გადახდისუუნარობის რეჟიმის გავლენა მხარეთა სახელშეკრულებო ურთიერთობებზე

ნიკოლოზ აბუთიძე

საქართველოს საზოგადოებრივ საქმეთა ინსტიტუტის (GIPA) საჯარო მმართველობის სადოქტორო პროგრამის დოქტორანტი, „გადახდისუუნარობის პრაქტიკოსი“

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აბსტრაქტი

წინამდებარე სტატია განიხილავს გადახდისუუნარობის პროცესში მმართველის უფლებამოსილებას ხელშეკრულებებთან დაკავშირებით, სადაც განსაკუთრებული ყურადღება არის გამახვილებული საქართველოს საკანონდებლოს ჩარჩოზე და გვთავაზობს მის შედარებით-სამართლებრივ ანალიზს საერთაშორისო პრაქტიკასთან. სტატია გამოყოფს მმართველის განსაკუთრებულ როლს ხელშეკრულების ბედის განსაზღვრასა და გადახდისუუნარო მოვალის ქონების შენარჩუნების, კრედიტორების, მოვალისა და სხვა დაინტერესებული პირების ინტერესების დაცვის პროცესში. განხილული ძირითადი საკითხები მოიცავს მმართველის უფლებამოსილების ფარგლებს ხელშეკრულების შეწყეტის უფლების განხორციელებისას, ipso facto დებულებების გამოყენების შესაძლებლობას და მის შედეგებს, ასევე შრომითი ხელშეკრულებების მიმართებას გადახდისუუნარობის კანონმდებლობის მიმართ.

ანალიზი გამოკვეთს ისეთ მნიშვნელოვან ხარვეზებს საქართველოს კანონში „რეაბილიტაციისა და კრედიტორების კოლექტიური დაკმაყოფილების შესახებ“, როგორიცაა ხელშეკრულებების შეწყვეტის პროცესის მკაფიო წესების და ასეთი ქმედებებიდან წარმოშობილი ზიანის ანაზღაურების სახელმძღვანელო მითითებების არარსებობა. აშშ-ის, გერმანიისა და ესპანეთის პრაქტიკაზე დაყრდნობით, კვლევა ხაზს უსვამს დეტალური რეგულაციების მნიშვნელობას პროცესის ეფექტიანობის გაუმჯობესების, პროგნოზირებადობის უზრუნველყოფისა და სამართლიანი შედეგების მიღწევის მიზნით. გარდა ამისა, ის განიხილავს დასაქმებულთა შრომითი ანაზღაურების მოთხოვნების დაცვას გადახდისუუნარობის პროცესში და განსაკუთრებულ აქცენტს აკეთებს საქართველოს კანონმდებლობის შრომის საერთაშორისო ორგანიზაციის (ILO) საერთაშორისო შრომის სტანდარტებთან შესაბამისობასთან დაკავშირებით.

სტატიაში მოცემულია რეკომენდაციები, რომლებიც მიმართულია საქართველოს გადახდისუუნარობის კანონმდებლობის დახვეწისკენ, რომელიც გულისხმობს ხელშეკრულების შეწყვეტის მკაფიო დებულებების გათვალისწინებას, დავების გადაჭრის მექანიზმების შექმნას და თანამშრომლების, მოვალის, კრედიტორებისა და სხვა მხარეთა ინტერესებისადმი დაბალანსებულ მიდგომას. შემოთავაზებული ცვლილებები მიზნად ისახავს გადახდისუუნარობის პროცესის ეფექტიანობისა და სამართლიანობის გაუმჯობესებას, ეროვნული კანონმდებლობის საუკეთესო საერთაშორისო პრაქტიკასთან ჰარმონიზაციას.

საკვანძო სიტყვები: გაკოტრება, მოვალე, კრედიტორი, მმართველი, ხელშეკრულების შეწყვეტა

THE EFFECT OF THE INSOLVENCY REGIME ON THE CONTRACTUAL RELATIONS OF THE PARTIES

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ABSTRACT

This article examines the trustee's authority over contracts during insolvency proceedings, with a focus on the Georgian legal framework and comparative perspectives from international practices. It highlights the trustee's pivotal role in determining the fate of existing agreements, balancing the need to preserve the insolvency estate while safeguarding the interests of creditors, debtors, and other stakeholders. Key issues discussed include the scope of the trustee's authority to terminate contracts, the implications of ipso facto clauses, and the treatment of labor contracts under insolvency law.

The analysis identifies significant gaps in the Georgian Law on Rehabilitation and Collective Satisfaction of Creditors, such as the absence of clear procedures for contract termination and guidelines for damage claims arising from such actions. Drawing on practices from the U.S., Germany, and Spain, the study underscores the importance of detailed regulations for enhancing procedural efficiency, ensuring predictability, and fostering equitable outcomes. Additionally, it explores the protection of workers' wage claims during insolvency, emphasizing the alignment of Georgian law with international labor standards set by ILO.

The article concludes with recommendations to refine the Georgian insolvency framework by introducing clear provisions for contract termination, establishing mechanisms for resolving disputes and balancing the interests of employees, creditors, debtor and other parties. These reforms aim to enhance the effectiveness and fairness of insolvency proceedings, aligning national law with international best practice.

KEYWORDS: Insolvency, Debtor, Creditor, Insolvency Manager, Termination of a Contract

INTRODUCTION

Insolvency proceedings represent one of the most complex areas of commercial and legal practice, with far-reaching implications for debtors, creditors, employees, and other stakeholders. At the heart of these proceedings lies the trustee's authority to manage the debtor's existing contracts—a task that involves navigating a delicate balance between preserving the insolvency estate and fulfilling the broader objectives of creditor satisfaction and debtor rehabilitation. Decisions regarding the assumption, termination, or modification of contracts can profoundly impact the success of the insolvency process, shaping the outcomes for all parties involved.

In Georgia, the 2020 Law on Rehabilitation and Collective Satisfaction of Creditors introduced significant reforms aimed at modernizing insolvency practices and aligning them with international standards. Despite these advancements, ambiguities remain concerning the trustee's powers over contracts, particularly regarding termination procedures, the handling of ipso facto clauses, and the protection of non-debtor parties' rights. These gaps not only create legal uncertainty but also hinder the effective resolution of financial distress.

This article explores the fate of contracts during insolvency, focusing on the Georgian legal framework and its alignment with international practices. By comparing Georgia's approach to those of jurisdictions such as the United States, Germany, and Spain, the study aims to identify best practices and propose solutions to address the existing shortcomings. Additionally, the article examines the treatment of labor contracts and the protection of workers' wage claims, highlighting the interplay between insolvency law and international labor standards.

1. FATE OF CONTRACTS IN CASE OF INSOLVENCY/BANKRUPTCY

From the moment an insolvency regime is initiated, one of the trustee's most critical responsibilities is resolving issues related to the debtor's existing contracts. Among the trustee's various powers, the authority to approve or terminate existing agreements and to enter into new ones holds particular significance.[1] The successful completion of the insolvency regime largely hinges on the trustee's ability to make sound decisions—approving and continuing only those agreements essential for the debtor's operations and for preserving and enhancing the insolvency estate, while terminating agreements that the debtor company is unable to fulfill or that are otherwise inadvisable to continue under the insolvency regime (e.g., contracts with unreasonably high rent).

However, the Law of Georgia "On Rehabilitation and Collective Satisfaction of Creditors" does not explicitly outline the procedures for terminating existing contracts by the trustee, nor does it address the associated legal risks.

To ensure the trustee can lawfully and effectively exercise these powers, several key issues must be addressed:

- Scope of Authority: Should the trustee's authority to terminate a contract be interpreted as including the right to terminate contracts without explicit grounds for termination specified within the agreement when such termination is necessary to achieve the objectives of the insolvency proceed-

1 Article 50, Law of Georgia on rehabilitation and the collective satisfaction of creditors' claim. [Online] available at: <https://matsne.gov.ge/ka/document/view/4993950?impose=translateEn> [Accessed 18.09.2024].

ings? Or is the trustee strictly bound to the termination provisions delineated within the contract?

- Legal Implications of Termination: What are the legal consequences for all parties following the termination of a contract by the trustee?
- Ipso Facto Clauses: What are the implications if the parties anticipate and include ipso facto clauses (automatic termination upon insolvency) in their contracts, and how should these clauses be addressed within the insolvency framework?
- Labor Relations: Does the trustee's authority to approve or terminate contracts extend to labor relations, and if so, what specific considerations or limitations apply in this context?

Clarifying these issues is essential for enhancing the trustee's capacity to navigate complex contractual matters while safeguarding the interests of the debtor, creditors, and other stakeholders within the insolvency process.

2 THE TRUSTEE'S AUTHORITY OVER CONTRACTS IN INSOLVENCY PROCEEDINGS: NATIONAL AND COMPARATIVE PERSPECTIVES

2.1 The Georgian model

The 1996 Georgian Law on Bankruptcy Proceedings regulated bilateral contractual relationships during insolvency proceedings. Specifically, the law granted the bankruptcy administrator the authority to either fulfill a contract or refuse its performance. While the law did not include detailed procedures for exercising this right, the administrator's choice limited the counterparty's ability to terminate the contract in cases where the administrator failed to fulfill the obligations undertaken. The counterparty was first required to demand that the administrator make a decision regarding the performance of the bilateral contract or its refusal.[2]

Special provisions were in place for labor and lease contracts, as outlined in paragraphs 2 and 3. These contracts continued to remain in effect upon the initiation of insolvency proceedings. However, labor contracts could be terminated by either party with a two-week notice period. The Bankruptcy Law introduced a shorter termination period for labor relations than what was prescribed by labor legislation at that time. By applying this shorter termination period, the bankruptcy administrator was able to discontinue unprofitable employment within the debtor's enterprise.[3]

Georgia's Insolvency Law of 2007 was primarily designed to facilitate the expedited liquidation of financially distressed corporate entities and private entrepreneurial ventures. The legislation aimed to ensure the efficient dissolution of such businesses, followed by the systematic distribution of any remaining assets among creditors.[4] The law did not contain any provisions regarding contracts. This meant that, upon the initiation of insolvency proceedings, the general rules on contracts continued to apply. This could lead to serious potential problems in dealing with insolvency matters effectively. A specific example here is that an absence of rules would mean that all standard contractual clauses relating to ter-

2 Compare. Migriauli, R. and Schnitger, H., 2011. Characteristics and comparison of Georgian bankruptcy legislation with international standards. Tbilisi: p. 64.

3 Compare. Migriauli, R., 2017. Introduction to Bankruptcy and Insolvency Law. Tbilisi: pp. 112-113.

4 Compare. Janus, H., 2016. Avoiding the insolvency of Georgia`s Insolvency Law. Tbilisi: p.1.

mination would still take effect, perhaps even invalidating vital agreements after the beginning of insolvency. Under general contract law, counterparties had the right to terminate agreements even in the absence of explicit termination clauses, in case the debtor failed to meet his payment obligations.[5]

The 2007 Insolvency Law was far from what had been recognized internationally as the "best practice" for insolvency frameworks.

On September 18, 2020, the Parliament of Georgia passed the new Law on Rehabilitation and Collective Satisfaction of Creditors, where substantial amendments in the previously existing legal setup were developed and moved to approach more international standards when it concerned insolvency in general.[6]

The Act comes up with the following principals that are in line with granting its application on effectively practical purposes possible. Among them are the appropriate management of the activities and estate of the insolvent debtor; effective and expeditious resolution of financial difficulties of the debtor as early as possible; transparency and predictability of the result of the procedure; maximization of the value of the insolvency estate preservation and increase; promotion rehabilitation of the debtor whenever possible; and equal treatment of creditors of comparable rank.[7]

Decision-making about contracts probably represents the most challenging task that can be undertaken by a trustee in a dynamic market economy. This is not simply a question of straightforward, short-term transactions, such as the supply of goods, but one of complex ongoing legal relationships like construction contracts, leases, and structural agreements. To make matters worse, the debtor will often be in different guises in those contracts – tenants or lessors, contractors or clients, borrowers or lenders – requiring that any decision be made multilaterally.[8]

Most debtors enter bankruptcy with some contracts that are still "executory".[9] When a contract is terminated, the trustee has a legal obligation to act in strict adherence to the principles laid down by the law. Central to this is the duty to maintain and, when possible, increase the insolvency estate. It is often necessary to terminate financially burdensome contracts in order to protect the debtor's business and the interests of creditors. Termination of contracts, however, raises critical issues. For example, the Georgian Civil Code gives the creditor a right to claim damages in case of non-performance or unlawful termination. Similarly, the Law on Rehabilitation and Collective Satisfaction of Creditors entitles the trustee to annul the contracts concluded by the debtor or to approve their annulment, including lease contracts, provided that such restoration of the ownership of the rented property to the debtor was stipulated.[10]

Notably, although the law does not ex-

5 Ibid. p. 65.
6 Principles for Effective Insolvency and Creditor/Debtor Regimes, Washington DC 20433: International Bank for Reconstruction and Development / The World Bank. 2021. p. 11.
7 Article 2, Law of Georgia on rehabilitation and the collective satisfaction of creditors' claim. [Online] available at: <https://matsne.gov.ge/ka/document/view/4993950?impose=translateEn> [Accessed 18.09.2024].
8 United Nations Commission on International Trade Law, Legislative Guide on Insolvency Law, New York: 2005. p. 120.
9 Jesse M. Fried., 1996. Executory Contracts and Performance Decisions in Bankruptcy, DUKE LAW JOURNAL. Durham, p. 518.
10 Article 74.4 „D", Law of Georgia on rehabilitation and the collective satisfaction of creditors' claim. [Online] available at: <https://matsne.gov.ge/ka/document/view/4993950?impose=translateEn> [Accessed 18.09.2024].

plicitly outline regulations relating to the consequences of contract termination, this lack of explicitness gives rise to many practical problems. For instance, the law does not provide for the extent to which a trustee is empowered to endorse agreements made by the debtor. Whereas the law confers on practitioners the powers to endorse contracts, it has not specified the manner and period within which such endorsement should be done. This lack of clarity has undesirable consequences for the debtor's contractors, as it generates uncertainty and hinders the non-debtor party's ability to make informed future business decisions.

The law also contains significant ambiguities regarding the trustee's authority to terminate contracts. It implicitly recognizes the right of trustees to free the estate from onerous contracts without the imposition of contractual penalties. Most debtors declaring bankruptcy have "executory" contracts, in which both parties still have obligations to each other. Moreover, the law fails to address the consequences of contract termination for both the debtor and the debtor's contractors. Insolvency-based contract terminations frequently result in damage claims, which may include actual losses and lost profits. In addition, most contracts involve a lot of inconvenience or hefty penalties at termination, further worsening the financial situation of the debtor. For instance, a lease agreement may require notice of three months of its termination. The most crucial practical issue arising in these cases is whether the other party to the debtor's contract has the right to claim damages upon termination. Once such a right is recognized, the law also has to detail how these claims are to be dealt with under the insolvency arrangement.

2.2 A Comparative-Legal Analysis Based on Foreign Practices

- **The American Model**

An executory contract does not automatically become part of the bankruptcy estate. Instead, pursuant to Section 365 of the Bankruptcy Code, the bankruptcy trustee responsible for administering the bankruptcy estate may assume or reject executory contracts with the bankruptcy court's approval.[11]

Assumption of Executory Contracts

For an executory contract to become binding on the bankruptcy estate, the trustee must formally assume it. Assumption renders the contract fully enforceable in its original terms and entirety for both the bankruptcy estate and the non-debtor party. The first significant impact of assumption is that the entire liabilities derived from a contract are classified as an administrative expense. Also, when a contract is rejected or repudiated with the other non-debtors party retains a right to claim, which has now become a kind of action for damages which could be pursued against a bankruptcy estate. These administrative expenses represent one category of claims out of different unsecured unsecured priority claims. Now, this category of liability needs to be satisfied before that category could be paid which in this case is lower, normally the administrative category of debts are paid for.

Rejection

Under the U.S. bankruptcy law, a trustee may choose to reject an executory contract, which constitutes a pre-petition breach by the debtor. As a result, the non-debtor party holds an unsecured claim for damages. Because of this, these types of claims participate pro rata in the distribution of the debtor's as-

11 Compare. Pottow, J.A.E., 2018. A New Approach to Executory Contracts. Texas Law Review, 96 (7), pp. 1147-1148.

sets together with other general unsecured creditors. These claims, being at the bottom of the distribution hierarchy, usually recover only a small percentage of their total value unless the non-debtor party has a security interest in the assets of the debtor.[12]

Treating rejection damages as unsecured claims is consistent with bankruptcy policies of equitable treatment of creditors and maximization of the value of the bankruptcy estate. Classifying such claims as unsecured allows the estate to divest itself of onerous contracts, thereby facilitating fairness among creditors and preserving value for the collective benefit of the estate.[13]

- **The German Model**

German bankruptcy law also grants the wide authority over executory contracts to the trustee to assume or reject them without needing a grant of permission to do so from the bankruptcy court. In the treatment affecting executory contract, German insolvency law pursues the one-sided principle that rehabilitation of a still-liquid debtor is preferable and that the economic value of its assets must, on behalf of creditors, be maximized.[14]

On filing the bankruptcy case, all the debtor's property including the executory contracts, by operation of law automatically become part of the bankruptcy estate. The contracts are treated as valid and binding upon the bankruptcy estate, although their effects are stayed pending a determination by the trustee as to whether or not to assume or reject. According to German Insolvency Code, the bankruptcy trustee is obliged to decide clearly on the assumption or rejection of an executory contract in writing for the sake of protecting the rights of the creditors, who also have the right to receive notice about such decision of the trustee. [15]

Rejection

In bankruptcy proceedings, a trustee may opt to reject an executory contract. In such cases, the non-debtor party is entitled to damages; however, these claims are categorized as general unsecured claims. Unless the non-debtor possesses a security interest in the debtor's assets, such claims share pro rata with other general unsecured creditors, who rank lowest in the priority hierarchy and often receive only a fraction of their claim's value.[16]

This can be justified by bankruptcy policies that emphasize treating the creditors fairly and maximizing the debtor's estate so as to benefit them all as a whole. This approach encourages trustees to reject any burdensome or detrimental contracts to the bankruptcy estate, thereby increasing its overall value.By contrast, the German bankruptcy framework treats non-debtor parties to rejected contracts as general unsecured creditors, entitled to share pro rata with other unsecured creditors.[17]

12 Compare. Chaim, M., 2017. The Rejection of Executory Contracts: A Comparative Economic Analysis, Mexican Law Review, 9 (2), pp. 101–102.
13 Compare. Westbrook, J.L., 1989. A Functional Analysis of Executory Contracts. Minnesota Law Review, 74 (2), pp. 229–230.
14 Compare. Tissot, R., 2012. The Effects of a Reorganization on (Executory) Contracts, presented at the International Insolvency Institute. pp. 39-40.
15 Compare. Mayer, B., 2016. German Insolvency Law – An Overview. London: Mayer Brown International LLP. pp. 7-8.
16 Compare. Eidenmüller, H,. 2023. The German Perspective, In Executory Contracts in Insolvency Law: A Global Guide. pp. 349–350.
17 Compare. Basedow, J,. 2012. Executory Contracts in Insolvency Law: A Comparative View. In The Max Planck Encyclopedia of European Private Law. pp. 789–790.

- **The Spanish Model**

Under Spanish bankruptcy law, the bankruptcy estate is not considered a legal entity distinct from the parties but rather the property seized from the debtor for the benefit of creditors. While the estate includes all property of the debtor, such property remains legally owned by the debtor. A trustee in bankruptcy is then appointed and takes over the management of the estate.[18]

Unlike under other systems, such as German bankruptcy law, Spanish law does not stay the effects of executory contracts during bankruptcy proceedings. Those contracts are still valid and binding, and both the bankruptcy estate and the non-debtor party must perform under the original terms of the contract. Thus, all executory contracts are automatically assumed, and the related obligations qualify as administrative expenses. These costs have a priority over other unsecured claims and are to be paid as they fall due.[19]

The Spanish Insolvency Act provides that the bankruptcy trustee may reject a contract upon its approval by the bankruptcy court. This is because not all contracts are beneficial to the bankruptcy estate, and some may be too burdensome. In this regard, the bankruptcy trustee is empowered to reject executory contracts, provided that such rejection is approved by the court. In this respect, rejection is considered as a breach of the contract.[20]

The main consequence of rejection is that the counterparty can claim damages, which rank as an administration expense. The rule is clear that the party who is not the debtor in the contract should be fully compensated by way of the loss of profits expected to be derived from the contract performance in that administration expenses are paid ahead of all other unsecured claims. This provision thus encourages the bankruptcy trustee to perform, rather than reject, the contract when performance would increase value for both the promisor and the promisee because it requires the bankruptcy estate to pay the full damages claim arising from the breach. The approach taken here is to discourage rejections that diminish value. [21]

Besides, the principle of equal treatment among creditors is also followed because all executory contracts are automatically deemed assumed. In this system, all contracts are treated as binding on the bankruptcy estate. Thus, the estate assumes not only the responsibility for contract performance but also the liability for damages arising from contract rejection. In this scheme, the non-debtor party is treated not as a creditor of the debtor but as a creditor of the bankruptcy estate.

Summary:

The comparative legal analysis of various national models in the present chapter has clearly highlighted the shortcomings of the Georgia's model. In particular, the law provides trustees with broad powers to annul contracts but fails to outline the procedures or timelines for such decisions. This creates uncertainty for both trustees and counterparties, potentially delaying insolvency resolutions. The framework does not adequately

18 Compare. Colldeforns Papiol, E**.,** 2021. Restructuring Plans and ICO Guarantees. In Special Issue on Bankruptcy Reform. pp. 130–131.

19 Sáenz de Santa María, S. and Jiménez López, L, 2021. Restructuring Plans and ICO Guarantees. In Special Issue on Bankruptcy Reform, Uría Menéndez, pp. 120–121.

20 Yáñez Evangelista, J., 2021. The System of Bankruptcy Reclamation in the Reform of the Bankruptcy Act. In Special Issue on Bankruptcy Reform, Uría Menéndez, pp. 159–160.

21 Alonso Hernández, Á., 2021. The Sale of Businesses in Distress According to the Reform: Liquidation Restructuring Plans vs. Prepack. In Special Issue on Bankruptcy Reform, Uría Menéndez, pp. 157–158.

address how damages claims resulting from contract terminations should be handled. For instance, creditors' rights to claim compensation remain unclear, leading to disputes and delays in distributing insolvency assets. The law does not sufficiently protect the rights of non-debtor parties, who often face uncertainty regarding the enforceability of agreements and potential damage claims after termination. While the law promotes debtor rehabilitation, the lack of detailed guidance on how trustees should prioritize contracts makes it harder to assess when fulfilling or rejecting contracts serves the broader goals of rehabilitation and creditor satisfaction.

Suggestions for Improvement:

- Introduce detailed provisions on how and when trustees should decide on endorsing or annulling contracts to reduce ambiguity and improve procedural efficiency;
- Clearly define the rights and remedies available to non-debtor parties, including a framework for damage claims, to foster trust and predictability in contractual relationships;
- Provide criteria for evaluating whether fulfilling or rejecting a contract supports debtor rehabilitation and creditor satisfaction, ensuring decisions align with the law's objectives;
- Establish specialized mechanisms for resolving contract-related disputes during insolvency to minimize delays and litigation costs;
- Develop specific rules for handling complex contracts, such as leases or long-term agreements, to address the nuanced challenges of ongoing legal relationships during insolvency;
- By addressing these shortcomings, the Georgian model can become more effective, equitable, and aligned with international best practices, ensuring better outcomes for both debtors and creditors.

3. PROTECTION OF WORKERS' WAGE CLAIMS IN ENTERPRISE INSOLVENCY

The opening of any insolvency proceeding against the company is a very catastrophic situation for its employees and usually takes the biggest hit when something goes wrong with their company. Insolvent companies more often than not acquire liabilities not only to suppliers or contractors but also to workforce employees. Employees are placed in a vulnerable position as their livelihoods are directly related to the company's ability to pay them.

For an insolvent company, underpayment or nonpayment of wages may have broader economic repercussions in the form of negative multipliers. Workers unable to spend due to no or little spending power cannot support the local economies, therefore depressing the economic recession experienced in the affected communities.[22]

ILO Convention No. 95, Protection of Wages Convention, 1949, lays down a clear rule of preference for the settlement of employees' wage claims in case of insolvency.

Article 11 of this convention provided for setting apart of employee wages due from debtor's assets in the distribution order among creditors. The Convention thus protected, under its provisions, the financial claim of the working people against competitive claims in the bankruptcy or liquidation proceedings, and, in fact, protected claims regarding the very important situation that

22 International Labour Organization. 2020. Protection of workers' wage claims in enterprise insolvency, Geneva, p. 1.

any worker would come across. Also, in this respect, ILO Convention No. 173, supported by Recommendation No. 180, strengthens such principles by asking national laws or regulations to grant a higher rank of privilege to workers' claims as compared with most other claims, including those of the state or social security systems for unpaid taxes or contributions. This ensures that workers' financial security remains a priority even amid insolvency proceedings. [23]

Article 104 of the Law on Rehabilitation and Collective Satisfaction of Creditors reflects key principles aligned with ILO conventions, particularly concerning the protection of employee wages. It stipulates that wages earned within the three months preceding the commencement of insolvency proceedings, up to a maximum of 1,000 GEL, must receive preferential treatment over other creditor claims.

Apart from giving priority to claims for wages, the law also creates provisions for regulation of employment contract in bankruptcy. These provisions would protect the employees' interests but also balance the creditors interest, a principle at the heart of the ILO's conventions. Unlike general authority of the trustee in terminating or approving the various contracts of the debtor, labor relations are subject to stricter regulation. The law explicitly obliges the trustee to terminate employment contracts in accordance with the procedures prescribed by the Labor Code of Georgia. In case of personnel replacement, the trustee is obliged to follow the norms of the Labor Code and provide a legally grounded reason for his actions.

This framework emphasizes an approach that ensures workers' rights in the case of insolvency, while simultaneously providing for a fair and legally appropriate way to resolve the conflict of claims. The Georgian insolvency law, through wage protection and the imposition of special procedural duties on trustees, is harmonized with international standards of labor and leads toward equitable solutions for all concerned parties.

Summary:

Insolvency proceedings often have severe consequences for employees, who are placed in a vulnerable position due to unpaid or underpaid wages, leading to broader economic repercussions in affected communities. The ILO Protection of Wages Convention, 1949 (No. 95) and ILO Convention No. 173, supported by Recommendation No. 180, prioritize employees' wage claims during insolvency, ensuring their financial security takes precedence over most other creditor claims. Georgia's Law on Rehabilitation and Collective Satisfaction of Creditors aligns with these principles, giving preferential treatment to wages earned within three months before insolvency proceedings (up to 1,000 GEL) and introducing regulations for the termination of employment contracts. Trustees must comply with the Labor Code of Georgia and justify personnel changes, balancing the rights of employees with the interests of creditors. This framework harmonizes Georgian insolvency law with international labor standards, safeguarding workers' rights while ensuring equitable outcomes for all stakeholders.

4. SCOPE OF FREEDOM OF CONTRACT IN INSOLVENCY PROCEEDINGS

A key objective of Georgian insolvency law is to promote the rehabilitation of insolvent entities while ensuring the fair and effective

23 ILO Convention No. 173 (and Recommendation No. 180).

protection of creditors' interests.[24] Achieving this goal necessitates significant adjustments to the debtor's operations. One of the mechanisms facilitating this process is the power granted to officeholders to either disclaim/reject or assume executory contracts and unexpired leases. This authority allows them to repudiate disadvantageous pre-petition executory contracts in the debtor's inventory while retaining beneficial ones, thereby preserving valuable agreements for the advantage of general creditors.[25]

To enhance the chances of a company's survival, Georgian law incorporates various mechanisms that directly affect the parties to contractual relationships. For instance, alongside the legal measures of a moratorium, courts are empowered, upon a reasoned application by the parties, to:

- Prohibit the debtor from returning items in its possession that are leased, retained under ownership, or held on other grounds;
- Restrict or prohibit the debtor from disposing of property, including its alienation or encumbrance;
- Suspend provisions of contracts allowing the debtor to dispose of property;
- Prohibit the debtor's contractors from terminating, suspending, or delaying the provision of essential services due to the initiation of insolvency proceedings, provided the debtor fulfills its post-insolvency obligations.[26]

Admittedly, such regulation restricts the principle of freedom of contract, embraced by the Civil Code of Georgia, for the sake of the specific dynamics in the state of insolvency and corresponding public interests. The freedom of contract would normally allow individuals to determine the form and content of agreements, including entering into mixed contracts not explicitly governed by law, and to choose contractual parties. It also includes the right to terminate contractual relationships in accordance with established rules.[27]

However, the same scope and form of civil law principle of private autonomy, and the attendant contractual freedom cannot be afforded to insolvency laws. The continuity of contractual relations with a limited company in a state of insolvency creates immense and serious risks for the other contractual party. Many of these others turn to the termination of a contract even in instances where the debtor has continued to carry on with its obligations as previously agreed upon. In such a scenario, it bars the possibility of one-way termination of contracts by the contractors and in those terminations, the court must introduce supplemental moratorium measures.

It implies a delicate balance between the rights of creditors and contractors, on one hand, and furtherance of the overarching public interest in maintaining insolvent companies viable on the other. Georgian law limits absolute contractual freedom in insolvency contexts to provide for a much more orderly and systematized solution of competitive interests.

24 Article 2, Law of Georgia on rehabilitation and the collective satisfaction of creditors' claim. [Online] available at: <https://matsne.gov.ge/ka/document/view/4993950?impose=translateEn> [Accessed 18.09.2024].

25 Udofia, M., 2014. "The Impact of the Insolvency on Corporate Contracts". Nottingham, p. 234.

26 Article 55, Law of Georgia on rehabilitation and the collective satisfaction of creditors' claim. [Online] available at: <https://matsne.gov.ge/ka/document/view/4993950?impose=translateEn> [Accessed 18.09.2024].

27 Gelashvili, I., in the book: Chanturia, L., "ed"., 2019. Comentary to the Civil Code, Book III, General Part of the Law of Obligations, Tbilisi: p. 55.

Summary:

Georgian insolvency law aims to rehabilitate insolvent entities while safeguarding creditors' interests. This involves empowering officeholders to assume beneficial executory contracts or reject disadvantageous ones, optimizing the debtor's operations for creditors' benefit. The law also provides mechanisms, such as moratoriums and court-imposed restrictions, to regulate contractual relationships, including prohibiting contractors from terminating essential services during insolvency proceedings if the debtor meets its obligations.

Although these measures limit the freedom of contract enshrined in the Civil Code of Georgia, they address the unique risks of continuing contractual relations with insolvent entities. By restricting unilateral contract terminations and allowing courts to impose additional measures, Georgian insolvency law seeks to balance creditors' and contractors' rights with the public interest in maintaining the viability of insolvent companies, ensuring an equitable and systematic resolution of competing claims.

5. ABILITY TO REQUEST IMMEDIATELY

An intriguing issue arises in cases where no additional moratorium measures are requested: can the contracting party, citing insolvency, withdraw from the contract (e.g., stop supplying goods to the debtor) or demand immediate performance from the debtor?

According to the Civil Code of Georgia, obligations shall generally be performed within the appointed time and creditors may demand early performance only in circumstances expressly provided by law.[28] Article 367 of the Civil Code permits creditors to demand early performance if the debtor becomes insolvent. Whereas this provision may seem directly to deal with insolvency, legal literature explains that "insolvency" in this context means the worsening of the financial situation but not the real insolvency proceedings.[29] Once insolvency proceedings are initiated, the relations between the debtor and creditors become subject to the Law on Rehabilitation and Collective Satisfaction of Creditors and governed by priority of collective satisfaction. Consequently, creditors cannot demand early performance of obligations, as future claims must be registered and resolved in compliance with the special law.

Although Article 367 is inapplicable after insolvency proceedings are initiated, creditors are not entirely precluded from terminating legal relationships with the debtor. Whereas the trustees are vested by the insolvency law with statutory powers to ratify or terminate contracts, the contracting parties can rely only on the rules contained in the Civil Code. The latter does not grant the creditors a right unilaterally to terminate contracts for reasons of insolvency proceedings; termination has to be justified in accordance with the stipulations of the contract or general principles of civil law.

5.1 Ipso Facto Clauses

A relevant consideration arises when parties include "ipso facto" clauses in their contracts, stipulating automatic termination or termination upon notice if insolvency proceedings are initiated against one of the parties. The purpose of such clauses is to allow a

28 Meskhishvili, K., Gelashvili, I., in the book: Chanturia, L., "ed"., 2019. Comentary to the Civil Code, Book III, General Part of the Law of Obligations, Tbilisi: p. 408.

29 Ibid. p. 409.

party to avoid a contractual relationship with an insolvent counterparty.[30]

Despite their frequent use, the enforceability of ipso facto clauses remains contested internationally. Jurisdictions vary in their treatment: some explicitly invalidate such clauses, while others lack specific regulations, relying instead on general legal principles.

For example, Polish law explicitly renders null and void any clause granting a party the right to modify or terminate a contract based solely on the counterparty's insolvency.[31] This does not prevent amendments or terminations after insolvency proceedings commence but ensures that the initiation of proceedings does not automatically justify unilateral termination. The rationale for nullifying ipso facto clauses lies in protecting the debtor's estate, preventing it from being dismantled by competing creditors, and maximizing the value of the bankruptcy estate.[32]

In the United States, ipso facto clauses were widely used until the Bankruptcy Code of 1978 abolished their enforceability. The Code allows insolvency trustees to assume or assign executory contracts, regardless of such clauses. This policy recognizes that continuous performance of critical contracts, such as leases, may be essential for preserving a business's value and ensuring its rehabilitation.[33]

The Legislative Guide on Insolvency Law acknowledges that prohibiting ipso facto clauses interferes with fundamental contract law principles but considers such interference necessary for successful insolvency proceedings. Maintaining essential contracts, such as leases, is often vital to preserving the debtor's business and ensuring a fair resolution for creditors.[34]

In Georgia, the Law on Rehabilitation and Collective Satisfaction of Creditors does not explicitly address ipso facto clauses, and the Civil Code permits parties to freely conclude contracts within the bounds of law, including clauses not explicitly provided for by law. While ipso facto clauses may appear permissible, their legality must be assessed in light of the general principles of insolvency law and the objectives of the insolvency process. Allowing contract termination solely on the grounds of insolvency jeopardizes the success of insolvency proceedings by complicating efforts to stabilize the debtor's business and meet creditor claims.

Given these considerations, ipso facto clauses conflict with the principles and objectives of Georgian insolvency law, even in the absence of explicit prohibitions. To balance the interests of contracting parties and the goals of insolvency proceedings, Georgian law offers preferential repayment of debts incurred after the initiation of insolvency, mitigating the risks for parties that continue business relations with an insolvent company.

Summary:

Under Georgian law, creditors cannot demand immediate performance of obligations from a debtor once insolvency proceedings have commenced, as future claims must be

30 Compare. Brain, C., Enforceability of "Termination on Bankruptcy" or Ipso Facto Contract Clause. pp. 3-4. [Online] available at: <https://www.bclplaw.com/a/web/99476/Enforceability-of-Termination-on-Bankruptcy-or-Ipso-Facto-Cont.pdf> [Accessed 12.10. 2024]

31 A Guide to Restructuring and Insolvency Procedures in Europe. 2019. London: p. 139.

32 Jonhsson, H., 2000. Insolvency Law and Economics. p. 1.

33 Tissot, R., 2016. The Effects of a Reorganization on (Executory) Contracts: A Comparative Law and Policy Study [United States, France, Germany and Switzerland]. p. 8.

34 United Nations Commission on International Trade Law, Legislative Guide on Insolvency Law. 2005. New York: p.123.

registered and resolved collectively under the Law on Rehabilitation and Collective Satisfaction of Creditors. While Article 367 of the Civil Code permits early performance demands in cases of financial deterioration, it does not apply during formal insolvency proceedings. Creditors wishing to terminate contracts must follow the general principles of the Civil Code, as unilateral termination based on insolvency alone is not allowed.

"Ipso facto" clauses, which allow for automatic termination of contracts upon insolvency, are widely contested internationally. While some jurisdictions, such as Poland, invalidate these clauses outright, others, like the United States, limit their enforceability to protect the debtor's estate and ensure the success of insolvency proceedings. In Georgia, the enforceability of ipso facto clauses is not explicitly addressed, but their application conflicts with the principles of insolvency law, which prioritize stabilizing the debtor's business and ensuring equitable treatment of creditors. Georgian law mitigates risks by offering preferential repayment for post-insolvency debts, balancing the interests of contracting parties with the objectives of insolvency proceedings.

CONCLUSION

The management of contracts in insolvency represents one of the most critical and complex issues in modern insolvency law. Trustees have to make a number of strategic decisions in order to balance estate preservation with broader goals of creditor satisfaction and debtor rehabilitation. This study has highlighted key areas where the Georgian legal framework faces challenges, including ambiguities in the trustee's authority to terminate contracts, the handling of ipso facto clauses, and the legal consequences of contract terminations. These gaps not only create uncertainty for stakeholders but also risk undermining the efficiency and fairness of insolvency proceedings.

The comparative analysis carried out with the participation of such jurisdictions as the United States, Germany, and Spain has shown that a clearly articulated detailed regulatory framework could substantially enhance the efficiency of insolvency regimes. This includes the following: clear procedural rules on the termination of contracts, damage claims procedures, and priority criteria with respect to taking over or repudiation of contracts-all very instructive examples for Georgia. Similarly, the standard requirements for international standards in the areas of labor contract treatment and workers' wage claim protection add more reasons why protecting vulnerable stakeholders should be provided with the greatest priority in an insolvency proceeding.

To address the identified shortcomings, Georgia's insolvency framework should focus on enhanced procedural clarity, fair treatment of non-debtor parties, and strong employee protection.This would also involve introducing special provisions on how to deal with sophisticated contracts, mechanisms of dispute resolution, and clear criteria for trustees to take decisions. By so doing, Georgia will join the ranks of countries whose insolvency law is in line with international standards and thus create a legal environment that is predictable, fair, and able to cope with the challenges of a dynamic market economy. The ultimate success of any insolvency regime depends not only on its legal provisions but also on how well it strikes a balance between competing interests in a way that fosters economic stability. Refining the legal framework will help Georgia's insolvency law continue to serve as a strong tool for financial rehabilitation, stakeholder protection, and economic growth.

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