

Sopiko Bakhbakhshvili*

Historical Evolution of Secured Creditors' Satisfaction in Georgian Insolvency Law: A Comparative Analysis with International Standards

Secured creditors hold a pivotal position in shaping the business sector, given their substantial market influence. To ensure their protection, it is essential that the regulatory norms governing insolvency in the country adhere to internationally recognized standards. In pursuit of this goal, the Law of Georgia “On Rehabilitation and The Collective Satisfaction of Creditors' Claims,” enacted on April 1, 2021, is noteworthy. This legislation, diverging significantly from its predecessor, meticulously addresses the role of secured creditors and delineates the criteria for their satisfaction within the framework of Georgian insolvency law.

The objective of this paper is to conduct a systematic analysis of the role played by secured creditors and the historical evolution of satisfying their requirements within the framework of Georgian insolvency law. Simultaneously, the study aims to assess how the enacted Georgian insolvency law aligns with the recommendations, principles, and directives of international organizations.

Keywords: *Fulfilling secured creditors' requirements, historical overview, international standards, comparative analysis, prioritization of secured rights.*

1. Introduction

Insolvency law is vital for business relationships. To ensure effective functioning and competitiveness, simplifying the closure processes is just as important as facilitating the ease of starting a business.¹ The key to a sustainable and developed economy lies in a thriving business sector. In the absence of efficient and effective insolvency procedures, a society may face economic and financial crises.² Hence, for the economy of a developing country like Georgia, it is crucial to establish well-organized legal regulations in line with international standards to ensure stability and growth.

Georgian law faced a serious challenge in this aspect. In the 2014 Doing Business report by the World Bank, Georgia was ranked 88th concerning insolvency and creditor satisfaction.³ The data for 2019 and 2020 showed only slight improvements and still presented unfavorable results.⁴ Furthermore, an evaluation report from the USAID project G4G explicitly stated that Georgian insolvency law

* Master of Laws, legal adviser to the Ministry of Justice of Georgia. <https://orcid.org/0009-0005-7857-5562>.

¹ The Government of Georgia, Strategy for the Socio-Economic Development of Georgia, Georgia 2020, 28-30 (in Georgian).

² International Monetary Fund, Ordinary and Effective Insolvency Procedures, Legal Department, 1999, 1

³ The Government of Georgia, Strategy for the Socio-Economic Development of Georgia, Georgia 2020, 30 (in Georgian).

⁴ <<https://subnational.doingbusiness.org/en/data/exploretopics/resolving-insolvency/score>> [20/06/2023].

negatively impacted the rights of secured creditors.⁵ Hence, there was a need for the country to take decisive measures in the realm of insolvency law, leading to the enactment of a new insolvency law in 2020. The law, in stark contrast to the preceding legal regulations, comprehensively addressed the roles of secured creditors, expanded the scope of their authority, and bolstered guarantees of protection. These amendments have made these issues highly relevant in both legal and business contexts.

The paper aims to provide a comprehensive examination of Georgian insolvency laws, with a particular focus on the role and significance of secured creditors, as well as the regulations governing the satisfaction of their demands. Through a historical review, the study aims to evaluate the changing legal status of secured creditors, determining whether there is a progressive or regressive trend over time.

The paper incorporates perspectives and viewpoints from international organizations such as the EU, the UN, and the World Bank regarding the satisfaction of secured creditors and their alignment with the current legal regulations in force in Georgia.

2. The Significance and Role of Secured Creditors in the Law of Georgia on Bankruptcy Proceedings

The Law of Georgia on Bankruptcy Proceedings⁶ was a groundbreaking legislative act in the history of independent Georgia. It distinctly aimed to underscore the significance of preserving enterprises through rehabilitation,⁷ thereby addressing the demands of creditors.

The Law of Georgia on Bankruptcy Proceedings categorized creditors into two main groups: bankruptcy creditors, as defined by the law, and creditors without the status of bankruptcy creditors, even though they had some connection to the insolvent debtor.

According to the law, for someone to be recognized as a bankruptcy creditor, two prerequisites must be met. Specifically, individuals qualified as bankruptcy creditors were those holding a valid property claim against the debtor at the commencement of bankruptcy proceedings,⁸ and this claim must have originated prior to the initiation of the bankruptcy proceedings. In essence, the obligation to fulfill this claim in its entirety should have been established before the commencement of the proceedings.⁹

The 1996 bankruptcy law recognized additional categories of creditors beyond those previously mentioned. Distinctions in their treatment were delineated based on the preferential and specific nature of their claims, with secured creditors benefiting from this particular legal status. The legislation

⁵ ISET, Regulatory Impact Assessment (RIA) of the selected topics under the Draft Law on Rehabilitation and Collective Satisfaction of Creditors, Final Report, 2019, 6 (in Georgian).

⁶ See Law of Georgia “on Bankruptcy Proceedings”, the Gazette of the Parliament of Georgia, 30.07.1996.

⁷ *Kadaria S.*, Historical Development of the Rehabilitation Process, *Journal of Law*, №1, 2022, 197 (in Georgian).

⁸ See Law of Georgia “on Bankruptcy Proceedings”, first paragraph of Article 6, the Gazette of the Parliament of Georgia, 30.07.1996.

⁹ *Migriauli R.*, Introduction to Bankruptcy Law, 2nd Revised Edition, Tbilisi, 2006, 70-72 (in Georgian).

specified additional creditor categories, namely insolvency estate creditors, property creditors, and secured creditors. Distinctions among these groups were predicated on the varied legal foundations substantiating their respective claims.¹⁰

a) Insolvency estate creditors

The concept of an insolvency estate creditor was foreign to Georgian insolvency law. The law provided for insolvency estate claims, i.e., claims arising from the bankruptcy estate. Consequently, individuals with the right to such claims were referred to as insolvency estate creditors in the literature. The insolvency estate creditor differed from all other types of creditors, as only their claim was directly addressed to the estate of bankruptcy.¹¹

While a prerequisite for an individual to qualify as a bankruptcy creditor was the existence of a claim before the commencement of proceedings, the insolvency estate creditor's claim emerged after the initiation of proceedings. Consequently, the claim of the bankruptcy creditor was directed toward the debtor, whereas that of the estate creditor was directed to the bankruptcy estate, given that such a claim materialized after the establishment of the estate itself.¹²

The insolvency estate creditors had the highest privileges due to their secure status. This security, not in the traditional proprietary security, stemmed from insolvency law, which granted them this distinct privilege.¹³ The creditors of the insolvency estate were defined as individuals financially dependent on the insolvent debtor, within the scope of the subsistence minimum, the court, the bankruptcy administrator, and others.¹⁴

b) Property creditors

The Law of Georgia on Bankruptcy Proceedings did not provide a specific definition for a property creditor, making their identification dependent on the nature of the claim. Specifically, if the debtor held an asset to which a third party had ownership rights, the bankruptcy administrator was required to return the said asset to the rightful owner and exclude it from the bankruptcy estate.¹⁵

A property creditor was an individual whose assets were mistakenly included in the bankruptcy estate. In such instances, the bankruptcy administrator was obligated to promptly return these assets to the stakeholder. Alternatively, the law allowed the creditor to seek satisfaction of their claim through legal proceedings in court.¹⁶

¹⁰ Ibid, 84-85.

¹¹ *Schnitger H., Migriauli R.*, the Law of Georgia on Insolvency, Characterization and Comparison with the Law of Georgia on Bankruptcy Proceedings and International Standards, Tbilisi, 2011, 83 (in Georgian).

¹² *Migriauli R.*, Introduction to Bankruptcy Law, 2nd Revised Edition, Tbilisi, 2006, 96-99 (in Georgian).

¹³ Ibid, 100-101.

¹⁴ See Law of Georgia “on Bankruptcy Proceedings”, Article 19, the Gazette of the Parliament of Georgia, 30.07.1996.

¹⁵ See Law of Georgia “on Bankruptcy Proceedings”, first paragraph of Article 20, the Gazette of the Parliament of Georgia, 30.07.1996.

¹⁶ *Migriauli R.*, Introduction to Bankruptcy Law, 2nd Revised Edition, Tbilisi, 2006, 90 (in Georgian).

c) Secured creditors

Unlike regular property creditors, secured creditors agreed to include the secured asset in the insolvency estate. However, depending on the nature of the proprietary security (such as a mortgage or a pledge), the secured creditor sought preferential satisfaction of their claim. Much like the property creditor, the secured creditor's claim was founded on proprietary security, originating prior to the initiation of insolvency proceedings. The secured creditor did not participate in the proceedings, as the bankruptcy administrator was obliged to promptly sell the secured asset and fulfill such a claim immediately after the commencement of the proceedings.¹⁷

It is noteworthy that the law specifically emphasized only one form of security for a claim – namely, the pledge. However, a systematic analysis of the law and a review of the practice reveal that the legislator, in essence, treated mortgages similarly to pledges.¹⁸

3. The Role and Significance of Secured Creditors in Accordance with the Law of Georgia on Insolvency Proceedings

When examining the historical evolution of Georgian insolvency law, it's evident that the Law of Georgia On Insolvency Proceedings introduced less favorable provisions, considerably impacting the circumstances for creditors. This was mainly because the law aimed for a quick resolution of the debtor's bankruptcy. However, many rules were unclear, and important issues were often not addressed,¹⁹ negatively impacting the legal standing of secured creditors.

The Law of Georgia on Insolvency Proceedings introduced the concepts of insolvency creditors, new creditors, and secured creditors.²⁰

Under the 2007 Act, an insolvency creditor²¹ was essentially synonymous with the previously discussed bankruptcy creditor.²² Regarding insolvency estates and property creditors, the 2007 law, unlike the 1996 law, did not explicitly define them. However, a careful analysis allows easy identification of these creditors. In terms of both rights and consequences, they were quite similar to their counterparts in the previous legislation.

The Law of Georgia on Insolvency Proceedings defined a secured creditor as either an existing creditor or a new creditor “whose claim is secured by a mortgage, lien, or other means of securing liabilities under the Tax Code of Georgia.”²³

¹⁷ *Ibid.*

¹⁸ See Law of Georgia “on Bankruptcy Proceedings”, 2nd paragraph of Article 20, the Gazette of the Parliament of Georgia, 30.07.1996.

¹⁹ Ministry of Justice of Georgia, Explanatory Note on the Draft Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, 2 (in Georgian).

²⁰ *Migriauli R.*, Key Features of the New Insolvency Law, Journal “Business and legislation”, 2009 (in Georgian).

²¹ See Law of Georgia “on Insolvency Proceedings”, sub-paragraph “I” of Article 3, Legislative Herald of Georgia, 31/03/2007.

²² *Migriauli R.*, Key Features of the New Insolvency Law, Journal “Business and legislation”, 2009 (in Georgian).

²³ See Law of Georgia “on Insolvency Proceedings”, sub-paragraph “L” of Article 3, Legislative Herald of Georgia, 31/03/2007.

According to the law, even a new creditor is considered a secured creditor, but in practice, this does not make much of a difference.²⁴ Hence, the distinction between the definitions of secured creditors in the 1996 and 2007 laws in this section seems more like a formality.

Furthermore, the 2007 law included the tax authority among secured creditors. This addition allowed the tax authority to use collateral on the debtor's property for securing debt payments, thereby broadening the scope of secured creditors.²⁵

Finally, it is noteworthy that while the 2007 law introduced the concept of a secured creditor, it lacked a clear regulation comparable to the 1996 law.²⁶ The 1996 law more precisely defined both the scope of the secured creditor's actions in satisfying the demand and the amount of satisfaction.²⁷

4. The Legal Nature and Significance of Secured Creditors in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims.

Under the new legal framework, the role, protection guarantees, authority scope, and methods of meeting requirements for secured creditors have been revised and aligned with leading international practices.

Unlike its predecessors, the 2020 Law on Rehabilitation and the Collective Satisfaction of Creditors' Claims does not explicitly address the concept of a creditor. In contrast to Georgian law, the German Insolvency Code explicitly defines a creditor. It states, 'the assets involved in the insolvency proceedings shall serve to satisfy the liquidated claims held by the personal creditors against the debtor on the date when the insolvency proceedings were opened (creditors of the insolvency proceedings).'²⁸

The mentioned definition aligns with Georgian reality to a certain extent, although it does not encompass all individuals who can be identified as creditors in cases of insolvency.²⁹ The same observation applies to the definitions of creditors found in previous Georgian legislative acts. Hence, the current approach of Georgian law appears more reasonable and precise. A creditor's status is based on the content of their claim, so the nature of the claim determines the creditor's status in insolvency, allowing for a more detailed classification within the legal system.³⁰

²⁴ *Schnitger H., Migriauli R., the Law of Georgia on Insolvency, Characterization and Comparison with the Law of Georgia on Bankruptcy Proceedings and International Standards, Tbilisi, 2011, 83, 51 (in Georgian).*

²⁵ See Law of Georgia "on Insolvency Proceedings", sub-paragraph "L" of Article 3, Legislative Herald of Georgia, 31/03/2007.

²⁶ See Law of Georgia "on Bankruptcy Proceedings", 2nd paragraph of Article 20, Legislative Herald of Georgia, 30.07.1996.

²⁷ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S., Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi 2021, 50 (in Georgian).*

²⁸ German Insolvency Code, Section 38.

²⁹ F.e.: unliquidated claim.

³⁰ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S., Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi 2021, 50 (in Georgian).*

Regardless of the variety of claims a creditor may have, we should categorize them in various directions. Before classifying creditors into specific categories, a thorough analysis of the nature of their demands is essential. These demands could include liquid or unliquidated claims, matured or unmatured (future) claims, contingent claims, and others.³¹ The 2020 law introduces a precise categorization of creditors' claims, playing a crucial role in ensuring fair and equitable satisfaction of creditors.

a) Secured creditors

Secured creditors play a particularly crucial role in insolvency law, whose significance is derived from the nature of proprietary security.

Generally, employing methods to secure a claim acts as a form of assurance for the creditor, ensuring that the demand will be satisfied even if the debtor fails to fulfill their obligation. This serves as a safeguard for the legal interests of the creditor.³² “It allows debtors to use the full value of their assets to obtain credit and develop their enterprises. In the case of default by a debtor, a secured transactions law seeks to ensure that the value of the encumbered assets protects the secured creditor.”³³ Thus, these relationships are widely recognized in civil law.

“The basic function of a security right is to minimize the risk of non-performance of the loan. This risk is eminent when the debtor becomes insolvent. In this sense, the value of a security right depends on its treatment during insolvency. Hence, “an efficient system of secured credit requires an effective and flexible enforcement of security rights”, particularly in insolvency proceedings.”³⁴

As emphasized by the United Nations, the clarity of rules in insolvency laws is paramount for the accessibility of secured credit. Clear rules enable secured creditors to define the risks associated with credit more effectively.³⁵

Reflecting the legal status of secured creditors is challenging in legislation, hence, this matter has been a recurring subject of discussion.³⁶ For instance, the Insolvency Act of 1986 in Great Britain, one of the pioneering legislations to introduce the mentioned concept with precision, defines a secured creditor, in relation to a company, [as] a creditor of the company who holds in respect of his debt a security over property of the company.³⁷

The Georgian insolvency legal framework presents a restricted definition of secured creditors.³⁸ A secured creditor is specifically one whose claim is secured solely by a mortgage or a pledge,

³¹ UNCITRAL, Legislative Guide on Insolvency Law, United Nation, New York 2005, 249.

³² *Zarandia T., Jugheli T.*, Securing Claims with Movable Property in Georgian Law, Legal Journal of Judges Association of Georgia “Justice and Law”, N2, 2009, 27 (in Georgian).

³³ UNCITRAL, Legislative Guide on Secured Transactions, United Nation, New York 2010, 423 (II).

³⁴ *Brinkmann M.*, The Position of Secured Creditors in Insolvency, European Company and Financial Law Review, 2008, 249.

³⁵ UNCITRAL, Legislative Guide on Secured Transactions, United Nation, New York 2010, 425.

³⁶ *Schnitger H., Migriauli R.*, the Law of Georgia on Insolvency, Characterization and Comparison with the Law of Georgia on Bankruptcy Proceedings and International Standards, Tbilisi, 2011, 90 (in Georgian).

³⁷ Insolvency Act 1986, UK, 182.

³⁸ ISET, Regulatory Impact Assessment (RIA) of the selected topics under the Draft Law on Rehabilitation and Collective Satisfaction of Creditors, Final Report, 2019, 22 (in Georgian).

following the procedures outlined in the Civil Code of Georgia.³⁹ The legislator reasonably delineates pledge and mortgage, given their direct connection to the debtor's property (both immovable and movable). Their accessory nature ensures the satisfaction of creditors' claims when necessary.

It's worth noting that unlike the 2007 law, the current regulation no longer designates the tax authority as a secured creditor. Although the Revenue Service can use a tax lien-mortgage on a debtor's property based on the Tax Code,⁴⁰ it's important to highlight that this measure is specifically for settling tax debt. It's not a contractual security, but a legal requirement.⁴¹

b) Unsecured creditors

The category of unsecured creditors may consist of individuals holding claims of both insolvent and new creditors, as well as those with contingent, unliquidated, indefinite, preferential claims, and others. All these types of creditors share a common characteristic: unlike secured creditors, they lack the privilege of satisfying their claims through security. Consequently, they form a relatively vulnerable category during insolvency proceedings.

Creditors play a crucial role in the debtor's business, particularly following the commencement of insolvency proceedings.⁴² Recognizing their pivotal role, many insolvency laws aim to maximize creditor involvement in proceedings⁴³ without upsetting the balance or granting them excessive powers in matters unrelated to their legal status.

Moreover, these laws strive to consider the unique characteristics of creditors, based on the nature of their claims, determining the most suitable time and extent for their satisfaction within insolvency proceedings.⁴⁴

5. Fundamental Principles for Satisfying Secured Creditors Following International Organizations' Recommendations

International organizations consistently underscore in their recommendations that the presence of a robust legal system is crucial, particularly in developing countries, for the protection and effective realization of secured rights. Despite the attractiveness of the business market in these countries due to low taxes and inexpensive labor, the presence of flawed legislative and executive systems undermines the ability of business entities to seek substantial collateral to safeguard their claims. This, in turn,

³⁹ See the Law of Georgia “on Rehabilitation and the Collective Satisfaction of Creditors' Claims”, subparagraph “T” of Article 3, Legislative Herald of Georgia, 25/09/2020.

⁴⁰ See the Law of Georgia “Tax Code of Georgia”, Article 239, Legislative Herald of Georgia, LHG, 54, 12.10.2010.

⁴¹ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi 2021, 78 (in Georgian).

⁴² UNCITRAL, Legislative Guide on Insolvency Law, United Nation, New York 2005, 190.

⁴³ *Kasak A.*, Is Full Preference for a Secured Claim in Insolvency Proceedings Justified?, *Juridica International*, 2019, 113.

⁴⁴ UNCITRAL, Legislative Guide on Insolvency Law, United Nation, New York 2005, 190-191.

hinders the stable development of business within the country.⁴⁵ Hence, international organizations urge developing countries to align their legislation as closely as possible with the best international practices.

Given the obligations outlined in the association agreement, special importance is placed on Directive (EU) 2019/1023 of the European Parliament and of the Council dated June 20, 2019. This directive addresses preventive restructuring frameworks, discharge of debt, disqualifications, and measures to enhance the efficiency of procedures related to restructuring, insolvency, and debt discharge. It also amends Directive (EU) 2017/1132 (Directive on restructuring and insolvency).⁴⁶ The Directive underscores once again the pivotal role of secured creditors in insolvency law.

The directive highlights the importance of sorting creditors of the insolvent debtor into different classes for fair treatment of similar rights. These classes should be established at the national level, grouping creditors based on shared interests, rights, and claims. Classes can be established on various grounds according to national needs, although the directive mandates the separate consideration of secured and unsecured creditors in all cases, “As a minimum, secured and unsecured creditors should always be treated in separate classes.”⁴⁷

The United Nations, in its guidelines, adopts a similar approach, emphasizing that clear rules within insolvency laws are crucial for the availability of secured credit. These rules should cover the rights of secured creditors, the guarantees ensuring their protection, and the scope of satisfaction. Such clarity is essential to accurately defining the risks associated with credit.⁴⁸ According to the UN guide, states should recognize and emphasize the distinctive role of secured creditors in insolvency law.⁴⁹ Legislative priorities should be assigned to determining the costs of insolvency proceedings and ensuring the satisfaction of secured creditors.⁵⁰

Following the World Bank's principles, it is recommended to promptly address secured creditors' claims during insolvency proceedings by utilizing funds obtained from the sale of secured assets. The organization emphasizes that such property cannot be utilized to satisfy other creditors' claims until the secured creditors' claims are fully addressed or until they provide their consent to such utilization,⁵¹ “The priority of secured creditors in their collateral should be upheld and, absent the secured creditor’s consent, its interest in the collateral should not be subordinated to other priorities granted in the course of the insolvency proceeding. Distributions to secured creditors should be made as promptly as possible.”⁵²

⁴⁵ The World Bank Group, Principles for Effective Insolvency and Creditor/Debtor Regimes, Washington DC 2021, 5.

⁴⁶ < <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1023> > [01.09.2023].

⁴⁷ Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019, 9. (44).

⁴⁸ UNCITRAL, Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, United Nation, New York 2014, 63

⁴⁹ UNCITRAL, Legislative Guide on Secured Transactions, United Nation, New York 2010, 425 and 25.

⁵⁰ UNCITRAL, Legislative Guide on Insolvency Law, United Nation, New York 2005.

⁵¹ The World Bank Group, Principles for Effective Insolvency and Creditor/Debtor Regimes, Washington DC 2021, 26.

⁵² Ibid (C12).

In general, the overarching goal of insolvency law is to apply an equitable approach to all creditors. Nevertheless, due to various distinguishing factors, this often results in the creation of a priority-based hierarchy, a structure that tends to be unique to each country. The principles of international organizations provide nations with general frameworks and alternative approaches. States are granted the flexibility to determine the sequence of creditor satisfaction in both rehabilitation and bankruptcy systems based on their specific national requirements.

6. Examining the Historical Evolution of Secured Creditor Satisfaction and Assessing the Alignment of Current Legislation with International Standards

Satisfying secured creditors in insolvency proceedings is one of the most pivotal challenges for the legislator.⁵³ According to Brinkmann⁵⁴ “it may be regarded as a waste of time to ask whether the priority of the secured creditor is justified; after all, the priority of the secured creditor was and is accepted in one form or another in all jurisdictions.”⁵⁵ Priority for secured creditors is a defensible policy choice on efficiency grounds.⁵⁶

The 2020 law has undergone significant amendments departing from the previous approach to the satisfaction of secured creditors, aligning it with the best international practices.

6.1. The Satisfaction of Secured Creditors in Accordance with the Law of Georgia on Bankruptcy Proceedings

Under the 1996 law, secured creditors did not have the right to segregate the asset from the insolvency estate and request its transfer to themselves. Instead, these secured assets were deemed integral to the insolvency estate. Nonetheless, they were authorized to request the sale of the secured items and the priority satisfaction of their claims with the proceeds.⁵⁷

Consequently, the secured creditor was distinguished from a bankruptcy creditor and received separate satisfaction outside the scope of bankruptcy proceedings. The bankruptcy administrator initially prioritized satisfying secured creditors before directly addressing the claims of bankruptcy creditors.⁵⁸

It is worth noting that, unlike the 2007 Act, the 1996 Act did not impose any restrictions on the sale of the insolvency estate.⁵⁹ Consequently, secured creditors were not required to wait for an auction to satisfy their claims.

⁵³ *Keay A.*, *Insolvency Law: A Matter of Public Interest?*, Northern Ireland Legal Quarterly, 2000, 1.

⁵⁴ Dr. Moritz Brinkmann M., professor for insolvency law at the University of Bonn, Germany.

⁵⁵ *Brinkmann M.*, *The Position of Secured Creditors in Insolvency*, European Company and Financial Law Review, 2008, 251.

⁵⁶ *Eidenmuller H.*, *Secured Creditors in Insolvency Proceedings*, European Company and Financial Law Review, 2008, 274.

⁵⁷ *Migriauli R.*, *Introduction to Bankruptcy Law*, 2nd Revised Edition, Tbilisi 2006, 90-91 (in Georgian).

⁵⁸ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, *Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims*, Tbilisi 2021, 78-79 (in Georgian).

⁵⁹ See Law of Georgia “on Bankruptcy Proceedings”, First paragraph of Article 26, the Gazette of the Parliament of Georgia, 30.07.1996.

Nevertheless, it is essential to highlight that the 1996 law introduced a fundamentally different approach to meeting the demands of secured creditors, particularly in terms of the amount of satisfaction for their claims. Specifically, the law deviated from the general rule set by the Civil Code of Georgia, which stipulates that the creditor's claim must be entirely satisfied from the proceeds of the item's sale.⁶⁰ It stipulated that the secured creditor could only satisfy $\frac{3}{4}$ of the claim from the proceeds of the realization of the secured object, while the remaining amount was allocated for the liquidation of assets and the administration of bankruptcy proceedings.⁶¹

6.2. Satisfying Secured Creditors in Accordance with the Law of Georgia on Insolvency Proceedings

The Insolvency Act of 2007 introduced significant changes, replacing many aspects of the 1996 Act, particularly in addressing the satisfaction of secured creditors.

The major change was in neglecting a crucial aspect of satisfying secured claims, a feature inherent in commercial law. The 2007 law effectively relinquished the secured creditors' right to pursue claims directly from the secured subject in full and with preferential treatment, separately from other creditors.⁶²

In return, the law granted secured creditors a more robust entitlement to fulfill their claims compared to unsecured creditors. In particular, they were positioned in the 4th priority, indicating that all secured claims, including those secured under the Tax Code of Georgia, would be satisfied after covering procedural expenses and the debts incurred by the debtor from the date of the court ruling on the admission of the insolvency petition.⁶³ In reality, secured claims were no longer linked to specific assets but were fulfilled using funds from the sale of the overall insolvency estate, which was an unusual rule.

The 2007 law presented an issue as it failed to account for the established order of security claims outlined in the Civil Code. For example, if multiple mortgages were registered on a property, each had an equal opportunity for satisfaction in insolvency proceedings, proportionate to their respective demands.⁶⁴

⁶⁰ See the Law of Georgia “Civil Code of Georgia”, Article 308, the Gazette of the Parliament of Georgia, 31, 24.07.1997.

⁶¹ See Law of Georgia “on Bankruptcy Proceedings”, Paragraph 2 of Article 20, the Gazette of the Parliament of Georgia, 30.07.1996.

⁶² *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors’ Claims, Tbilisi 2021, 79 (in Georgian).

⁶³ See Law of Georgia “on Insolvency Proceedings”, First paragraph of Article 40, Legislative Herald of Georgia, 31/03/2007

⁶⁴ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors’ Claims, Tbilisi 2021, 80 (in Georgian).

6.3. Satisfaction of Secured Creditors under the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims"

Special treatment and respect for secured creditors is a common feature in all European insolvency regimes,⁶⁵ and Georgia embraced this principle in the enactment of the 2020 law. In particular, the 2020 law reinstated the connection between secured creditors and the encumbered objects, and it considered the hierarchy of collateral security.⁶⁶

The law restricts the preferential claim of secured creditors to the debtor's other unencumbered assets. The remaining assets of the debtor can only be utilized to settle the debts of secured creditors if they are not completely satisfied with the secured property and the creditor seeks to recover the outstanding portion from other assets.⁶⁷ However, in this situation, the creditor loses the secured status and advantages, transitioning into the category of unsecured creditors.⁶⁸

6.3.1. Throughout the Rehabilitation Process

Throughout the rehabilitation of the enterprise, the fundamental principle for satisfying secured creditors is that they should not receive a reduced amount than what they would have obtained through the realization of the secured subject.⁶⁹ A court shall not approve a rehabilitation plan with altered content.⁷⁰

In the 2020 law, the legislator incorporated mandatory provisions regarding the satisfaction of secured creditors. Throughout the rehabilitation processes, rehabilitation costs shall be satisfied preferentially,⁷¹ followed by priority given to the satisfaction of claims arising after the delivery of a ruling declaring an application for insolvency admissible and opening a rehabilitation regime.⁷² This should occur without prejudice to the rights of secured creditors.⁷³

Therefore, the drafting of a rehabilitation plan must be designed to ensure the swift, efficient, and complete satisfaction of the secured creditors' demands.⁷⁴

⁶⁵ The European Law Institute (ELI), Instrument of the European Law Institute, Rescue of Business in Insolvency Law, 2017, 243

⁶⁶ Ministry of Justice of Georgia, Explanatory Note on the Draft Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, 16 (in Georgian).

⁶⁷ See the Law of Georgia "on Rehabilitation and the Collective Satisfaction of Creditors' Claims", Paragraph 4 of Article 105, Legislative Herald of Georgia, 25/09/2020.

⁶⁸ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi 2021, 79 (in Georgian).

⁶⁹ Unless there is consent from the said creditors.

⁷⁰ See the Law of Georgia "on Rehabilitation and the Collective Satisfaction of Creditors' Claims", Article 83, paragraph 2, sub-paragraph "D", Legislative Herald of Georgia, 25/09/2020.

⁷¹ *Ibid*, First paragraph of article 79.

⁷² See the Law of Georgia "on Rehabilitation and the Collective Satisfaction of Creditors' Claims", First paragraph of article 80, Legislative Herald of Georgia, 25/09/2020.

⁷³ *Ibid*, First paragraphs of articles 79 and 80.

⁷⁴ The World Bank Group, Principles for Effective Insolvency and Creditor/Debtor Regimes, Washington DC, 2016, 25.

As secured creditors reestablished their legal ties with the encumbered assets, the legislator introduced the option to remove moratorium measures on specific items,⁷⁵ enabling their sale during rehabilitation processes.

A court may make a decision on cancelling certain moratorium measures on the basis of a well-founded application of a creditor, a debtor, a manager, or other stakeholders.⁷⁶ If a rehabilitation manager fails to apply to the court for the release from a moratorium and the sale of property used as collateral, they must prove that the property, for which the creditor seeks the removal of specific moratorium measures and sale, is necessary for achieving the purposes of rehabilitation.⁷⁷ The court should issue the final decision.⁷⁸

Hence, even under the rehabilitation regime, secured creditors retain the option to directly satisfy their claims by liquidating the secured asset, if this does not prevent the full implementation of the rehabilitation plan.

In addition, where a debtor has a secured contractual obligation relationship with a creditor, the duration of which exceeds 5 years, and the debtor fulfills the current obligations arising from this relationship, the claim arising from said relationship shall be satisfied with the continuation of the existing contractual relationship, irrespective of the rehabilitation plan, unless this causes evident damage to the creditor.⁷⁹

6.3.2. Throughout the Bankruptcy Process

Throughout the enterprise bankruptcy proceedings, where creditor satisfaction follows a strict legal order, secured creditors, owing to their secured claims, are excluded from the distribution ranks of the insolvency estate.⁸⁰ Their satisfaction is aligned with these processes.

The law provides secured creditors with the ability to seek satisfaction in accordance with the mortgage/pledge agreement, with the order determined by the rules of the registration of the security measure.⁸¹

A cursory examination of these regulations may lead practitioners to mistakenly perceive secured creditors as entirely excluded from insolvency proceedings. However, the matter is more nuanced. The European Union, in its directive, explicitly emphasizes the significance of safeguarding relatively vulnerable creditors and urges states to establish a legal framework that avoids granting an indefinite advantage to any class of creditors, irrespective of their priority.⁸²

⁷⁵ See the Law of Georgia “on Rehabilitation and the Collective Satisfaction of Creditors' Claims”, First paragraph of article 58, Legislative Herald of Georgia, 25/09/2020.

⁷⁶ Ibid, First paragraph of article 87.

⁷⁷ ISET, Regulatory Impact Assessment (RIA) of the selected topics under the Draft Law on Rehabilitation and Collective Satisfaction of Creditors, Final Report, 2019, 44 (in Georgian).

⁷⁸ See the Law of Georgia “on Rehabilitation and the Collective Satisfaction of Creditors' Claims”, 2nd paragraph of article 87, Legislative Herald of Georgia, 25/09/2020.

⁷⁹ Ibid, Paragraph 3 of article 87.

⁸⁰ See the Law of Georgia “on Rehabilitation and the Collective Satisfaction of Creditors' Claims”, First paragraph of article 104, Legislative Herald of Georgia, 25/09/2020.

⁸¹ Ibid, Article 105.

⁸² Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019, 11.

Therefore, the 2020 law establishes the responsibility of the bankruptcy manager to base each decision on the best interests of the creditors' community, inclusive of the creditor ranks specified in Article 104 of the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims. This obligation is directly tied to the satisfaction of secured creditors, as they are unable to request the sale or transfer of ownership of the secured object without considering the interests of other creditors.⁸³ The secured asset must remain within the insolvency estate until the bankruptcy manager resolves its fate, ensuring its optimal sale for maximum returns.⁸⁴ If the bankruptcy manager reasonably decides it is best for the collateral to stay in the insolvency estate and be sold as a going concern,⁸⁵ secured creditors cannot oppose this decision solely based on the nature of the collateral provision outlined in civil law.

It is noteworthy that if a secured creditor's claim cannot be fully satisfied due to the insufficient proceeds from the sale of the collateral, the unsatisfied portion of the claim will be included in the rank of unsecured claims.⁸⁶

7. Conclusion

Following the research, it is evident that the Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors' Claims provides the most comprehensive and sophisticated framework for satisfying secured creditors.

The 2020 law eliminated many of the unfair practices outlined in the Law of Georgia on Insolvency Proceedings. Specifically, the 2020 law reinstated the link between secured creditors and the encumbered assets, allowing them again to prioritize the satisfaction of their claims through the subject of security. Simultaneously, the law took into account the hierarchy of secured interests and rectified the unjust approach that granted equal satisfaction opportunities to all secured creditors, irrespective of the timing of their registration.

In conclusion, the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims mostly aligns with international standards and best practices, especially in addressing the satisfaction of secured creditors.

Bibliography:

1. Insolvency Act 1986, UK.
2. German Insolvency Code, 05.10.1994.

⁸³ *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi 2021, 83 (in Georgian).

⁸⁴ See the Law of Georgia "on Rehabilitation and the Collective Satisfaction of Creditors' Claims", First and 2nd paragraphs of article 101, Legislative Herald of Georgia, 25/09/2020.

⁸⁵ the so-called: Sale of going concern.

⁸⁶ See the Law of Georgia "on Rehabilitation and the Collective Satisfaction of Creditors' Claims", Paragraph 4 of article 105, Legislative Herald of Georgia, 25/09/2020.

3. Law of Georgia “Civil Code of Georgia”, the Gazette of the Parliament of Georgia, N786, 24.07.1997.
4. Law of Georgia “Tax Code of Georgia”, Legislative Herald of Georgia, N3591, 12.10.2010.
5. Law of Georgia “on Bankruptcy Proceedings”, the Gazette of the Parliament of Georgia, N286, 30.07.1996.
6. Law of Georgia “on Insolvency Proceedings”, Legislative Herald of Georgia, N4522, 31/03/2007.
7. Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019,
8. Law of Georgia “on Rehabilitation and the Collective Satisfaction of Creditors' Claims”, Legislative Herald of Georgia, N7165-Ib, 25/09/2020.
9. *Brinkmann M.*, The Position of Secured Creditors in Insolvency, *European Company and Financial Law Review*, 2008, 249, 251.
10. *Eidenmuller H.*, Secured Creditors in Insolvency Proceedings, *European Company and Financial Law Review*, 2008, 274.
11. *Kadaria S.*, Historical Development of the Rehabilitation Process, *Journal of Law*, №1, 2022, 197 (in Georgian).
12. *Kasak A.*, Is Full Preference for a Secured Claim in Insolvency Proceedings Justified?, *Juridica International*, 2019, 113.
13. *Keay A.*, Insolvency Law: A Matter of Public Interest?, *Northern Ireland Legal Quarterly*, 2000, 1.
14. *Meskhishvili K., Batlidze G., Amisulashvili N., Jorbenadze S.*, Fundamentals of Insolvency Proceedings in Accordance with the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Tbilisi, 2021, 50, 78-79, 83 (in Georgian).
15. *Migriauli R.*, Introduction to Bankruptcy Law, 2nd Revised Edition, Tbilisi, 2006, 70-72, 84-85, 90-91, 96-99 (in Georgian).
16. *Migriauli R.*, Key Features of the New Insolvency Law, *Journal “Business and legislation”*, 2009 (in Georgian).
17. *Schnitger H., Migriauli R.*, The Law of Georgia on Insolvency, Characterization and Comparison with the Law of Georgia on Bankruptcy Proceedings and International Standards, Tbilisi, 2011, 51, 83, 90 (in Georgian).
18. *Zarandia T., Jugheli T.*, Securing Claims with Movable Property in Georgian Law, *Legal Journal of Judges Association of Georgia “Justice and Law”*, N2, 2009, 27 (in Georgian).
19. The European Law Institute (ELI), Instrument of the European Law Institute, Rescue of Business in Insolvency Law, 2017.
20. The Government of Georgia, Strategy for the Socio-Economic Development of Georgia, Georgia 2020 (in Georgian).
21. International Monetary Fund, Ordinary and Effective Insolvency Procedures, Legal Department, 1999.
22. ISET, Regulatory Impact Assessment (RIA) of the selected topics under the Draft Law on Rehabilitation and Collective Satisfaction of Creditors, Final Report, 2019 (in Georgian).
23. Ministry of Justice of Georgia, Explanatory Note on the Draft Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims (in Georgian).
24. United Nations Commission on International Trade Law (UNCITRAL), Legislative guide on insolvency law, United Nation, New York 2005.
25. United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide on Secured Transactions, United Nation, New York 2010

26. United Nations Commission on International Trade Law (UNCITRAL), Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, United Nation, New York 2014
27. The World Bank Group, Principles for effective insolvency and creditor/debtor regimes, Washington DC, 2016.
28. The World Bank Group, Principles for effective insolvency and creditor/debtor regimes, Washington DC, 2021.
29. <<https://subnational.doingbusiness.org/en/data/exploretopics/resolving-insolvency/score>>[20.06.2023].
30. <<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1023>> [24.07.2023].