabilitation Plan and then such plan is approved by the court.

Despite this, the Bank still maintains a certain leverage to block the rehabilitation or take away the secured assets from the rehabilitation process (thus, in our case de facto hindering the rehabilitation). For example, in order the court to approve the Rehabilitation Plan (including when the Bank votes against the proposed draft Rehabilitation Plan), the plan shall meet the following requirements:

- the Secured Creditor (including the Bank) should receive at least what they would receive upon the realization of the secured assets;[104]and
- the obligations of the Secured Creditor (including the Bank), from the terminated agreements, will be performed in accordance with annuity rules.[105]

[103] See Article 89.3 of the Draft Law

[104] See Article 85.2(d) of the Draft Law

[105] See Article 86 of the Draft Law

Thus, the approved Rehabilitation Plan, which do not meets the criteria above, can be potentially challenged and reversed by the Bank.

Moreover, the Bank may take away the secured assets from the rehabilitation and divest them if any time after the Rehabilitation Decision, the Company fails to make two consecutive instalments under the loan. In this case, the court shall lift the moratorium imposed on the secured assets of the Bank and enable the Bank to proceed with the enforcement measures against the secured assets.

Conversion

During the rehabilitation period, the court may decide on conversion of the rehabilitation to the bankruptcy.

In general, the Draft Law allows two ways conversions: (a) conversion of the rehabilitation proceedings into the bankruptcy (the "**Bankruptcy Conversion**"); and (b) conversion of the bankruptcy proceedings into the rehabilitation (the "**Rehabilitation Conversion**").

The Bankruptcy Conversion is more difficult than the Rehabilitation Conversion. More specifically, adoption of the Insolvency Admissibility Decision (made based on the rehabilitation request) prohibits the Insolvency Application requesting a bankruptcy of the Company or if Insolvency Application requesting the bankruptcy is admitted then it shall be suspended until the court adopts the decision on the rehabilitation of the Company.[106] Such conversion can be made only if: (i) the court rejects the Insolvency Application requesting the rehabilitation and the creditors apply then to the court with the bankruptcy application; (ii) the court adopts the Rehabilitation Decision, but then will not approve the Draft Rehabilitation Plan, as a result of which the Court may decide on the Bankruptcy Conversion;[107] (iii) upon the request of the Rehabilitation Manager if it is clear that the rehabilitation goal will not be achieved.

Costs

According to the Draft Law, there three major costs related to the rehabilitation process:

4. The state fee in the amount of GEL 5,000 (approximately $1,852);[108]
5. The cost of the Insolvency Supervisor. The Draft Law does not set out such cost. However according to the current Order of the Ministry of Justice, the fee of the Insolvency Supervisor will amount to 6% of debtors' assets, around $18,519 and for the purpose of this report we assume that the same fee will apply.
6. The cost of the Rehabilitation Manager, which is set out in Article 122.6 of the Draft law and in our case will not exceed $21,296.

Summary

As to the timing, according to the Draft Law, the Rehabilitation Plan shall be approved and submitted to the court maximum within 10 months from the date when the Insolvency Application is submitted to the Company. However, the Draft Law sets out no period for the judge to approve

[106] See Article 45.1 of the Draft Law

[107] See Article 97.1 of the Draft Law

[108] See Article 121.3 of the Draft Law

the submitted Rehabilitation Plan. Absent this period, we are not able to provide an approximate timeline for the final approval of the rehabilitation Plan by the court.

As to the costs, the minimum cost of the rehabilitation will be around $41,667, 21% of the debtors' assets.

Bankruptcy pursuant to the Draft Law

The Nature of Bankruptcy

The goal of bankruptcy manager (the "**Bankruptcy Manager**") who is an insolvency practitioner is to satisfy the claims of all creditors under supervision of creditors by way of realization of the property of the company, when the company cannot be rescued through the rehabilitation.

Initiation of Bankruptcy

The bankruptcy proceedings shall be commenced through filing the Insolvency Application to the court. the applicant shall specify that (i) the Company is insolvent or is expected to become insolvent; and (ii) it seeks for the bankruptcy of the Company and that the bankruptcy does not contradict with the interests of the creditor(s).[109] The Insolvency Application requesting the rehabilitation shall meet the particulars set out in Article 41 and 43 of the Draft Law. Upon the submitting the Insolvency Application, the applicant (if a legal person) shall pay state fees of GEL 5,000.[110]

Below we assume that by the Insolvency Application is made by the Bank, which is requesting the bankruptcy of the Company. The Insolvency Application, amongst other things, shall contain an argumentation proving that the Company is insolvent or its insolvency is expected and that the bankruptcy does not contradict with the interests of the creditor(s).[111]

The court registers the Insolvency Application if it meets with formal requirements of the law. After registration, the Creditor is given two months to deliver the Bankruptcy Application and relevant materials to the Company in accordance with the articles 70 and 78 of Civil Procedures Code of Georgia.[112] Before satisfying the Insolvency Application, the court first shall assess whether the Company is insolvent. Only after such assessment, the court will resolve, whether to admit the Insolvency Application and thus commence the bankruptcy proceedings. The admissibility review by the court shall take 10 days from the date of delivery of the Bankruptcy Application and relevant materials to the Company by the Creditor.[113] If the Insolvency Application has any errors the court will set 5 days for the applicant to correct and remedy the errors.[114] The Insolvency Admissibility Decision shall be published and immediately sent to the Public Registry and the Enforcement Bureau.

[109] See Article 43 of the Draft Law

[110] See Article 121 of the Draft Law.

[111] See Article 43 of the Draft Law

[112] See Article 44 of the Draft Law

[113] If the application is filed by the Company, then the court decides the admissibility within 7 days from the date of filing of the Insolvency Application. Article 44 of the Draft Law introduces special regulation for delivery of Insolvency Application to the Company, when it is submitted by the Creditor.

[114] See Article 46.1 of the Draft Law

The court will refuse to issue the Bankruptcy Admissibility Decision if: (a) formal requirements in accordance with the law are not met and/or (b) court decides that Company is not insolvent or its insolvency is not expected; or (c) the assets are not sufficient to cover the costs of proceedings.[115]

The Insolvency Admissibility Decision will trigger the moratorium measures as set out in Article 56 of the Draft Law.

Simultaneously with the Insolvency Admissibility Decision, the court appoints the Insolvency Supervisor (i.e. the Enforcement Bureau). The Enforcement Bureau shall approve certain transactions of the Company, as well as prepare the initial creditors' registry.[116]

To sum: the period from the Insolvency Application until the adoption of the Insolvency Admissibility Decision (a) may take up to 7 days if the Insolvency Application is submitted by the Company or (b) may take up to 10 days from the moment the Company receives the Insolvency Application (thus in total maximum of 2 months and 10 days) if it is submitted by the Creditor. Thus, if the Secured Creditor files the Insolvency Application on 1 February 2017, the court will adopt the Insolvency Admissibility Decision by 11 April 2017.[117]

Bankruptcy Decision

Within 25 days from the date of the Insolvency Admissibility Decision, the Insolvency Supervisor shall prepare and submit to the court the insolvency report which shall set out, amongst others, information on the assets of the Company, the initial creditors' registry and other relevant information.[118] The court shall review the insolvency report within 5 days from its submission and resolve whether to initiate the bankruptcy or terminate the insolvency proceedings.

If the court approves the bankruptcy regime, it will issue a decision on commencement of the bankruptcy (the "**Bankruptcy Decision**").[119] The Bankruptcy Decision shall set out the issue related to bankruptcy management and moratorium measures and shall appoint bankruptcy manager (the "**Bankruptcy Manager**"). The Bankruptcy Decision shall be published by the Bankruptcy Manager within two days from adoption of the Bankruptcy Decision.[120]

To sum: the period from the Insolvency Admissibility Decision until the Bankruptcy Decision may take up to 30 days. Thus, if the Insolvency Admissibility Decision is made by 11 April 2017, the Rehabilitation Decision shall be made by 11 May 2017.

Bankruptcy Manager

On the date of issuing the Bankruptcy Decision, the court appoints the Bankruptcy Manager. The Bankruptcy Manager shall be the insolvency practitioner.

[115] See Article 46.5 of the Draft Law

[116] See Articles 48.1 and 48.2 of the Draft Law

[117] It has been calculated maximum of time without additional complicated scenarios and spent time;

[118] See Article 51 of the Draft Law

[119] See article 64 of the Draft Law

[120] See Article 100 of the Draft Law

By the appointment of the Bankruptcy Manager, the authority of the director(s) of the Company shall be suspended. If the Bankruptcy Manager deems necessary, the director shall cooperate with the Bankruptcy Manager and assists him/her based on respective compensation.[121]

Apart from the creditors' registry, the Bankruptcy Manager shall gather full information of the Company's assets and insolvency assets in general, distribute assets between the creditors and starts realization of the property.[122] The Bankruptcy Manager prepares report including information on Company's finances and realization form of the assets. The report shall be published in the electronic form.

To sum: the period from the date of issuance of the Insolvency Admissibility Decision until completion of the creditors' registry may take up to 60 days. Thus, the creditors' registry shall be completed by 11 June 2017. However, there is no specific date given by the Draft Law for the realization of property and/or for collection of full information on the Company's assets by the Bankruptcy Manager.

Realization of Property and Satisfaction of Claims including Compensation of Costs

The Bankruptcy Manager is entitled to decide on the form of realization of the insolvency property. Such realization can be made via auction or direct sale, as going concern or in piecemeal (depending on through which form of realization, the best value can be realized).[123] Note that this does not apply to the realization of the secured property which shall be made in agreement with the Secured Creditors (see below).[124]

The decision on the form of divestment of property shall be published at Legislative Herald. The creditor(s) may address the Bankruptcy Manager with an alternative proposal on realization. The (final) decision on realization is made by the Bankruptcy Manager.[125]

The decision to sell the property through auction is made only if there is no other realization forms possible. The sale of property on the auction is conducted by the Enforcement Bureau in order to ensure the protection of creditor interests. The service fee related to auction services shall be determined by the Decree of the Minister of Justice and shall be reimbursed from the realization value of the property.[126]

The length of the auction (time between commencement and completion) shall not be less than 7 days and more than 10 days.[127] Moreover, the price of the property on the first auction is determined based on the expert report with 75% of the market price of such property set out in the report. If the property is not sold on the first auction and if the first proposed price of the asset is less than the value of claim of the creditor, any of the creditor whose claim covers but does not exceed the price of the asset on the first auction, has a right to request the Bankruptcy Manager to transfer the ownership right on such asset to him/her, within 10 days from the date on which such auction took

[121] See Article 101 of the Draft Law

[122] See Article 102 of the Draft Law.

[123] See Article 103 of the Draft Law

[124] See Article 107 of the Draft Law

[125] See Article 103 of the Draft Law

[126] See Article 103 of the Draft Law

[127] See Article 103.4 of the Draft Law

place. In such case, the creditor is obliged to cover the claims of all the creditors from previous and his/her order.

If on the first auction the property was not sold or was not transferred into the ownership of the creditor, after no less than 10 days and no more than 40 days the second auction shall be conducted. On the second auction, the initial price of the property is 50% of its market price.[128]

If the property is not sold on the second auction or there is left part of the insolvency property unsold, the third auction within not more than 40 days from the date of the second auction shall be conducted. On the third auction, the initial price of the bankruptcy asset is GEL 0.[129]

If the property is not sold on the third auction or certain part of the property remains unsold, the Enforcement Bureau shall publish the proposal on transfer of such property in common ownership of creditors. The property is transferred to those creditors which submit their application regarding receipt of such property within 10 calendar days from the date of such proposal. The creditors shall receive the property in kind, based on the market price.[130]

In sum: the maximum period of entire process of divestment of the property through the auction (three rounds of auction) may take up to 120 days. Length of first auction10+gap between first and second auction 40+ gap between second and third40+length of second and third auction 2*10+10 days for payment, so in total maximum 120.

Order of Satisfaction of Claims

(a) Unsecured Creditors

The order of satisfaction of the creditors from the value of the realization of the property is the following:[131]

1. First rank: the costs associated with bankruptcy regime with the order as set out by the law;

2. Second rank: the Company's debts created after the Insolvency Admissibility Decision, including tax liabilities;

3. Third rank: the creditors listed in the creditors' registry. The claims of creditors in the registry is also covered in the following order: (a) preferential claims existing before the Insolvency Admissibility Decision, which are 3 months' salary/vacation expenses/injuries for the employees, however no more than GEL 1,000 per one creditor; (b) preferential tax claim – amount of indirect taxes (VAT, excise duty and import duty) created prior to one year of the Insolvency Admissibility Decision; (c) unsecured claims, among them other debts from taxes; (d) the claims in the penalties and interests (including administrative, among them, tax penalties) accrued to the liabilities existing before the Insolvency Admissibility Decision; (e) creditor's non-privileged claim agreed as such by the Company

[128] See Article 103.9 of the Draft Law
[129] See Article 103.10 of the Draft Law
[130] See Article 103.11 of the Draft Law
[131] See Article 106 of the Draft Law

and respective creditor; and (f) the claims from the corporate relationships (payment related to dividend distributions, share buy-outs, capital decreases).[132]

Distribution is based on the principle of *proportionality.* After distribution the Bankruptcy Manager issues the distribution report that shall be submitted to the creditors and to the court and finally, approved by the court.[133]

(b) Secured Creditors

The Secured Creditors (e.g. the Bank) do not form the part of registry creditors. They are to be satisfied from the secured property in which they hold the security rights. [134] For these purpose, the Bankruptcy Manager shall evaluate the secured property.[135]

The Secured Creditors may ask realization of the secured property. The Bankruptcy Manager shall make realization of the secured property in accordance with the request of the Secured Creditors, if otherwise cannot be reached more profitable result.[136] 7% shall be deducted from the amount received from the realization of the secured property and will be included in the insolvency asset.[137]

The Secured Creditors shall be satisfied from the sale of the relevant property in accordance with the ordinance as established by the Civil Code of Georgia. If value of the realization of the property is less than the secured claims and if the secured creditors agree, the unsatisfied part of the secured claims may be placed in the category of the unsecured claims. If the value of the realization of the property exceeds the claim of secured creditor(s), the amount beyond the secured creditor's claim shall become a part of the insolvency asset.[138]

Below we consider two scenarios:

(a) The Company (business) is sold and as a going concern via auction;
(b) The secured property is realized in piecemeal via auction.

a. Sale of business as a going concern via auction

- The business is sold as a going concern for $200,000.
- The Bankruptcy Costs amounts to $ 39,148 (this includes court fee, bankruptcy manager fee, and trustee fee).[139]
- The Bank, as a secured creditor, out of the total claim $170,000 receives $120,000 (the value of the hotel's entire real estate property).
- Shareholders as a secured creditor, out of the total claim $ 50,000 receives $ 10,000 (the value of the hotel's movable property (If sold piecemeal) excl. vehicles).
- Preferential creditors of the first rank (payroll) receive 100% of the claim, i.e. $ 20,000,

[132] See Article 106 of the Draft Law

[133] See Article 106 of the Draft Law

[134] See Article 107 of the Draft Law

[135] See Article 102 of the Draft Law

[136] See Article 107 of the Draft Law

[137] See Article 107 of the Draft Law

[138] See Article 107 of the Draft Law

[139] Breakdown of total costs: $ 1,852 (equal GEL 5,000) – the fee for opening the insolvency proceedings; $21,296 – fee of the Bankruptcy Manager; $14,000 NBE fee for trustee; $2,000– auction fee (1% of the proceeds)

- Preferential creditors of the second rank (tax claim) receive the remaining amount $10,852.

Table 7. Recovery Rates under Different Scenarios

	Scenario 1	*Recovery rate %*
Sold for	$	200,000.00
Secured Creditors - BANK	$120,000.00	71%
Secured Creditors - Shareholders	$10,000.00	20%
Preferential - Payroll	$20,000.00	100%
Preferential - Tax	$10,851.85	27%
Unsecured	$-	0
Other Unsecured	$-	0
Bankruptcy Costs	$39,148	100%

Source: Authors' Calculations

b. The secured property is realized in piecemeal via auction.

In this case secured property is realized as a piecemeal via auction for $140,000. Bankruptcy costs amount to $34,348. However, it is not clear how the proceeds will be distributed among the creditors and the proceeding costs.

In sum: The Draft Law does not foresee the period during which the Bankruptcy Manager and the secured creditors shall agree on form and value of realization of the secured assets and if they cannot agree, what is the period within which the decision of the Bankruptcy Manager shall be made. In case of auction, it is unclear, what is the period within which the expert shall evaluate the property.

Based on rough estimations, the process realization should be completed within 4 months from the Bankruptcy Decision (if realization is made through auction). Total time period according to the draft law and assumptions given above shall amount to 7 months and 10 days and therefore, the debtor's bankruptcy shall finalize by the end of September, 2017.

Completion of Bankruptcy Proceedings

Upon completion of the Bankruptcy the Bankruptcy Manager prepares and presents to the creditors and to the court the debtor's bankruptcy report. According to the mentioned report and information from the creditors the court renders the decision on termination of the bankruptcy proceedings and on deregistration of the company from the registry unless the company has been sold as an ongoing business unit and its purchaser has registered as a shareholder of such company.[140]

[140] See Article 108 of the Draft Law

f. Anticorruption Risks in the Insolvency

We are of the view that the Draft Law provides certain mechanism aiming at avoiding or decreasing the corruption risks within the insolvency proceedings, which may take place, amongst others, via collusion among different actors involved in the insolvency. These mechanism are set out below.

Random Appointment of the Insolvency Practitioner

According to the Draft Law, the Insolvency Practitioner shall be elected by a random selection and upon that selection to be appointed by the court. Although a random selection system may have certain disadvantages (for example, the specific features of the distressed company may not be matched by the appropriate qualification of the selected practitioner), at the same time, it may ensure integrity, impartiality and independence of the practitioner as the selection will not be influenced by the creditors. This is a considerable shift from the existing regulation by which the rehabilitation or bankruptcy manager is appointed by the creditors.

In sum, proposed mode of the section of the Insolvency Practitioner may ensure that the Insolvency Practitioner will act on unbiased basis serving the interest of the distressed company and all creditors and not pursuing a certain interest of particular group of the creditors.

Limitations on the Compensation of the Insolvency Practitioner

Under the same token, setting out the limitation on the remuneration of the Insolvency Practitioner may also serve a goal of safeguarding the Insolvency Practitioner from undue influence. The Draft Law provides with the maximum rates for the remuneration of the Insolvency Practitioner, which are fixed as a percentage varying according to the value of the insolvency assets. Ultimately, the final determination of the remuneration which the Insolvency Practitioner may charge falls within the ambit of the court. Depending on a scope of the work undertaken by the Insolvency Practitioner, the court may decrease the remuneration below the established threshold, or vice versa, go above such threshold and approve the remuneration in excess of that threshold. In this respect, the Draft Law takes different approach compared to the Current Law. According to the latter, the remuneration of the insolvency office holder is determined by the majority of the creditors acting in free discretion and such remuneration is not limited by the law.

The proposed regulation of the remuneration under the Draft Law may take away from the creditors a certain leverage to influence the conduct of the Insolvency Practitioner and ultimately ensure that the practitioner will act on unbiased and impartial basis.

Decision on Bankruptcy/Rehabilitation of the Company

Another instrument which can also alley the corruption risk is the provision of the Draft Law, by which ultimate decision on whether to open bankruptcy or rehabilitation proceedings rest with the court. According to the Current Law, it is the Conciliation Council (consisting of the members nominated by the creditors) which decides on which particular insolvency proceedings will apply to the distressed company. Conversely, the Draft law takes different approach vesting on the judge an authority to resolve on this matter. Moreover, it sets out the criteria based on which the court's decision shall be passed. Such criteria refers to the economic, instead of the nominal or strictly

legal, determinates as it shall asses how much payoff a creditor had received if his claim were to be enforced in a bankruptcy (sale of assets) regime versus through the rehabilitation regime.

In sum, It can be supposed that the vesting the authority with the court to resolve on bankruptcy or rehabilitation of the distressed company, coupled with the certain criteria for such decision making, may allay the risk of the collusion within the insolvency proceedings. In addition to increasing certainty and predictability in the legal system this will help the country advance on its **UN Agenda commitments, that is SDG target 16.5 to substantially reduce corruption and bribery in all their forms and target 16.6 which calls for effective, accountable and transparent institutions at all levels**.

g. Sustainable Development Goals

The proposed changes to the regulatory framework is expected to have number of direct and indirect impacts on Sustainable Development Goals. Key goals that the initiative will help advance include Goal 8: Decent Work and Economic Growth, particularly global target 8.1[141] and 8.3[142], Goal 9: Industry, Innovation and Infrastructure (target 9.3[143]). As was stated in Section II evidence illustrating a positive correlation between the strength of a country's insolvency framework and economic and social outcomes captured in these goals are abundant. In the sub-section B below we explicitly quantify expected impacts of the proposed legislation on economic growth and employment. The main channel how insolvency framework is believed to impact economic development is through its significance for financial market development, which has proved to become important catalyst for economic progress, industrial development and innovation.

Most immediately the proposed Draft Law will help build strong institutions, including in terms of strengthening the position of the court with broader authorities in insolvency proceedings, which advances UN 2030 Agenda with respect to Goal 16: Peace, Justice and Strong Institutions (target16.6[144]).

Figure 12 below illustrates our assessment of relative magnitude of impact the Draft Law is expected to have on each of the 17 Goals and set of Global targets it will help achieve in the coming years[145]. The numbers next to the 17 Goals identify targets which are expected to be affected most significantly. While no direct attribution can be made to most other Goals, indirect benefits in the longer run will help fight inequality, poverty and hunger through stronger and more inclusive economic growth and institutions.

Possible impacts on environmental sustainability is not straightforward and is mostly indirect. While increased economic activity and industrialization could potentially increase ecological

[141] Sustain per capita economic growth in accordance with national circumstances and, in particular, at least 7 per cent gross domestic product growth per annum in the least developed countries

[142] Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.

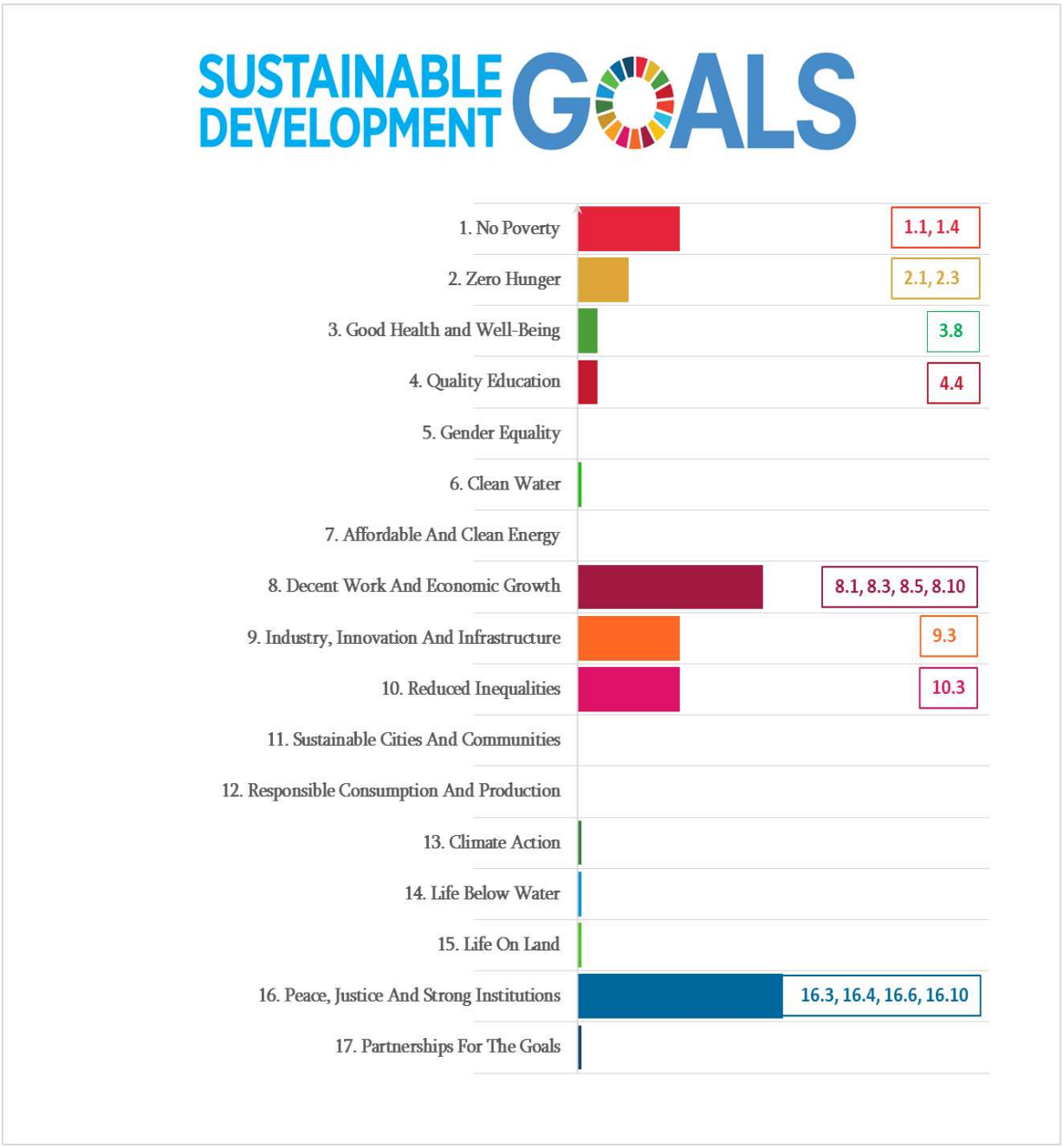
[143] Increase the access of small-scale industrial and other enterprises, in particular in developing countries, to financial services, including affordable credit, and their integration into value chains and markets.

[144] Develop effective, accountable and transparent institutions at all levels.

[145] To arrive at the impact measurement of the Draft Law on the SDGs, we have scored nationally adopted targets on a scale from 0 to 10 and attributed maximum value of the targets to their respective goals. For example, target 8.3 has been scored 10 which is the maximum out of all the Goal 8 targets, therefore Goal 8 has been attributed score 10 even if other targets were scored less than 10.

footprint (Global Footprint Network, 2007), better legal and regulatory framework will contribute to more environmentally and socially responsible corporate governance. Addressing trade-offs and promoting synergies between the goals by looking beyond economic factors to measure progress towards sustainable development is therefore critical.

Figure 4. Sustainable Development Goals and Targets



B. Quantitative Analysis

a. Doing Business Indicators

In this section we predict Georgia's score on Strength of Insolvency Framework, which currently stands at 11. Based on our analysis we predict that the score will increase to 14. Details and scores on individual indicators can be seen below in the Table 8. Most significant progress is expected on Reorganization Proceedings Index where Georgia currently receives zero out of three possible points.

Table 8. Doing Business Resolving Insolvency in Georgia Indicators (Predictions)

Strength of Insolvency Framework Index			**14**
Commencement of proceedings index		**3**	Article
Can debtors initiate both liquidation and reorganization proceedings?	**Debtors can initiate both types of proceedings**	1	41.2
	They can initiate only one of these types (either liquidation or reorganization	0.5	
	They cannot initiate insolvency proceedings.	0	
Can creditors initiate both liquidation and reorganization proceedings?	**Creditors can initiate both types of proceedings**	1	41.2
	They can initiate only one of these types (either liquidation or reorganization	0.5	
	They cannot initiate insolvency proceedings.	0	
What standard is used for commencement of insolvency proceedings?	A liquidity test (the debtor is generally unable to pay its debts as they mature) is used	1	
	The balance sheet test (the liabilities of the debtor exceed its assets) is used;	0.5	
	Both the liquidity and balance sheet tests are available but only one is required to initiate insolvency proceedings	1	6.3
	Both tests are required	0.5	
	Different test is used	0	
Management of debtor's assets index		**6**	
Can the debtor (or an insolvency representative on its behalf) continue performing contracts essential to the debtor's survival?	**yes**	1	58.c
	Continuation of contracts is not possible or if the law contains no provisions on this subject.	0	

Can the debtor (or an insolvency representative on its behalf) reject overly burdensome contracts?	**yes**	1	58(d)
	rejection of contracts is not possible	0	
Can transactions entered into before commencement of insolvency proceedings that give preference to one or several creditors be avoided after proceedings are initiated?	**yes**	1	67.1.c
	Avoidance of such transactions is not possible.	0	
Can undervalued transactions entered into before commencement of insolvency proceedings be avoided after proceedings are initiated?	**yes**	1	67.1.c
	avoidance of such transactions is not possible	0	
Does the insolvency framework include specific provisions that allow the debtor (or an insolvency representative on its behalf), after commencement of insolvency proceedings, to obtain financing necessary to function during the proceedings.	**yes**	1	77.5.d
	Obtaining post-commencement finance is not possible or if the law contains no provisions on this subject.	0	
Does the post-commencement finance receive priority over ordinary unsecured creditors during distribution of assets?	**yes**	1	82.2
	post-commencement finance is granted super priority over all creditors, secured and unsecured;	0.5	
	No priority is granted to post-commencement finance.	0	
Reorganization proceedings index		**3**	
Is the reorganization plan voted on only by the creditors whose rights are modified or affected by the plan?	**yes**	1	84.6
	all creditors vote on the plan, regardless of its impact on their interests	0.5	
	Creditors do not vote on the plan or if reorganization is not available.	0	

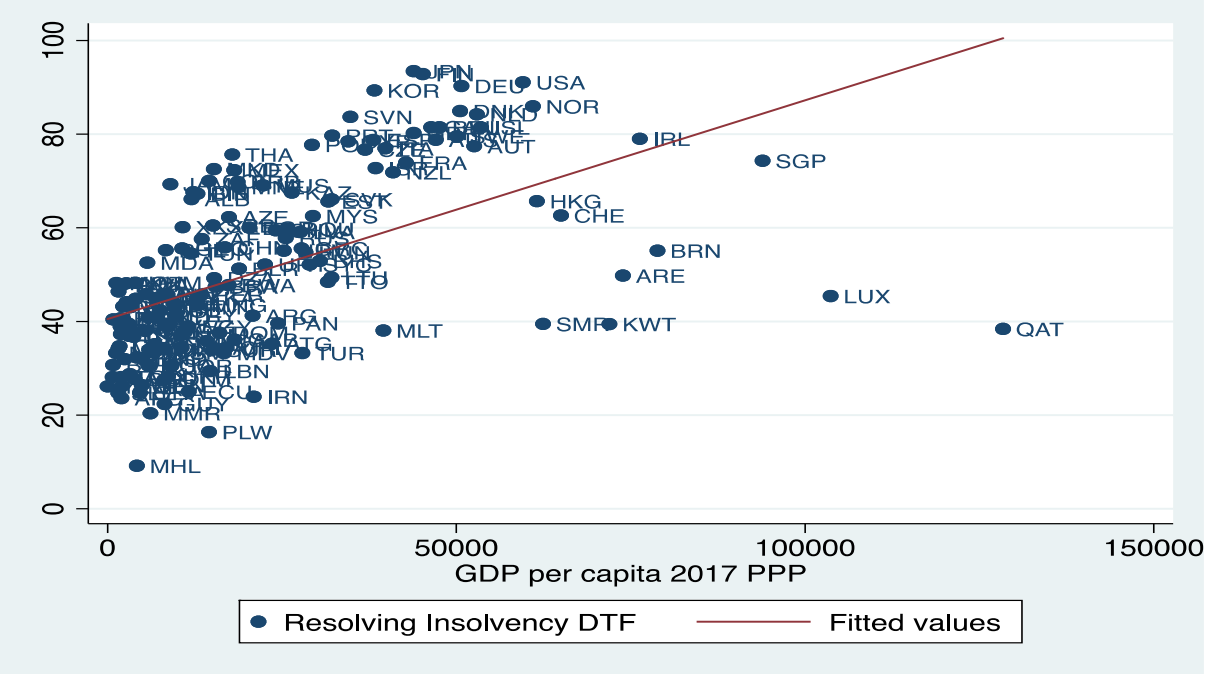
Are creditors entitled to vote on the plan divided into classes, each class votes separately and the creditors within each class treated equally?	**the voting procedure has these three features**	1	84.7
	The voting procedure does not have these three features or if reorganization is not available.	0	
Does the insolvency framework require that dissenting creditors receive as much under the reorganization plan as they would have received in liquidation?	**yes**	1	85.2
	No such provisions exist or if reorganization is not available.	0	
Creditor participation index		**2**	
Do creditors appoint the insolvency representative or approve, ratify or reject the appointment of the insolvency representative.	yes	1	
	no	0	11.1&11.2
Are creditors required to approve the sale of substantial assets of the debtor in the course of insolvency proceedings?	yes	1	
	no	0	77.5.c
Does an individual creditor have the right to access financial information about the debtor during insolvency proceedings, either by requesting it from an insolvency representative or by reviewing the official records?	**yes**	1	49.2
	no	0	
Can individual creditor object to a decision of the court or of the insolvency representative to approve or reject claims against the debtor brought by the creditor itself and by other creditors?	**yes**	1	55.1
	no	0	

Source: Authors' estimations

b. Economic Impacts

Academic literature establishing strong interdependencies between economic outcomes and institutional quality including that of creditor protection has been expanding rapidly in the recent years. The Figure 2 below illustrates positive correlation between economic well-being and insolvency framework measured through Resolving Insolvency Distance to Frontier Indicator. Countries with high GDP per capita tend to be closer to the insolvency framework frontier. While empirically causation is difficult to establish, the main channel how insolvency framework is believed to impact economic development is through its significance for financial market development, which has proved to become important catalyst for economic progress. The remaining part of this section reviews four strands of the literature concerning effects of insolvency reform: 1) Impact of Insolvency Reform on Equity and Credit Markets; 2) Impact of Insolvency Reform on Financing Conditions for Companies; 3) Impact of Insolvency Reform on Entrepreneurship and Company Formation; 4) Impact of Insolvency Reform on Macroeconomic Outcomes.

Figure 5. Correlation Analysis between DTF and GDP Per Capita



Source: World Bank

Impact of Insolvency Reform on Equity and Credit Markets

La Porta et al (1997) study determinants of financial development focusing on the linkage between legal environment and financial markets. Using a sample of 49 countries, the authors find that poorer investor protections (measured by quality of legal rules and law enforcement) lead to smaller and narrower capital markets. Results show that legal origin of a country matters. Specifically, civil law countries have weakest investor protections and therefore least developed financial markets compared to common law countries.

Djankov et al. (2008) study efficiency of debt enforcement procedures using the data of 88 countries. The authors present the same case study of an insolvent firm to insolvency practitioners in each country and collect responses regarding the most likely debt enforcement procedures (foreclosure, liquidation or reorganization) to be used. The responses show that roughly equal number of countries use foreclosure, liquidation and reorganization to deal with the firm. Based on responses, the time and the cost of selected procedures are calculated and the measure of the procedure efficiency is derived for each country. The analysis also employs data of country-specific economic and legal characteristics.

The authors find that on average all procedures are time-consuming, costly and inefficient. The inefficiency comes from long delays, high administrative costs and piecemeal sales of viable businesses. The efficient outcome of keeping the firm as a going concern is achieved in only 36% of the cases. On average 48% of the firm's value is lost in debt enforcement. No differences in efficiency are found among procedures. The most important determinants of the debt enforcement efficiency appear to be country's legal origin and per capita income. On average, common law countries achieve higher efficiency scores in debt enforcement that German or French legal origin countries. The richer countries are much more efficient in debt enforcement and are more likely to keep the firm as a going concern. Though, in some cases even rich countries (e.g., France and Italy) fail to achieve the efficient outcome. Countries with higher efficiency scores have higher private debt to GDP ratio, which means that efficient debt enforcement regime facilitates growth of credit market.

Araujo et al (2012) evaluate consequences of the bankruptcy reform carried out in Brazil in 2005. Before the reform, Brazil's bankruptcy legislation had several flaws including weak protection of creditors, liquidation timing and lack of creditors' influence in reorganization procedures. The new legislation aimed at elimination of these problems. Using data of Brazilian and non-Brazilian firms, the authors estimate the effects of the reform on the development of credit markets. While average private credit to GDP ratio before the reform in Brazil constituted 9.36%, after the reform it reached 12.88%. The reform induced significant increase in the total amount of debt and the long-term debt, whereas the cost of debt financing fell down by between 7.8-16.8% depending on the model specification. In the similar vein, big strand of the empirical literature suggests that effective insolvency law and creditor rights foster access to finance and reduces cost of borrowing. [146]

Impact of Insolvency Reform on Financing Conditions for Companies

Davydenko & Franks (2008) explore the effects of different treatments of secured creditors in insolvency upon the terms of credit. They use bank data on secured landing in UK, France and Germany and find that unfavorable bankruptcy provisions make creditors require more collateral. The authors report that French bankruptcy law is least creditor-friendly compared to the German and English laws.

[146] See Armour et al (2015) for a survey.

Ferrando et al (2015) investigate how probability of getting credit by a firm is affected by the strength of creditor protection, strength of property rights, time and cost of resolving a dispute. Using data of nearly 50,000 firms from 11 European countries, authors find that the probability that a firm gets credit is higher lower is cost and shorter is time of resolving a dispute. Stronger property rights and creditor protection are also associated with higher probability of credit access. For the investigated sample, it turns out that probability of obtaining credit is 40% higher in countries with better judicial system.

Impact of Insolvency Reform on Entrepreneurship and Company Formation

Entrepreneurship and new company formation are considered important drivers of economic growth. The emerging literature establishes direct links between insolvency law and entrepreneurship. Lee et al (2011) employ the data of 29 countries throughout 19 years to address the question whether the differences in bankruptcy laws induce different levels of entrepreneurship development as measured by the new firm entry rate. The authors find that entrepreneur-friendly bankruptcy laws are significantly correlated with the level of entrepreneurship development. Specifically, the authors highlight importance of the following components of entrepreneur-friendly bankruptcy laws: (1) the time spent on bankruptcy procedure, (2) the cost of bankruptcy procedure, (3) the opportunity to have a fresh start in liquidation bankruptcy, (4) the opportunity to have an automatic stay of assets, and (5) the opportunity for managers to remain on the job after filing for bankruptcy.

Carcea et al (2015) investigate the role of efficient pre-insolvency framework in early debt-restructuring process and its effect on entrepreneurship. The authors find that the efficient pre-insolvency framework, that stimulates early initiation of debt-restructuring proceedings via informal out-of-court renegotiations, increases the chance of survival of a company with financial distress and facilitates entrepreneurship (measured by the self-employment rate) across EU member states.

Impact of Insolvency Reform on Macroeconomic Outcomes

As already noted above, Djankov et al (2008) find that debt enforcement efficiency is highly correlated with country's per capita income. Richer countries are much more efficient in debt enforcement and are more likely to keep the firm (of the case study) as a going concern. In the same vein, using data of 29 OECD-member countries Smrcka et al (2014) find that higher GDP per capita is associated with more efficient insolvency proceedings.

AFME report (2016) establishes link between insolvency regime and country's economic performance by estimating potential economic impacts of harmonization of insolvency laws in the EU. At first, the report uses a bond pricing model to estimate the impact of insolvency regimes on the financial market performance in EU. Specifically, the effect of recovery rates (as measured in the World Banks' Doing Business report) on the corporate bond spreads (measured as the difference between bond's yield to maturity and the risk free rate) is studied. Second, financial market performance is linked with the macroeconomic variables and the effect of insolvency reform on economic growth and employment is unveiled. The main findings of the report are as follows. 10 percentage point increase in recovery rate is associated with a reduction in bond spread of 0.37

percentage points, suggesting that EU countries with better insolvency regimes have lower borrowing costs. Once unobservable country-specific characteristics are taken into account, 10 percentage point increase in recovery rate becomes associated with a reduction in bond spread of 0.18 percentage points and the effect is significant at 1% level. The report estimates that if all EU countries achieve the recovery rate of 85%, this would result in 41 to 78 billion Euro increase in the GDP of EU per annum and the total employment would increase by 600,000 to 1.2 million across EU.

Model Description

This section outlines the approach we take to evaluate economic consequences of the insolvency reform.

We consider the Doing Business case-study of an insolvent firm and argue that probability of the firm going into reorganization, liquidation or foreclosure depends on the characteristics of an insolvency regime under consideration. Estimation of a multinomial logit model, in which dependent variable is the probability of insolvency outcome (reorganization, liquidation or foreclosure), allows us to derive fitted values for outcome probabilities before and after the insolvency reform in case of Georgia. Having probability estimates at hand, we can identify the effect of the reform on the recovery rate for the secured creditor. Finally, we estimate the effect of the reform on GDP and employment following the mechanism employed in the AFME report (2016).

To describe the model in detail, let $p_{ij} = pr(outcome_i = j)$ be probability that the insolvent firm in country i ends up with the insolvency outcome j, where $j \in \{reorganization = 1;\ liquidation = 2;\ foreclosure = 3\}$. Then we can write down a general multinomial logit model as follows:

$$\ln\left(\frac{p_{i1}}{p_{i3}}\right) = \beta_{01} + B_1 X_i \qquad (1)$$

$$\ln\left(\frac{p_{i2}}{p_{i3}}\right) = \beta_{02} + B_2 X_i \qquad (2),$$

Where, X_i includes the values for the set of independent variables for country i that affect the insolvency outcomes. Note that we can derive the value for $\ln\left(\frac{p_{i1}}{p_{i2}}\right)$ by subtracting (2) from (1).

Based on the established insolvency literature, we use the following independent variables to explain cross-country differences in insolvency outcomes: Time of insolvency procedures; Cost of insolvency procedures; Strength of insolvency framework sub-indexes – commencement of proceedings index, management of debtor's assets index, reorganization proceedings index and creditor participation index; Legal origin of a country; GDP per capita of a country;

The next step of estimation is concerned with identifying probability of retaining or selling the firm as a going concern and probability of piecemeal sale. According to the Doing Business indicators in Georgia, it is unlikely that the business will be sold as a going concern once liquidation outcome has been reached; since reform measures are unlikely to affect this outcome other than introducing

additional options for realization of debtors' assets we continue to assume that the business is sold in piecemeal unless the firm enters rehabilitation regime; therefore probability of going concern in directly determined by the probability of rehabilitation that we are going to estimate.

To calculate the recovery rate we follow methodology introduced by Djankov et al. (2008) and adopted by Doing Business methodology:

$$R_{gc} = \frac{(100 - cost - 0.2 * 0.25 * t)}{(1+r)^t}; \quad R_{liq} = \frac{(70 - cost - 0.2 * 0.25 * t)}{(1+r)^t} \quad (3)$$

Where, R_{gc} is a recovery rate of the firm in the case of rehabilitation or if sold as a going concern in other outcomes, in which case 100% of the value is retained, however the formula also considers depreciation of the assets and time it takes to resolve the case. Final value is discounted by the lending rate to take into account the time value of money. R_{liq} is a rate of return to the secured creditor if the firm is sold piecemeal in which case it retains 70% of its value; c is the cost as a percentage of the going concern value of the firm; r is discount rate and t is time before payment.

Using fitted values for probabilities in (3), we get the change in recovery rate as a result of the insolvency reform.

Our model closes by estimating the effect of the insolvency reform on GDP and employment. According to AFME report (2016), each percentage point improvement in recovery rate is associated with an increase in GDP between 0.03% and 0.06. Therefore, we calculate the lowest possible effect of the recovery rate on GDP as follows:

$$\frac{GDP_{after} - GDP_{before}}{GDP_{before}} = \frac{R_{after} - R_{before}}{R_{before}} \times 0.03 \qquad (4)$$

And the upper bound of the effect is calculated according to the following:

$$\frac{GDP_{after} - GDP_{before}}{GDP_{before}} = \frac{R_{after} - R_{before}}{R_{before}} \times 0.06 \qquad (5)$$

According to the same report, a percentage point increase in recovery rate induces an increase in employment between 0.02% and 0.04%;

Below in table 9 we report value of variables used for estimation. The costs and time variables under current and proposed framework has been calculated following the case study analysis above. However due to significant gaps in the Current Law which does not set adequate deadlines for different actors, we base our analysis on Time value reported in the Doing Business Resolving Insolvency Indicator. As for the values for proposed reforms we make an assumption that the time it will take to conclude the insolvency proceeding is the one stipulated in the Draft Law and derived in the Case Study Analysis section.

We estimate recovery rates and consequent economic impacts using three different scenarios as described below.

Scenario 0 – No changes in any of the parameters that determine rate of return for creditors. The recovery rate differs from the one reported by the Doing Business indicators, because we use actual amount of costs that has been reported in the case study. This scenario serves as a baseline to compare economic outcomes of the reforms against.

Table 9. Assumed Values of Variables Used for Estimation

Law	Indicator	Liquidation	Rehabilitation
Current Law	Time (years)	2	2
	Cost (% of assets)	18	21
	Commencement of proceedings index	2.5/3	
	Management of debtor's assets index	5.5/6	
	Reorganization proceedings index	0/3	
	Creditor participation index	3/4	
Draft Law	Time (years)	0.58	0.83
	Cost (% of assets)	25	21
	Commencement of proceedings index	3/3	
	Management of debtor's assets index	6/6	
	Reorganization proceedings index	3/3	
	Creditor participation index	2/4	

Scenario 1 – In this scenario we assume that the most likely outcome of the business case is Rehabilitation hence, the going concern value of the company is maintained. This leads to significant increase in recovery rates for creditors which is translated into significant economic increase in welfare and contribute to fulfillment of SD Goals 8 and 9. The outcomes of this scenario can be taken as a maximum what can be achieved due to the reform to insolvency framework.

However, one should remember that quick change in the outcome of the insolvency proceeding from liquidation to rehabilitation is highly unlikely.

Scenario 2- In this scenario, on the other hand, we assume that the most likely outcome of the proceeding is still liquidation, and piecemeal sale. The only change from the baseline scenario is the time and cost it takes to complete the insolvency proceeding. Economic outcomes estimated in this scenario can therefore be treated as a lower bound of possible economic gains.

Scenario 3- In this scenario we estimate probability of rehabilitation using econometric model described above. According to this model with the anticipated changes in the quality of regulatory framework probability of rehabilitation changes from around 0.05% to around 52%.

Estimated impacts on recovery rates as well as Distance to Frontier scores and potential rankings and macroeconomic outcomes are reported in the Table 10 and Table 11 below. Therefore most significant advancement in the rankings and macroeconomic outcomes are expected if in addition to legislative changes, contributors to the Doing Business Resolving Insolvency indicators perceive Rehabilitation as the most likely outcome of the case.

Table 10. Description of Scenarios and Estimated Recovery Rates, Distance to Frontier Scores and Ranking

	Rehabilitation	Going Concern	Reform	Recovery Rate	Distance to Frontier	Ranking
Scenario 0	No	No	No	33.84	52.59%	63[147]
Scenario 1	Yes	Yes	Yes	68.39	80.56%	15
Scenario 2	No	No	Yes	39.51	65.02%	46
Scenario 3	52%	52%	Yes	54.53	73.10%	30

Source: Authors' Estimations

This analysis is based on a strong assumption that all the deadlines as stipulated in the Draft Law is adhered to. While many of the deadlines in the Current Law is not being respected due to the problems outside the law itself, it is very difficult to expect that these deadlines will necessarily be met due to the changes proposed in the Draft Law unless additional efforts to deal with these problems are thoroughly addressed.

[147] This ranking slightly differs from current ranking because we are using estimated values for costs, not the ones reported in the Doing Business reports.

Table 11. Estimated Macroeconomic Impacts

	Impact on GDP				Impact on Employment			
	%	mln GEL	%	mln GEL	%	('000)	%	('000)
Scenario 1	6.13%	2330	3.1%	1165	4.08%	70	2.0%	35
Scenario 2	1.0%	382	0.5%	191	0.7%	11	0.3%	6
Scenario 3	3.7%	1395	1.8%	698	2.4%	42	1.2%	21

C. Summary of Impacts

The following analysis of impacts summarizes all possible direct and indirect impacts as well as distributional effects (even though they are not calculated). All impacts are assessed relative to the status quo, that is Option 1- No policy change;

Table 12. Summary Impact of Selected Options[148]

High impact	Medium impact	Low impact

IMPACT	OPTION 2
Administrative	Administrative burden on public entities is expected to be high, tight deadlines envisioned in the Draft Law will exert significant administrative burden on National Bureau of Enforcement and Tbilisi and Kutaisi City Courts. Sufficient administrative resources need to be mobilized for the anticipated positive impacts of the reform to be realized.
Regulatory Framework	Impact on regulatory framework of the Draft Law is expected to be high. The channels through which the Draft Law will impact the regulatory framework are the following: - Compared to the Current Law, the Draft Law provides different allocation of the competences between the actors involved in the insolvency proceedings. For example, the decision on the bankruptcy or rehabilitation of the distressed company is made by the judge, not by the Conciliation Council as envisaged under the Current Law. - The Draft Law introduces the concept of the insolvency practitioner by which the person may assume the role of the bankruptcy or the rehabilitation manager if he meets certain qualification criteria

[148] Impact assessment is based on combination of two factors: Likelihood and magnitude of behavioral or institutional changes in analyzed domains. E.g. high impact indicates that it is highly likely that the impact on the domain will be realized and magnitude of the changes will be significant.

	- The Draft Law amends the current ranking of the creditors. In particular, according to the Draft Law, the Revenue Service, even if it applies the tax security measures (such as tax pledge and tax mortgage) available under the tax legislation will not rank as the secured creditor. - Within the bankruptcy proceedings, the Draft Law provides the satisfaction of the secured creditors only to the extent of the realized value of the secured assets. - The Draft Law provides more neat criteria based on which the rehabilitation plan of the distressed company shall be prepared and then approved by the court. Such criteria shall ensure that the rehabilitation plan is not approved in the detriment of the creditors. - The Draft Law enables the unsecured creditors to prevail in approval of the rehabilitation plan even if the secured creditors are against such plan. Notably, in order the unsecured creditors to prevail, the rehabilitation plan shall meet the criteria which are clearly elaborated in the Draft Law. - The Draft Law sets out the maximum thresholds for remuneration of the bankruptcy and rehabilitation manager. Subject to the substantiated grounds, the court may increase the fee above these thresholds. As a result, advancement in international rankings on regulatory framework such as Doing Business Resolving Insolvency indicator is expected.
Economic	The expected economic impact of the reform are numerous. Empirical literature studying relationship between legal environment and economic outcomes has established robust link between the two, namely stronger insolvency systems and credit protection in general can lead to equity and credit markets development, improve financing conditions for companies, foster entrepreneurship and company formation and lead to more favorable macroeconomic outcomes. According to our estimates proposed regulatory interventions could increase Georgian GDP from 0.5% to 6.13% and employment from 0.3% to 4.08% with an assumption that the tight deadlines and procedures in the Draft Law are strictly adhered to (***This in itself facilitates fulfillment of SD Goal 8***).
Social	Expected social impact of the Draft Law is low. Even if the proposed legislation singles out a new class of the creditors: the preferential creditors, which amongst others, includes the employees of the distressed company whose claims from the employment take precedence over the claims of the secured and unsecured creditors, significant share of economically active population such as natural persons including individual entrepreneurs are **left behind**. Therefore no improvements in social variables concerning distressed natural persons could be expected.
Environmental	Direct and immediate impact of the Draft Law on the environment is expected to be low but in the longer run development of better corporate governance can lead to more responsible corporate culture benefiting **environmental sustainability**.

Public financing	Impact on public financing is expected to be high in the short to medium run through programs to institutionalize new systems: - Costs of setting up the IOH practice - Training costs for judges - Training costs of other public sector employees that directly or indirectly contribute to the implementation of the law. - Costs of adjusting legal infrastructure to the Draft Law by amending related laws, and by-laws, administrative orders, etc. .
SMEs	Impact on SMEs and particularly small and micro enterprises are expected to be low. According to the Draft Law the cost of the proceeding is not expected to decrease substantially, therefore it is expected that financial constraints will still deter small companies from enjoying the benefits the new Draft Law has to offer. Moreover, due to the prevalent financing mechanisms it is less common for small enterprises to go through formal insolvency proceeding; however the regulatory environment should provide enough flexibility to swiftly exit a failing business and direct resources to its more productive use.
Natural persons	With respect to the fact that the voluntary agreement proposed in the Draft Law is a voluntary act of the debtor, it is unlikely that the debtors who are natural persons, will actively use the voluntary agreement, especially in those cases where the outstanding amount is not too much and/or the debtor is reluctant to the fact that he/she might be recorded in the Debtor Registry and/or exposed to other restrictions. Therefore low impact on natural persons is expected.

VI. Comparison of options using multi-criteria analysis

While comparing the alternatives to identify the preferred one option, we consider a number of criteria which cover five core dimensions of standardized policy-analysis practice[149]. These criteria are:

Effectiveness: the capability to produce the desired results. In our case, the capability to:

1. Improve efficiency of the insolvency framework by increasing opportunities for viable firms to be rescued and by fostering equitability, transparency and predictability in the distribution of the debtors' assets when firm rescue is not feasible.
    a. Increase the value of a firm's assets and recoveries by creditors;
    b. Improve efficiency in liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;

[149] See for example: Morestin, Florence. A framework for analyzing public policies: practical guide. Centre de collaboration nationale sur les politiques publiques et la santé, Institut national de santé publique Québec, 2012.

c. Foster business enabling environment;

Feasibility: This criterion assesses how easy it is to realize the policy option. This includes compliance rates, the possible scarcity of resources, and adequate capacity to cope with complex regulatory changes.

Minimization of risks: This criterion evaluates the capacity of the option to minimize the realization of the following vulnerabilities and risks:

- Frictions in implementation and enforcement of the Draft Law due to capacity constraints at the NBE and Courts further deteriorating efficiency of public institutions.
- Inadequate trust of secured creditors in the insolvency legal framework.
- Preparedness of private enterprises to make use of early restructuring options or redesigned formal insolvency procedures.

Maximization of collateral benefits: This criterion evaluates the capacity of the option to maximize the positive externalities generated by the reform, including:

- Increase attractiveness of the country to foreign investors
- Facilitate the access of enterprises to domestic and international capital, with positive repercussions on economic growth
- Foster entrepreneurship and job creation
- Positive impact on the economic, social and environmental dimensions of sustainable development (**principle of integrative approach under the 2030 Agenda**)

Distributional impacts: This criterion assesses effect of the option on the most vulnerable parts of society (**LNOB principle under the 2030 Agenda**).

We do not explicitly attribute weights to each criteria and leave it up to the policy-makers to determine weights according to their priorities.

Summary of Options

Assessment of each policy option with respect to each criterion is summarized in the Table 13 below. The judgment on each policy option has been made based the discussion above and ranking has been done using non-linear/non-compensatory approach to Multi-Criteria Analysis. That is scores (number of +)[150] cannot be compensated across criteria.

Table 13. Comparison of Options using Multi-Criteria Analysis

EVALUATION CRITERIA	OPTION 1	OPTION 2
Effectiveness	+	++
Feasibility / Ease to comply	++	+

[150] Number of + is determined by relative ranking based on the qualitative assessments in the previous sections. That is since we have two options the option that is considered to be more effective in terms of achieving objectives is given ++ on the Effectiveness criterion while option one is given +, there is no numerical difference or distance between + and ++.

Minimization of Potential Risks	++	+
Maximization of Potential Benefits	+	++
Distributional impacts	+	++

Ranking of options

According to the analysis, both options have some merits; as it was stated above, we do not attribute specific weights to the criteria; if all the criteria are weighted equally by the policy-maker Option 2 will dominate Option 1 and should be preferred option. However if Feasibility/Ease to Comply and Minimization of Potential Risks criteria receive very high priority that is, are weighted higher than other criteria, the preferred option should be Option 1.

VII. Monitoring and Evaluation Plan

Analysis of effectiveness of the Draft Law once it is implemented requires rigorous monitoring and evaluation plan to track its performance against defined objectives[151]. Below we propose set of indicators to be monitored and reported publicly. Regular monitoring of these indicators will help policy makers keep track of reform performance and provide timely response to any bottlenecks which can arise, especially at the early stages of implementation. Regularly (at least annually) reporting publicly on these indicators will help increase accountability and transparency of public institutions and bring country in line with sustainable and inclusive development standards.

Responsibility: Tbilisi and Kutaisi City Courts

- Number of entrepreneurial legal disputes regulated by the Law on Insolvency Proceeding– This, in our opinion is the most important indicator to track, since the Draft Law will have direct and immediate impact on this measure.

Statistics on entrepreneurial legal disputes as it is available now lacks important details that could help isolate specific problems and challenges faced by the stakeholders. Therefore we propose complementary set of indicators:

- Number of entrepreneurial legal disputes related to insolvency by type of applicant (debtor/creditor)
- Duration of insolvency proceeding, by regime (# of months)

Responsibility: National Bureau of Enforcement

- Share of rehabilitation versus bankruptcy in total insolvency resolutions (%)
- Recovery rate by secured and unsecured creditors (%)
- Value of post insolvency proceedings assets relative to insolvency mass (%)
- Cost of insolvency proceeding, by regime (% of insolvency mass)

Responsibility: Ministry of Economy and Sustainable Development

- Doing Business Resolving Insolvency Score and Ranking

The following indicators are composite and/or perceptions-based, therefore it will take years before significant improvement in these indicators can be observed. Moreover, many other factors, including macroeconomic development will impact progress in these areas; therefore attribution and isolation of the impacts of the Law on Insolvency Proceedings will be a challenge. Nevertheless, for achieving the objectives of the intervention it is of utmost importance to track progress in these measures of socioeconomic development:

- Efficiency of legal framework in settling disputes - Global Competitiveness Indicators, World Economic Forum;
- Financing through local equity market - Global Competitiveness Indicators, World Economic Forum;
- Ease of access to loans - Global Competitiveness Indicators, World Economic Forum;
- World Bank Governance Indicators (SDG 16.6)

[151] 2030 Agenda Accountability Principle

- Rule of Law
- Government effectiveness
- Voice and Accountability
- Control of Corruption
- Regulatory Quality

VIII. Procedural Issues and Consultation of Interested Parties

A. Consultation and Expertise

To develop a comprehensive overview about the Current Law on Insolvency Proceedings and the possible solutions to the problems identified and described in the preceding sections, the RIA team opted for a multiplicity of methods, including but not limited to: desk research, literature review, request of official data, telephone interviews, and in-depth interviews of the identified stakeholders, informal and formal.

The goal of the first phase of the consultation and data gathering was to define the problem, objective(s) of the policy and identify possible policy options. As for the second, complementary phase of consultations and data gathering, it will have the main purpose of helping the team gather the missing information / data necessary to compare the different policy alternatives to the status quo and select the best one.

In parallel, Ministry of Justice has been holding number of consultative meetings with interested parties and stakeholders, RIA team members have been invited to attend the meetings and hear oral or written feedback provided by the stakeholders. The combined list of invited and interviewed stakeholders can be seen in the APPENDIX IV below.

Legal guidance to the RIA team was provided by Berlin Economics, and particularly its international expert Hans Janus who has authored number of studies on insolvency systems internationally including in Georgia. Section below provides assessment of the expert.

Assessment by International Insolvency Law Expert[152]

The recommendation to replace the Law on Insolvency Procedures by a complete new Law has been followed. The new Draft Law from 2018 is a modern, well structured, transparent and economically sound legislative act.

The greatest change and most important improvement is the complete change in philosophy of insolvency proceedings. Now the rehabilitation of the debtor's enterprise, wherever possible, is in the center of all insolvency measures.

The state administration's influence on Insolvency procedures is much reduced, notably by the much smaller role of NBE, and the role of courts is strengthened significantly.

The introduction of a new profession of Insolvency Practitioners and making their involvement in all types of insolvency procedures mandatory, cannot be valued high enough.

Creditors' role is strengthened by better rights to apply for debtor's insolvency and by more rights for the newly established Creditors' Committee.

There is a very good chance that corruption, asset-stripping and intransparent sales of assets and distribution of proceeds will be pushed back under the new Draft Law, if adopted.

[152] Longer version of the assessment can be found in Appendix II

The ranking of Georgia in the World Bank's Doing Business Reporting will, on the basis of this Draft Law, undoubtedly improve further.

B. Stakeholder Survey by RIA Team

First of all, main stakeholders were identified and categorized in the influence-interest matrix format. A set questions for each category of stakeholders was developed, and official consultations /interviews has been organized and conducted with: legal practitioners, business associations, investment companies, Government of Georgia (GoG) Agencies, civil society and research institutions among others.

Table 14. Stakeholders' MAP

INFLUENCE / INTEREST	LOW INFLUENCE	HIGH INFLUENCE
Low Interest	Business Associations Business Ombudsmen Partnership Fund National Agency of Public Registry Legislative Herald of Georgia NGOs	Parliament Committees (Legal Issues Committee and Sector Economy and Economic Policy Committee)
High Interest	Lawyers, Practitioners Businesses with the experience in insolvency proceedings Unsecured Creditors Revenue Service Competition Agency Individuals Secured Creditors (Banks, MFOs, etc.)	National Bureau of Enforcement Court Ministry of Justice Ministry of Finance Ministry of Economy and Sustainable development

Table 15. Summary of interviews with legal experts

STAKEHOLDER / STAKEHOLDER GROUP	SUMMARY OF RESPONSES
Legal Experts/Consultants Tornike Artkmelidze/ Independent lawyer, member of Conciliation Council Tamta Ivanishvili- Senior Associate, BLC law office Irakli Gaprindashvili/ Managing Partner, GLCC Oberon Kwok Barrister at St Philips Chambers	**Gaps in Law** • The stated **purpose of the current law**, "… to equally protect the rights of a debtor and of a creditor(s)" is not acceptable for the most of the legal experts and practitioners. However, one of the experts highlighted that the creditors and debtors should be protected equally throughout an insolvency proceeding. Survival of the company is equally important for the long run purposes and the process should be fully supportive to the purpose. Otherwise, creditors could deal with the recovery through enforcement only. • **NBE is the only institution who can be trustee** in the transition period of insolvency proceedings. This creates several consequent problems. In Georgia the trustee (NBE) is remote from the company at a very difficult period of its operation. In all countries, the trustee enters the company with an aim to study, to analyze and to prepare the position for the stakeholders about current situation as well as about perspectives of the company. Based on the very limited capacity of the NBE, this is not done in practice. At the same time, the status of trustee as a state institution, grants it more rights than the trustee should have in general (freeze the bank accounts for example). Because of the law, the activity is monopolized, which does not create any incentive to improve competencies in the area. In general, duties of Insolvency Office Holders (IOH) is key and very complex in the process of insolvency. The lack of required qualification of an IOH is a significant gap of the law. • **Costs of the proceeding** is exceptionally high. The costs constits of the service charge by the government/NBE, the cost of court, the cost of legal service, etc. All these sum up to the significant share of the total claims. Even more, the law defines that the undistributed amount of assets after the bankruptcy procedures, should be transferred to the NBE. Therefore, it is clear that the company does not have incentive to apply to the court in a timely manner, when it is still possible to maintain to rescue the company. • Given the existing practice, that in most cases **Revenue Service** represent the biggest share of the credit pool, treating the government as a secured or senior unsecured creditor, decreases the rate of recovery for junior unsecured creditors. There is no

reason for the RS to vote to accept delayed payment considered in the rehabilitation plan, rather such high priority status incentivizes the RS to opt out with the immediate payment which means bankruptcy.

- The **rights of the unsecured creditors** (rather than the RS) are not adequate to their interest. Naturally, unsecured creditors would avoid the piecemeal sale of the asset and would try to keep the company operating. Currently, by the law, the unsecured creditors cannot vote on a rehabilitation plan, while the secured creditors most likely want to recover as much as possible of its loan, as quickly and cheaply as possible, even in the case, when the rehabilitation of the company is possible.

Gaps in implementation

- NBE as a trustee avoids to approve the decisions of the insolvent company, which could improve liquidity position of the latter. For example, if the company owns the property which is not a secured under any of the loans and can be sold to improve cash statement, or to reduce number of employees, the NBE appears to be ineffective institution.
- Efficiency of the process is mainly challenged by delays in implementation. The problem mostly comes from the overloaded court system. Even, though the special category in the court has been created, overdue of the terms prescribed by the law, remains one of the main problems. Mainly, stakeholders mention the violation of the term in the moment of requesting the creditors' meeting, while fast decision and acting is vitally important to maintain the asset value. The most painful is the transition period from filing for insolvency to opening of the bankruptcy or rehabilitation regime. This is due to the several factors altogether: there is no deadline for formation of the conciliation committee; trustee cannot prepare qualified reports that should help creditors to make fast decision.
- In practice in Georgia companies file for insolvency at a very last stage of their financial difficulties, when rehabilitaion chance of the company is nonexistent. The practice is supported by the high costs attributed to the process, described above. Most importantly, the court does not permit to open the case until the company is in a very bad condition, otherwise the court refuses as if company wants to misuse this right and enjoy moratorium, to discontinue the current liabilities, to postpone the execution process, etc. Even though, the conditions for insolvency is well defined in the acting law (expected insolvency as well as the actual insolvency), this

	does not work in reality and openness of the process remains as an obstacle for the companies. **Advice/Recommendations** • To disengage the NBE from the proceeding as an obligatory trustee. Possible solutions: to create the register of authorized Insolvency Office Holders with the adequate qualification requirements. This should help solve several severe problems at a time: decrease time needed for transition, decrease cost of having independent IOH (through competition), better informed creditors with more efficient creditor decisions. • Do not prioritize RS amongst other creditors. This will increase the likelihood of recovery for all creditors and increase probability of rehabilitation. • Review the terms and state realistic terms in the law. This will make process more predictable and credible. • Increase the capacity of the court. This will shorten the terms needed and will allow court to receive and execute more cases. • Increase rights of unsecured creditors e.g. to vote on a rehabilitation plan.

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APPENDIX I- Executive Summary of Assessment Report by USAID Governing for Growth in Georgia project

EXECUTIVE SUMMARY

The Ministry of Justice of Georgia ("MoJ") has requested the USAID *Governing for Growth (G4G) in Georgia* project to perform an assessment of the Georgian insolvency system. The MoJ is currently considering amending the *2007 Law on Insolvency Proceedings* (the "Law")[153] and has formed an internal working group to prepare draft amendments in response to a widespread recognition that there are problems in its application and to its sparse utilization. The Deputy Minister of Justice requested G4G support in performing an evaluation of both the Law and the overall insolvency system to assist the ministry in its drafting efforts and to ensure that the resulting legislation will be more consistent with emerging "international best practices" for insolvency regimes. The results of the assessment[154] by the G4G team are set out in the following sections of this report.

LOW LEVEL OF USE OF INSOLVENCY PROCEEDINGS

It appears that the Law is utilized relatively infrequently as a tool to resolve financial distress in Georgia.[155] It is possible, as we have been told, that the Law's infrequent use is in part because of the stigma that still attaches to insolvency. However, another reason may also be because the Law, and the manner in which it has been interpreted, has not met the needs of either debtors or creditors in the current economy. As discussed further herein, the Law adversely affects the rights of senior secured creditors, largely ignores the rights of unsecured creditors, and does not provide a flexible enough framework for "rehabilitation" to be a useful strategy for either debtors or creditors. Managers and directors of companies facing financial difficulty might be more inclined to take timely insolvency action if the legal framework were to provide appropriate incentives to encourage sooner intervention and better overall practice. In the context of financial distress, the sooner action is taken, the more options there are to address the problem.

PRINCIPAL FINDINGS

- The report's most significant findings are summarized below:

- The stated purpose of the Law is not expressed in terms which maximize the protection of creditors' rights or of the net value of the debtor's assets. The stated purpose of the Law, "…to equally protect the rights of a debtor and of a creditor (creditors)," is unusual in the emphasis that it gives to the debtor. Insolvency laws are more commonly thought

[153] All references herein are to the *Law of Georgia on Insolvency Proceedings*: Parliament of Georgia, 28th of March 2007, (No: 4522-IS), as amended 11th of December 2014 (No: 2922-IS) unless otherwise indicated.

[154] We wish to note the excellent cooperation our team received from the Georgian Ministry of Justice, and its agency, the National Enforcement Bureau, in particular the NBE's openness and candor in discussing the many challenges they face in carrying out the complex requirements under difficult circumstances on a day-to-day basis.

[155] *See chart in Appendix G, displaying the few case filings in number (approximately 25 – 100 per year) relative to business registrations (approximately 10,000 – 20,000 per year).*

of as providing a collective mechanism for creditors to maximize the recovery of amounts due to them when the debtor is unable to generally meet its contractual obligations when they become due. While reorganization of the debtor's business is generally considered preferable to the outright sale of the debtor's assets, reorganization is best viewed as a strategy to maximize the value of the debtor's assets for the benefit of its creditors, rather than an end in itself. Such a change in the orientation of the legislation will require substantial redrafting.

- The lack of clarity in the responsibilities of the Insolvency Office Holder ("IOH") and the debtor significantly hinders the maximization of the value of the insolvent debtor's assets.

- It is not clear in the Law that the protection of the net asset value of all of the debtor's assets for the benefit of the pre-insolvency creditors is the most basic of the trustee's responsibilities.

- The National Bureau of Enforcement ("NBE") in its role as trustee, does not appear to be organized in such a way as to effectively allow it to protect the intangible assets of an insolvent debtor, including accounts receivable. The IOH has an obligation to protect the value of all intangible assets of the debtor, as well as the real and moveable tangible assets. Where it lacks the specialized expertise to convert a particular type of asset (accounts receivable, for example) into cash, the IOH should be able to engage such experts to assist it.

- The Law fails to establish a framework to ensure that people performing IOH roles are accountable, competent, honest, or have the necessary experience. Protecting the assets of the debtor for the benefit of the creditors is a complex and difficult role, which requires a broad understanding of the laws which affect an insolvent business, as well as sufficient business knowledge to deal with the debtor's assets effectively.

- The lack of rigorous qualifications and experience required by parties who carry out the duties of an IOH remain unaddressed since the 2009 European Bank for Reconstruction and Development ("EBRD") survey which previously identified these deficiencies.

- The NBE, in carrying out its responsibilities in insolvency cases, should seek specialized technical training for the staff of its Insolvency Department.

- The MoJ should also consider developing a mid-term strategy to convert the Insolvency Department of the NBE into a regulatory body for the oversight and licensing of private sector IOHs.[156]

- The use of mandatory auction as the exclusive sales method for assets in bankruptcy cases is not always the most effective method for realizing the highest net value. Other suitable mechanisms for disposal of assets in a transparent and appropriate manner should be included in an amended law, including the power to sell perishable and time-dated inventory.

[156] *Georgia is the only country in the EBRD survey in which the IOH is a government agency; other countries have opted for solutions in which private sector individuals and sometimes legal entities are appointed to IOH roles, subject to varying degrees of oversight.*

- The relatively few articles which comprise the Law leave many common situations unaddressed. This lack of detail in the Law to address specific issues impacts efficient case resolution and the ultimate realization of asset values. There is often no legal basis provided to protect the interests of either creditors or the debtor in certain common situations. For example, the Law does not contain provisions:
    - That require public utilities to continue to provide essential services;
    - Regarding the rights of the IOH and creditors when there are goods in transit at the time a proceeding is opened;
    - That allows the IOH to effectively recover assets divested by the debtor immediately before the insolvency proceeding is opened;
    - That specify whether and under which circumstances the IOH can temporarily continue some of the operations of the debtor in order to protect the value of the assets;
    - That specify under what circumstances the IOH can sell perishable or time-dated inventory urgently, to protect their value.
- The lack of precision in the current Law has also led to its inconsistent application by the courts in numerous instances.
- The grouping of all secured creditors into a single rank of creditors seriously undermines the principle of "first-in-time" to register collateral, which is a foundational rule generally used to establish priority of mortgage charges and liens in modern commercial usage globally. This important principle of determining the priority of mortgages, liens and other types of security fails to apply once an insolvency proceeding has been opened. Instead, in certain circumstances, the claims of all secured creditors are "pooled," together and treated as though all secured creditors had the same rights irrespective of priority. Besides lacking fairness, this treatment increases the level of uncertainty and unpredictability for lenders, which negatively impacts the cost and availability of credit to all borrowers. This treatment is inconsistent with international best practices.
- Ineffective provisions in the Law regarding rehabilitation plans restrict the use of business rescue as a tool to maximize value. In particular:
    - The rehabilitation provisions of the Law lack fairness, in that the unsecured creditors are not entitled to vote on a plan that affects their rights profoundly;
    - The rehabilitation provisions of the Law require *full* settlement of the claims of all creditors. This in sharp contrast to the more usual requirement that a plan may propose *less than full* recovery, subject to creditor agreement expressed by vote, with the typical safeguard that the plan should provide at least as great a recovery by all ranks of creditors as they would realize from the outright sale of the debtor's assets. The Law should be amended to allow rehabilitation plans to offer less than full settlement of the claims of each rank of creditors, subject to the requirement that no class of creditors is worse off under a plan than they would be if the debtor's assets were sold.

- The large number of ranks of creditors, the claims of which must be satisfied before any distribution can be made to the next rank, means that the lower ranks of creditors are likely to have to wait a considerable period before they receive any amounts due to them. Where there is a structure with many ranks of creditors, the most junior creditors may well prefer to a smaller but much earlier recovery which will result if the assets of the debtor are sold. Such a tiered structure of many ranks of creditors is less likely to have the support of junior unsecured creditors than a structure with fewer ranks. The number of ranks should be reduced, and in particular, provisions allowing for the satisfaction of small "administrative convenience" claims be added.

- The claims of the government (typically unpaid taxes) should be treated as a general unsecured claim, as laws that grant the state a superior priority in a bankruptcy distribution have fallen out of favor in modern international practice. Granting a high-priority status to state claims only creates a strong disincentive for this highly-privileged creditor to ever vote in favor of a rehabilitation plan, instead preferring a bankruptcy distribution where the state will immediately be paid in full. Conversely, this same scenario also creates a strong incentive for the more junior and unsecured creditors to opt for rehabilitation solely to avoid the state immediately taking all in a bankruptcy distribution thereby leaving little remaining for them.

PROPOSED AMENDMENTS

After the conclusion of the fieldwork for this assessment, the team received a set of proposed amendments to the Law from the MoJ on 22 May, 2015. While some of the proposed amendments address certain concerns raised in this report, such as an all-creditor vote on a rehabilitation plan, the proposed amendments generally do not address all the issues identified. Certain fundamental issues remain unaddressed, including: the purpose of the Law, the preservation of the relative ranking secured creditors, as well as the lack of clarity regarding the basic primary functions of the NBE in its role as trustee. While the proposed amendments are a welcome improvement, we believe considerably more will need to be done to fully address the fundamental issues raised in this report.

EARLY DISMEMBERMENT OF THE DEBTOR

The data provided by the NBE on the open insolvency proceedings (included as Appendix C) suggest that in many proceedings the banks have been successful in having the debtor transfer its real assets to the banks' names before the opening of an insolvency proceeding. This has the effect of dismembering the debtor's "going concern value" and making the prospects of a successful rehabilitation plan remote. If so, this should be addressed by new amendments containing provisions covering preferential transfers. Because the information from the NBE was made available after our fieldwork ended, the team was not able to fully examine whether the banks recovered more than amounts due to them when the debtor's real assets were transferred to bank ownership.

NEED FOR A SUBSTANTIALLY NEW LAW

Based upon our current review, we find that the current insolvency system in Georgia, regulated by the *2007 Law on Insolvency Proceedings,*[5] possesses significant legal and economic weaknesses. Stronger policies underlying the legislation that governs the insolvency system are needed to create a more effective environment for the resolution of financial failure in Georgia. Addressing these and other issues raised in the main body of the report are likely to require a major redrafting or an altogether new law if it is to achieve close consistency with emerging norms of international best practice[6] for national insolvency systems.

APPENDIX II- Assessment of the International Expert

Dr. Hans Janus

Georgia

Draft Law „On Rehabilitation and Collective Satisfaction of Creditors“

1. Background

A modern and well-functioning insolvency procedure is generally regarded as an important measure for enabling firms to address their financial difficulties and to rescue companies, save jobs and satisfy creditors' claims. Advanced insolvency procedures usually contain rules for out-of-court workouts, court based rehabilitation or bankruptcy procedures and hybrid options. Many countries also have Consumer Insolvency legislation in place. The importance of insolvency procedures in general and of procedures to rescue the companies and give entrepreneurs a "second chance" is highlighted by many studies of International Institutions like United Nations, European Union, World Bank, IMF, European Bank for Reconstruction and Development (EBRD) and others. In the Doing Business assessment of World Bank "Resolving Insolvency" is one out of 11 indicators for assessing a country's business friendliness.

2. Georgia's current insolvency legislation

Georgia's "Law on Insolvency Proceedings" of 2007 with later amendments only partially meets the requirements of a modern insolvency law. Despite a substantial and mainly positive amendment of 2017 it remains being far from international best practice. National and international experts criticized this legal act and recommended not to amend the current legislation but to replace it by a completely new legal act[157]. The 2017 amendment led, as a consequence, to a much improved judgment of Georgia's rating for "Resolving Insolvency" in the World Bank's Doing Business Report, letting Georgia jump from Position 106 (2017) to Position 57 in 2018 for this specific indicator[158]. However, Resolving Insolvency remains by far Georgia's worst rated single indicator.

3. Legal materials available for this assessment

This assessment is based on the following legal acts:

a) 2018 Draft Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors , English translation;
b) 2007 Law of Georgia on Insolvency Proceedings, English translation, Status of 2014;

[157] USAID G4G, Assessment of the Insolvency System in Georgia, 2015, p. 35; *Saha/Janus*, Reform des Insolvenzrechts – Priorität für die Wirtschaftspolitik, Newsletter of German Economic Team (GET) Georgia, March-April 2016; *Janus/Migriauli*, Georgiens schwieriger Weg zu einem modernen Insolvenzrecht, Wirtschaft und Recht in Osteuropa (WiRO) 2016, p. 336-338.

[158] Worldbank, Doing Business 2018, Reforming to Create Jobs, Economy Profile of Georgia, p. 51-56.

c) 2017 Amendment to the Law of Georgia on Insolvency Proceedings, not as legal document, but only in the form of newsletters describing the content.

For the 2018 Draft Law on Rehabilitation and Collective Satisfaction of Creditors it must be said, that the English translation gives a clear picture of the content of the legal act and the intentions of the authors of this draft law. However, there are a lot of typos, errors, omissions and some seemingly illogical sentences[159].

4. General Findings

The 2018 Draft Law on Rehabilitation and Collective Satisfaction of Creditors would be, if adopted, a quantum leap forward for Georgia's insolvency legislation. The most substantial change is a complete redirection of philosophy and objectives of insolvency proceedings from liquidation of the enterprise to its rehabilitation. Some striking findings in comparison with the Law currently in force are:

a) The Law is considerably longer than the current law. This fact alone reduces the risk of misunderstandings, vagueness, circumventions etc.
b) Purposes and Principles have been defined completely different: From asset sale and distribution of proceeds to rehabilitation of the enterprise (Art. 1, 2, 71, 101). This is an important improvement, positively addressing the main weakness of the current legislation.
c) Introductory Articles of several Chapters highlight the "Concept" of the subject regulated. This is helpful for understanding motivations and objectives of lawmakers. This approach helps later when interpretation of certain articles should become necessary.
d) The newly introduced "Voluntary Agreement" strengthens the concept of survival of the debtor by offering a pre-insolvency (out-of-court) procedure under the supervision of an Insolvency Practitioner (Art. 21, 24). Unclear, whether Nominee of the Voluntary Agreement and Supervisor are the same or different persons (Art. 18 par. 7, 21).
e) Natural persons are in principle not subject of this Draft Law on Rehabilitation and Collective Satisfaction of Creditors (Art. 4 par. 2 and 3) but they can also be debtors in a Voluntary Agreement (Chapter II, Art. 18 par. 3). They can after successful realization of the Agreement receive discharge from their remaining debts (German: "Restschuldbefreiung"). This, however, is not a real Consumer Bankruptcy procedure.
f) The physical continuation of debtor's business operations can be protected by the court by prohibiting contractors to discontinue their critical services (Art. 58).
g) "Insolvency" and "expected insolvency" remain the grounds for opening insolvency proceedings (Art. 5). However, Art. 6 (Concept of Insolvency) extends the grounds for opening insolvency proceedings by "assumed insolvency" including amongst others insufficient level of assets in relation to aggregate obligations (German: Überschuldung)
h) The position of "Insolvency Practitioner" is being introduced as mandatory, thus addressing one of the most important shortcomings of the current legislation and current insolvency procedures in Georgia.

[159] Just as a few examples: The enumeration of Chapters is not correct, there are two Chapters VI. and two Chapters XII., there are several Articles commencing with paragraph 1, but not having paragraphs 2 or higher, one Article (74) shows only paragraphs 5 and 6, but no other paragraphs, etc.

i) Creditors' rights to apply for insolvency procedures strengthened by abolishment of various previous restrictions (minimum claim amounts, presentation of positive court decisions against creditor, applications only jointly by two or three creditors etc.).
j) Important steps of the process will be made public on the website of LEPL NBE (Art. 45 par. 4, acceptance of admissibility; Art. 46 par. 5 and 6, rejection of admissibility, declaration of bankruptcy; Art. 52, call for creditors' meeting, resolutions and minutes; Art. 55, Creditors' Registry; Art. 64 Par. 3, court order of commencement).
k) Voidable Acts regulated much more detailed and closer to international standards.
l) Employees defined as preferred creditors (Art. 71 par. 5; see Art. 46 par. 5.1 current law).
m) Debtor in possession under supervision by a supervisor (Art. 72 par. 1, 75) as new form of rehabilitation management established (German: Eigenverwaltung, Schutzschirmverfahren).
n) Cross-border Insolvency much more detailed.
o) High level of transparency established by manifold obligations to publish important steps of insolvency procedures.

5. Some preliminary recommendations / questions

There are some aspects of the new Draft Law, which deserve some deeper consideration. It cannot be excluded that in the original version of the draft in Georgian language these things are clear.

a) The Draft Law does not include a Consumer Bankruptcy Procedure. A legal regulation of Consumer Insolvencies should either follow as separate legal act or be incorporated in the Draft Law.
b) Insolvency Practitioners (Art. 10) become extremely important for all types of insolvency procedures. This is new and very positive. The Insolvency Practitioner can be a physical or legal person (Art. 10 par. 2) and act as Supervisor or Nominee in the case of a Voluntary Agreement (Art. 76), Rehabilitation Manager or Bankruptcy Manager. The minimum professional qualification required and the obligation to preserve/increase professional knowledge should be defined, either in the Draft Law or, perhaps even better, in a specific Legal Regulation on the profession of Insolvency Practitioners.
c) The rules for the selection of the rehabilitation/bankruptcy managers need to be made and the electronic system built up (Art. 10 par. 5). Is this the same electronic system referred to in Art. 17? Because of its importance for transparency of insolvency procedures such an electronic system should be established as fast as possible.
d) Article 3 "Definition of Terms" contains some but not all definitions. Not included, for example, is the definition of "Debtor" in Art. 4 par. 4.
e) Private Complaints against court orders have an extremely short deadline of 5 days which cannot be prolonged (Art. 8 par. 4). Other deadlines, e.g. for court decisions, have fairly short deadlines as well. For the sake of a rapid procedure this is positive. But, in the interest of the parties of an insolvency procedure and of the quality of decisions to be taken, one could consider having slightly longer deadlines.
f) If the creditor applies for the debtor's insolvency it is his task to forward the court's documents (registration of application and notification) to the debtor (Art. 44). Why is this not done officially by the court?

g) There are many obligations to publish certain documents or decisions. It is not always clear, which means of publication have to be used. Sometimes it is the Legislative Herald of Georgia or the Electronic System (Art. 17) and sometimes additional information is missing, e.g. Art. 45 par. 4 or Art. 73 par. 1. Clarification should be given.
h) In Art. 66 the use of the terms "rehabilitation supervisor", "rehabilitation manager" and "rehabilitation administrator" (?) needs to be checked again.
i) Voidable Acts. Clarification in Art. 67 that omissions (non-actions) by the debtor's management can be a ground for voidance too and are treated equal with actions should to be considered.
j) Art. 56 – 60 (Moratorium) in the English translation have a lot of mistakes. In particular this section should be checked again and corrected.
k) Role of LEPL NBE: Why is the NBE calling the creditors' meeting and not the rehabilitation supervisor or rehabilitation manager himself (Art. 76 par 3a, Art. 77 par. 5 z bb). A different rule applies for the bankruptcy manager: he can either call for a creditors' meeting himself or address NBE (Art. 102 par. 3a). Why?
l) Expiration of term: The deadline for termination of rehabilitation regime in Art. 96 is missing.
m) Ranking of creditors is regulated in Art. 106 and 107. In Art. 106 par. 1c a cross-reference to Art. 107 (Secured creditors) should be made; otherwise Art. 106 looks as if Secured creditors would have been forgotten.

6. Possible impacts by Draft Law, if adopted

Without applying any scientific quantitative or qualitative methods for measuring the possible impacts of the Draft Law it can already be said now that significant improvements will be directly attributable to the implementation of the Draft Law. Some of them are:

- The new Profession of Insolvency Practitioners will help making insolvency proceedings more professional, more market-oriented, more transparent and fairer.
- The rights of creditors have been strengthened considerably, particularly in the phase of application for insolvency.
- Ranking of creditors seems to be fairer than under current Law: Very dominant position of NBE, Tax Authorities and Secured creditors is reduced and ranking more balanced.
- The focusing on rehabilitation brings Georgia much closer to international best practice.
- The introduction of "Voluntary Agreement" is a significant improvement because it is a genuine pre-insolvency procedure.
- This procedure is usable also for natural persons if they conduct a commercial business.
- Time limits and deadlines serve a rapid proceeding of insolvency cases.
- The corruption risk should be significantly reduced. The sale of the debtors' assets through auctions will happen in a much lower number of cases, since rehabilitation is the priority procedure. Also, the "Conciliation Committee" has disappeared from the Draft Law and its authorities are now with the Creditors' Committee, the Court and the Insolvency Practitioner much better balanced.
- Transparency has much improved by numerous obligations to make important steps of the procedure and court decisions public and thus accessible for interested parties.

7. Risks and Mitigation

The Draft Law on Rehabilitation and Collective Satisfaction of Creditors brings a radical change in philosophy for Insolvency Proceedings: From liquidation and sale of assets to rehabilitation of the company and giving the entrepreneur a "second chance". As stipulated in Art. 1 of the Draft Law the purpose of the law is "collective satisfaction of creditors through rehabilitation if possible, or distribution of proceeds generated from sale of the insolvency estate if there is no chance for rehabilitation".[160] In fact this Article contains two objectives which could get into conflict with each other, i.e. sale of the insolvency estate vs. rehabilitation. The time perspective also plays an important role. A rapid liquidation can bring a quick and more or less satisfactory solution for the creditors, whereas a rehabilitation usually needs more time. In the long run, however, rehabilitation often is the more attractive solution for creditors.

Are the two purposes of equal importance or is there a predominance of one of them? Although both purposes are mentioned very prominent in Art. 1, there is a gradual differentiation. "Collective satisfaction of creditors" shall be reached "through rehabilitation" and only through sale of the insolvency estate "if there is no chance for rehabilitation". Art. 1 thus opens room for interpretations but rehabilitation seems to be intended by lawmakers as the preferred option.[161] Art. 2 highlights the "Principles of the Law" and gives some important hints for interpreting the purposes of the law and for its implementation in court-based or out-of-court insolvency proceedings. Over time judges, Insolvency Practitioners, attorneys and university law professors will come to balanced viewpoints in this question.[162]

This new concept made a complete new law necessary. The new draft law is much better than the current one and a great step forward for Georgia's commercial law. There are, however, as in every case of a new legislative act, some inherent risks or weaknesses unavoidable in such a challenging project.

In the following possible risks, but also weaknesses of the current draft law, and measures to mitigate those will be analyzed.

[160] A similar regulation can be found in § 1 of Germany's Insolvency Law (Insolvenzordnung) of 1994 with later amendments.

[161] Whether this assessment is correct or not depends very much on the quality of the English translation of the Draft Law.

[162] Although § 1 of Germany's Insolvenzordnung is worded very similar, the words "if there is no chance for rehabilitation" are missing. Consequently the two options are regarded in Germany as being of same importance, see for example *E. Braun*, Insolvenzordnung, 7th edition 2017, § 1 InsO, Note 3; *U. Foerste*, Insolvenzrecht, 7th edition 2018, p. 10, 11.

1. **Possible risks and measures of mitigation**[163]

Risk	Mitigation
Insufficient professional know-how of Insolvency Practitioners	Insolvency Practitioners play according to Art. 10 a very important role. Minimum professional standards for Insolvency Practitioners ought to be established. An obligation to regularly update/improve professional knowledge should be introduced.
Random selection of Insolvency Practitioners could lead to appointment of an Insolvency Practitioner who is not capable to manage the specific case	In particular for bigger insolvency cases the Insolvency Practitioner will need support staff to handle the case. Not all Insolvency Practitioners therefore will be able to manage the case. In principle an automatic selection is not bad, because it is an objective procedure which avoids non-objective influence. However one could consider giving the last word to the court, so that, if necessary, another Insolvency Practitioner can be chosen.
Unavailability of electronic selection system for Insolvency Practitioners	In principle the idea is good to base the decision on sequence order rule and alphabetical order. The underlying assumption is, however, that every Insolvency Practitioner is equally suited to handle the case. Here I have my doubts and recommend, again, that the court shall have the power to replace the Insolvency Practitioner by another one more capable to handle the case.
Grounds for Opening Insolvency Proceedings should be worded more precise	Art. 5 No. 1 defines two grounds for opening insolvency proceedings: Insolvency and expected insolvency. Art. 6 No. 3 offers "assumptions" for the debtor's insolvency, without further differentiation, which of the two grounds for insolvency is assumed to have materialized. This is a bit unclear and may lead to unnecessary discussions. In my view Art. 6 No. 3 b) is as relevant as the two grounds for insolvency defined in Art. 5 No. 1. Therefore "aggregate obligations exceeding the total value of assets" should be included in Art. 5 No. 1 as a third ground for opening insolvency proceedings. Art. 6 could then really serve as an Article clarifying which events justify the assumption that the debtor is insolvent.
Obligation to submit the Application for Opening the Insolvency Proceedings by the Debtor seems not to	Art. 14 No. 1 stipulates the obligation of the Debtor to file insolvency within 3 weeks. Art. 14 No. 2 refers to Art. 6 No. 1. Most likely this is a typing error and the correct reference is Art. **5 No. 1.** But even such a reference would not be

[163] All Articles referred to without mentioning the legal act, are those of the Draft Law on Rehabilitation and Collective Satisfaction of Creditors (the Draft Law).

cover all legal grounds for Insolvency	sufficiently correct. The reference must be made to all grounds for insolvency according to Art. 5 No. 1, i.e. "insolvency" and "expected insolvency" and, according to Art. 6 No. 3 b), "aggregate obligations exceeding the total value of assets".
Regulations on Criminal Law liability of Debtor not or too late filing for insolvency missing	Art 14 No. 1 stipulates the obligation of the Debtor to file insolvency within 3 weeks. The dimension of the Criminal Law liability is not mentioned in the Draft Law. This can be found, however, in Art. 207 of Georgia's Criminal Code. Neither Art. 14 No. 1, nor Art.207 Criminal Code are detailed and clear enough. For a criminal liability it must be made totally clear which form of misconduct will be punished how. Art. 14 No. 1 and Art. 207 Criminal Code should make clear whether only the omission of filing for insolvency leads to criminal liability or the belated filing or incorrect filing as well and whether the amount of punishment is different. A harmonization between the Draft Law and Criminal Code is necessary.
Term of five days for submittance of a private complaint is too short	A private complaint in accordance with Art. 8 is the only and thus extremely important legal remedy against a court order in the insolvency proceeding. Five days to submit a private complaint (Art. 8 No. 4 with no option for prolongation) or five days for the court to appeal the upper instance court (Art. 8 No. 7 – with or without option for prolongation?) is too short. In such a short term it will be impossible in quite a number of cases to deliver such a complaint with an properly worked out statement of grounds. The term should be extended to two weeks.
Voluntary Agreement, natural person: Release from debts lacks detailed regulations. This can lead to very different results of voluntary arrangement procedures, missing of any standardization or harmonized practice and it gives debtors and creditors no confidence what they may expect from a voluntary arrangement	Natural persons which honor their creditors' debts in a voluntary arrangement only partially, cannot be sure that individual creditors after the voluntary arrangement's completion request payment of the unpaid part of the original claim. The lifelong liability would be the consequence. Therefore the purpose of the voluntary arrangement is according to Art. 18 No. 3 the natural person's final discharge from debts. Any detailed regulations are missing however. The law must make clear under which conditions and through which procedure the debtor gains "the release from debts". Art. 33 No. 1 and No. 3 are in my view insufficient in relation to natural persons, because they do not define a responsibility of the debtor to continue to work and to cede his earnings from his business or his employment for a certain number of years to his creditors.

Voluntary Agreement, role of "nominee" lacks definition or clear role description	In Art. 3 there is no definition of the "Nominee". Art. 21 says the nominee is the Insolvency Practitioner. I assume the "nominee" is an Insolvency Practitioner mandated by the debtor as his legal advisor. To avoid such intransparency the the Draft Law needs to be amended.
Rules with respect to a Natural Person: Substance of this Article difficult to understand	The substance of Art. 25 is difficult to understand. That specific characteristics of natural persons as debtors in a voluntary arrangement need to be reflected and that conflicts with the Law must be avoided is self-evident. Is Art. 25 in this form necessary?
Insolvency Application: Role of creditor may risk a delayed opening of the procedure	According to Art. 44 the creditor who applied for insolvency is responsible to forward the respective documents already registered by the court to the debtor. If the debtor lacks experience or is hindered to doing so, the opening of the procedure can be significantly delayed and the legal position of other creditors can be damaged. It should be considered to make the courts responsible after registering the application to forward it to the debtor without delay. The term of 2 months foreseen in Art. 44 No. 2 for sending the court's notification by the applying debtor to the creditor seems to be much longer than necessary.
Role of LEPL National Enforcement Bureau as a supervisor before commencement of the Rehabilitation/Bankruptcy regime. Monopoly situation raises doubts and should be reconsidered.	In the phase between the court's order on accepting the admissibility on the opening of rehabilitation/bankruptcy proceedings and the commencement of these proceedings NBE is the sole Institution acting as supervisor. Such a monopoly position always needs an unchallenged justification. One of the great advantages of the Draft Law is the introduction of the profession of Insolvency Practitioners. These Insolvency Practitioners become responsible, however, only with the commencement of the Rehabilitation or Bankruptcy proceedings. Why can Insolvency Practitioners not act as "Preliminary Supervisors" like replacing NBE or at least as equally available option? In such a case even an exchange of supervisor can be avoided during the procedure.
LEPL National Enforcement Bureau is responsible for call and organizing creditors' meetings. The reasoning for not giving this authority to Insolvency Court and/or	NBE is responsible for calling and organizing creditors' meetings (Art. 52 No.1, 76 No. 3 a), 77 No. 5 z) bb), 102 No. 3 a)). This as well is a quasi-monopolistic situation (except the case of bankruptcy management, where also the bankruptcy manager is authorized to convene a creditors' meeting. In my view the calling for a creditors' meeting should be made by the

Insolvency Practitioners is unclear.	insolvency court, which also should preside over the meeting. More important is, who is entitled to request such a meeting. The Insolvency Practitioner serving as Rehabilitation Supervisor, Rehabilitation Manager or Bankruptcy Manager should be entitled to request a creditors' meeting. If the responsibility of a preliminary Insolvency Practitioner before the commencement of the procedure should be established, he could also request the (first) creditors' meeting (see Art. 52 No. 1).

2. Other Laws needing amendments or necessary to draft

There are at least two other Laws of Georgia which need to be amended if the Law on Insolvency Proceeding should be approved:

a) Criminal Code

The Criminal Code needs some amendments in the relevant Articles dealing with liability for misconduct in Insolvency cases, in particular in Art. 207 Criminal Code.

b) Law on Enforcement Proceedings

In Art. 3 No. 1 of the Law on Enforcement Proceedings the responsibilities of NBE in connection with Insolvency Proceedings are defined. This regulation does not fit to the Draft Law.

c) Law on Consumer Insolvencies

In the Draft Law there is only a regulation for natural persons executing commercial activities. Consumer Insolvencies are not regulated by this draft law. However such insolvencies are of growing importance in many countries. It is advisable for Georgia also to develop a legal frame for consumer insolvencies.

8. Conclusion

The recommendation to replace the Law on Insolvency Procedures by a complete new Law has been followed. The new Draft Law from 2018 is a modern, well structured, transparent and economically sound legislative act.

The greatest change and most important improvement is the complete change in philosophy of insolvency proceedings. Now the rehabilitation of the debtor's enterprise, wherever possible, is in the center of all insolvency measures.

The state administration's influence on Insolvency procedures is much reduced, notably by the much smaller role of NBE, and the role of courts is strengthened significantly.

The introduction of a new profession of Insolvency Practitioners and making their involvement in all types of insolvency procedures mandatory, cannot be valued high enough.

Creditors' role is strengthened by better rights to apply for debtor's insolvency and by more rights for the newly established Creditors' Committee.

There is a very good chance that corruption, asset-stripping and intransparent sales of assets and distribution of proceeds will be pushed back under the new Draft Law, if adopted.

The ranking of Georgia in the World Bank's Doing Business Reporting will, on the basis of this Draft Law, undoubtedly improve further.

APPENDIX III- Questionnaire for Stakeholders

General Questions:

1. What is the objective of the current law?
2. In general, what should be the objective of an insolvency law?
3. How likely is it to rescue a viable business through insolvency proceeding under the current law?
4. What are the basic principles of an insolvency law that incentivizes a business to file for insolvency while it is still possible to rescue the business?
5. How reasonable is the timeframe defined in the current insolvency law?
6. Are the deadlines usually met? What are the main factors that cause violation of the deadlines?
7. What is the key problems with the current law? In the implementation? In the enforcement?
8. How can a debtor abuse provisions defined in the insolvency process? What are the levers he has, does not have or should have?
9. How effective / efficient is the existence of the mechanism of the Conciliation Council and / or the council's decision on regime of insolvency? Is there a need for a Conciliation Council envisaged by law?
10. How effective are the appeal mechanisms defined in the law?
11. To what extent are the interests of creditors considered in the current law? Including of unsecured creditors? Late claims
12. How legitimate is the ordering of creditors defined by law? Also, from the perspective of economic efficiency, what is the justification of creditor ordering set by the law?
13. How high up claims of secured creditors should be placed?
14. How high up claims of the revenue service should be placed?
15. Is it possible to carry out respective action within the timeframes defined by the law? Should there be such deadlines specified within the law?
16. In the insolvency proceedings, what should be the role of courts? Secured creditors? Other creditors? Trustee? Debtor? Lawyer?
17. How effective is the National Bureau of Enforcement as a trustee?
18. Who should be a trustee?

19. How effective is the creditors' meeting defined by the law? Decision making mechanisms at the creditors' meetings.
20. What leverage / powers should the creditors meeting have in the process of rehabilitation and bankruptcy?
21. How efficient is the existing practice of selling property through auction?

Commencement of Insolvency Case:

1. When should the case be opened? Should it be harder? Easier?
2. Who should have the right to submit an application?
3. How sufficient / exhaustive are the terms for filing insolvency defined in the law?
4. How effective is the mechanism of notification of the insolvency process commencement?
5. What measures should follow commencement of a bankruptcy case?
6. How moratorium can be misused by a debtor?
7. Who should make a decision on a regime of insolvency?
8. How could we "force" a debtor / creditor to have a well prepared/justified application when filing insolvency?
9. When should creditors' claims be verified?
10. Who should check creditors' claims?

Rehabilitation:

1. Should an objective of the legislative act regulating insolvency proceedings be rehabilitation?
2. What is a minimum requirement a rehabilitation plan should satisfy?
3. How long preparation of the rehabilitation plan should take? Who should participate? Who should be allowed to approve?
4. Who should lead the rehabilitation process? How independently should decisions be taken?
5. What role should the court have in the process of rehabilitation?

Bankruptcy:

1. When should bankruptcy regime commence?
2. Who should take the decision on bankruptcy of the debtor?
3. Who should be a bankruptcy manager? Who appoints? Should he be appointed from a specific list?

4. In your opinion, what is the objective of a creditor today (realization of the property of the company or the rehabilitation of the company)?
5. What is an efficient period of time for bankruptcy to be completed?
6. How efficient is the bankruptcy process today?
7. In what form should the property in the bankruptcy mass be realized?

Individuals

1. Should the Law on Insolvency Proceedings apply to bankruptcy of natural persons? What is the need for additional laws and instruments to regulate the bankruptcy of individuals?
2. How adequate is 10-year "discharge period" of individuals in today's reality?

APPENDIX IV - List of stakeholders

Stakeholder Group	Confirmed Attendees	Meeting Organized by:	Comments[164]	Goal	Meeting date
Members of Association of Banks of Georgia	TBC Bank	Ministry of Justice	**Yes**	**Discuss the Draft**	**22/06/2018, MoJ**
	Bank of Georgia	Ministry of Justice	**Yes**	**Discuss the Draft**	**22/06/2018, MoJ**
	Liberty Bank	Ministry of Justice	**No**	**Discuss the Draft**	**22/06/2018, MoJ**
	Cartu Bank	Ministry of Justice	**No**	**Discuss the Draft**	**22/06/2018, MoJ**
	Silk Road Bank	Ministry of Justice	**No**	**Discuss the Draft**	**22/06/2018, MoJ**
	Zurab Gvasalia, President, Association of Banks of Georgia	Ministry of Justice	**No**	**Discuss the Draft**	**22/06/2018, MoJ**
Judges	Levan Mikaberidze	Ministry of Justice	**No**	**Present the Draft**	**28/06/2018, MoJ**
	Mzia Todua	Ministry of Justice	**No**	**Present the Draft**	**28/06/2018, MoJ**
	Lasha Kochiashvili	Ministry of Justice	**No**	**Present the Draft**	**28/06/2018, MoJ**
	Tamar Chuniashvili	Ministry of Justice	**Yes**		
	Tamar Burjanadze	Ministry of Justice	**No**	**Present the Draft**	**28/06/2018, MoJ**

[164] Submitted written comments

Academia	Irakli Burduli, TSU	Ministry of Justice	**No**	**Present the Draft**	**01/08/2018, MoJ**
	Natia Chitashvili, TSU	Ministry of Justice	**No**	**Present the Draft**	**01/08/2018, MoJ**
	Davit Gugava, DAUG	Ministry of Justice	**No**	**Present the Draft**	**01/08/2018, MoJ**
	Marine Kordzadze, Grigol Robakidze University	Ministry of Justice	**No**	**Present the Draft**	**01/08/2018, MoJ**
Georgian Bar Association/Legal Experts	Davit Asatiani	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Giorgi Chekhani	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Tea Khamkhadze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Koba Memanishvili	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Levan Sanikidze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Nodar Zarqua	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Vazha Jaoshvili	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Zurab Mukhuradze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Irakli Mikhelidze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Giorgi Chitadze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Tamar Khokhobashvili	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**

	Aleksandre Amashukeli	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Marine Niqabadze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Aleksandre Tsuladze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Lasha Kharshiladze	Ministry of Justice	**No**	**Present the Draft**	**01/07/2018, MoJ**
	Tamta Ivanishvili	ISET RIA Team	**No**	**Discuss current challenges**	**01/12/2017, BLC**
	Tornike Artkmelidze/ Independent lawyer, member of Conciliation Council	ISET RIA Team	**No**	**Discuss current challenges**	**01/12/2017, ISET**
	Oberon Kwok, Lawyer, St. Philip Barristers	ISET RIA Team	**No**	**Discuss needed reforms**	**29/11/2017, ISET**
	Irakli Gaprindashvili, Managing Partner, GLCC	ISET RIA Team	**No**	**Discuss current challenges**	**01/12/2017, ISET**
Parliamentary Committees	Legal Issues Committee	Ministry of Justice	**No**	**Present the Draft**	**31/08/2018, Parliament**
	Budget Office	Ministry of Justice	**No**	**Present the Draft**	**31/08/2018, Parliament**
	Sector Economy and Economic Policy Committee	Ministry of Justice	**No**	**Present the Draft**	**31/08/2018, Parliament**
Business Associations	Iva Chkonia, Head, Georgian Distributors Business Association	ISET RIA Team	**No**	**To discuss current challenges**	**29/11/2018, ISET**
	Lasha Rizhmadze, Georgian Distributors Business Association	ISET RIA Team	**No**	**To discuss current challenges**	**29/11/2018, ISET**