IN THE NAME OF THE REPUBLIC OF ARMENIA

DECISION
OF THE CONSTITUTIONAL COURT OF THE REPUBLIC OF ARMENIA

ON THE CASE OF CONFORMITY OF ARTICLE 249 OF THE CIVIL CODE OF THE REPUBLIC OF ARMENIA WITH THE CONSTITUTION OF THE REPUBLIC OF ARMENIA ON THE BASIS OF THE APPLICATION OF MARETA ARAKELYAN

Yerevan **July 19, 2016**

The Constitutional Court of the Republic of Armenia composed of G. Harutyunyan (Chairman), F. Tokhyan, A. Tunyan (Rapporteur), A. Khachatryan, V. Hovhanissyan, H. Nazaryan, A. Petrosyan,

with the participation of (in the framework of the written procedure) the Applicant Mareta Arakelyan,

representative of the Respondent: official representative of the RA National Assembly V. Danielyan, Chief Specialist at the Legal Consultation Division of the Legal Department of the RA National Assembly Staff,

pursuant to Point 1 of Article 100 and Point 6 of Part 1 of Article 101 of the Constitution of the Republic of Armenia, Articles 25, 38 and 69 of the RA Law on the Constitutional Court,

examined in a public hearing by a written procedure the Case on conformity of Article 249 of the Civil Code of the Republic of Armenia with the Constitution of the Republic of Armenia on the basis of the Application of Mareta Arakelyan.

The Case was initiated on the basis of the Application submitted to the RA Constitutional Court by Mareta Arakelyan on 29.02.2016.

Having examined the written report of the Rapporteur on the Case, the written explanations of the Applicant and the Respondent, having studied the Civil Code of the Republic of Armenia and other documents

of the Case, the Constitutional Court of the Republic of Armenia **ESTABLISHES:**

1. The RA Civil Code was adopted by the RA National Assembly on 5 May 1998, signed by the RA President on 28 July 1998 and entered into force on 1 January 1999 according to the RA Law on Enactment of the Civil Code of the Republic of Armenia adopted by the National Assembly of the Republic of Armenia on 17.06.1998.

Article 249 of the Civil Code, titled: **"Procedure for levying execution on the pledged property without applying to court,"** prescribes:

"1. For the purpose of satisfying her/his claim, a pledgee shall have the right to levy execution on the collateral and realize it without applying to court, including transferring the pledged property to the ownership of the pledgee or a third person mentioned by the pledgee for the corresponding amount of the principal obligation, if:

1) It is provided for by the contract of pledge, or

2) There is a written agreement concluded between the pledgee and the pledgor, and, when a consent or permission of a third person has been required for conclusion of the contract of pledge – also the written consent of the latter, without the court judgment on realization of the pledged property.

2. In case of non-fulfillment or improper fulfillment of an obligation secured by a pledge, the pledgee shall notify the pledgor in writing and in a proper manner on the execution levied on the collateral without applying to court (notification of execution). The pledgor shall have the right to challenge, through judicial procedure, the lawfulness of the execution levied on the collateral, in accordance with this Article; in this case the court may suspend the process of levy of execution on the collateral. The court may suspend the process of levy of execution on the collateral provided the pledgor provides security equal to the value of the collateral for the compensation of possible damages caused to the pledgee.

After the notification of execution has been properly served to the debtor, the pledgee shall have the right to take the collateral into her/his possession (if it is a movable property), as well as to take reasonable measures for preserving, maintenance of the collateral and ensuring its safety.

The pledgee shall, by virtue of this Code, have the right – subject to Article 195 of this Code – to realize the collateral through direct sales or public biddings on behalf of the pledgor, two months after serving the notification of execution to the debtor, unless the pledgor and the pledgee have agreed on another procedure for realizing the collateral. The pledgee shall be obliged to realize the collateral at a reasonable price existing at the market at the given moment.

Current version of the challenged Article 249 of the Code was fixed by the RA Law HO-188-N dated 04.10.2005.

2. The procedural background of the Case is the following: according to the loan agreement No. 068-23, concluded between Gegham Arakelyan, the husband of the Applicant, and Unibank CJSC (hereinafter referred to as the Bank) on 20.07.2007, the Bank granted him a loan of 36.000.000 AMD at a rate of 15 percent per annum with the maturity date until 20.07.2019. The purchased house with a land plot located at Davtashen, 3rd quarter, 59/1, Yerevan was mortgaged in favor of the Bank.

According to the agreement on the subsequent mortgage of real estate No. 270-23/Ա.Հ, concluded on 12.10.2009, the Bank granted Gegham Arakelyan a loan of $ 50.000 at a rate of 24 percent per annum with the maturity date until 12.10.2011. Under an agreement certified on 12.10.2009 by Nune Sargsyan, notary of "Kentron" notary office, the Applicant agreed that Gegham Arakelyan (her husband) mortgaged the house – acquired at the time of their marriage – located at Davtashen, 3rd quarter, 59/1, Yerevan, and in case of non-fulfillment of loan obligations, the Applicant agreed that the claims of the pledgee were satisfied at the expense of the pledged property, without applying to court.

According to the notification of enforcement of the recovery No. 269, sent by the Bank to Gegham Arakelyan on 15.03.2011 (and Gegham Arakelyan received this notification), the Bank informed that in case of improper performance of obligations by Gegham Arakelyan within 10 days, the Bank has the right – through direct sale or public bidding – to realize in its own favor the mortgaged house located at Davtashen, 3rd quarter, 59/1, Yerevan, two months after the notification is sent.

As a result of extrajudicial execution, the mortgaged house – according to agreement No. 858/ԱՀ of 17.10.2012 – was transferred to the ownership of Ovsanna Arakelyan, Deputy Chairman of the Board of the Bank.

On 15.05.2013, the Applicant and her husband submitted a claim to the Court of First Instance of Ajapnyak and Davtashen Administrative Districts against Unibank CJSC, Ovsanna Arakelyan, Yerevan division of the State Committee of Real Estate Cadastre adjunct to the RA Government, third party: Nune Sargsyan, notary of "Kentron" notary office, demanding to restore the right to the property, invalidate the contract of sale of real estate and apply the consequences of invalidity of the contract.

Based on the provisions of Article 249 of the RA Civil Code, on 21.10.2014 the Court rendered a Judgment on the civil case ԵԱԴԴ/0529/02/13, according to which the claim was rejected.

The Judgment was appealed to the RA Civil Court of Appeal. The Court of Appeal found justified the circumstance that the Bank violated the mandatory requirement of the RA Civil Code to notify the pledgor on the extrajudicial procedure for levying execution on the collateral, on 29.01.2015 the Court rendered a Decision on partial satisfaction of the appeal and sending the case to the same Court for new and full consideration.

By the Decision of 27.11.2015, the RA Court of Cassation rejected the Decision of the RA Civil Court of Appeal dated 29.01.2015, and gave legal force to the Judgment of the Court of First Instance dated 21.10.2014.

3. The Applicant finds that Article 249 of the RA Civil Code – in regard to the part of the content provided by the law enforcement practice – contradicts Articles 10, 60 and 61 of the RA Constitution, insofar as it does not correspond to the constitutional approaches of acknowledgement, guaranteeing and protecting the right to property.

Comparing the guarantees stipulated by Articles 10 and 60 of the RA Constitution with the provision "for the purpose of satisfying her/his claim, a pledgee shall have the right to levy execution on the collateral and realize it without applying to court" – stipulated by the challenged Part 1 of Article 249 of the Code – the Applicant grounds

her above conclusion as follows: a) it is obvious that in the case of realization of the pledged property by extra-judicial procedure, the seizure of property – against the will of the owner – by the pledgee without a court decision is provided, which implies deprivation of the right to property against the will of the owner; b) it is obvious that in the disputed legal norm there are no objective grounds for the deprivation of the right to property provided for by law."

Referring to the basic mandatory conditions for the deprivation of property – prescribed in the Decision DCC-903 of the Constitutional Court, the Applicant finds that the deprivation of the right to property must be realized through court, on free of charge basis, as a compulsory action arising from liability. Meanwhile, the issue of the claim of a bank-pledgee to the property of a person – in the currently established judicial and law enforcement practice – is resolved in the context of the execution process carried out by banks-pledgees and credit companies at their discretion, which leads to arbitrariness and lawlessness in the process of deprivation of property.

To ground the alleged violation of the right to judicial protection, the Applicant states that based on the challenged Article of the Code, the Bank extra judicially executed her property, did not notify her about the execution and failed to send her notifications of execution, and the Applicant finds that as a result, she – as a co-owner of the house – has lost the chance to challenge the legitimacy of levying execution on the property, and accordingly, the right to judicial protection of the right to property. In addition, according to the Applicant, in the challenged norm the mechanisms for comparing the voluntary and compulsory grounds for termination of the right to property with respect to the pledged property are not revealed precisely enough. According to the Applicant, the extrajudicial realization of property – provided for in the first part of the challenged norm – is the forfeiture of property against the will of the owner, and the second part provides for a mandatory term for the existence of an agreement on the transfer of the property of the owner in return for debts, and establishes that an extrajudicial execution of the property cannot be carried out in case there is no written agreement concluded at the will of the owner with the pledgee on the transfer of property. According to the Applicant, the agreement on the transfer of the house to the Bank in return for debts should be

drafted in writing and certified by a notary. Referring to the Decisions rendered by the RA Court of Cassation on civil cases No. ԵԿԴ/2013/02/12 and ԵԱԴԴ/0529/02/13, the Applicant considers that due to various, mutually exclusive and contradictory interpretations to the challenged norm in the judicial practice, the Court of Cassation restricted her right to judicial protection and the right to property, which led to the violation of her rights and legitimate interests.

To substantiate her position, the Applicant refers to a number of decisions of the RA Constitutional Court, as well as to Protocol No. 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms.

4. The Respondent finds that the provisions challenged by the Applicant do not contradict the RA Constitution. Referring to Protocol No. 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, the Respondent notes that Article 1 of the Protocol does not concern the relations that are purely contractual between private individuals.

According to the Respondent, in Part 4 of Article 60 of the RA Constitution it is a question of dispossession, which implies the transfer of the right to property against the will of the person, whereas in the framework of the challenged Article, a person loses property in terms of prior consent regarding the collateral. The Respondent states that in case of realization of the collateral in extrajudicial order it is necessary that the person expresses her/his consent either directly by the pledge agreement or by a written consent separately from the pledge agreement. By such legal regulation, the legislator established a guarantee of a clear expression of the will of the person: the expression of will must be carried out exclusively in writing, i.e. on an objective material carrier. Consequently, according to the Respondent, the person agrees in advance with the possible legal consequences in case of improper performance of her/his obligations, and in regard to this part, the consequences are predictable for the person. This logic is inherent in the essence of obligations in civil-legal relations.

On the Respondent's opinion, the Applicant unreasonably refers to the possible contradiction of the challenged provision with the constitutional right of a person to judicial protection, since Article 249 of the

Code enables the pledgee to challenge – in accordance with the same Article – the legitimacy of levying execution on the collateral, and in this case the court can suspend the process of levying execution the collateral.

According to the Respondent, within the framework of this constitutional dispute the Applicant obviously challenges the lawfulness of application of the provisions at issue against her.

As for the assessment of contradictory acts passed by the RA Court of Cassation, the Respondent considers that the competence of the RA Constitutional Court does not include consideration of lawfulness of judicial acts and their legal assessment.

Considering the above-mentioned, the Respondent finds that the provisions stipulated by Article 249 of the RA Civil Code are in conformity with the requirements of the RA Constitution. At the same time, taking into account the circumstance that the Applicant challenges the lawfulness of application of the norm, the Respondent makes a motion for the termination of the proceedings of the Case.

5. The RA Constitutional Court states that within the framework of concrete constitutional control, the Applicant points the following two issues:

1. Violation of her right to property as a person having the right of common ownership of the collateral,

2. Failure to ensure the right to judicial protection in the process of levying execution on the collateral by extrajudicial procedure.

Therefore, in order to resolve the constitutional legal dispute raised in the present case, the RA Constitutional Court considers it necessary to address the following issues:

1) Is the procedure for levying execution on the collateral in extrajudicial procedure – according to the interpretation to the latter in law enforcement practice – in consonance with the content of the right to property, protected by the RA Constitution?

2) Do not the legal regulations of Article 249 of the Code restrict the right of access to a court – provided for by the RA Constitution and the European Convention for the Protection of Human Rights and Fundamental Freedoms – to the extent that a person can be deprived of the right to judicial protection?

6. Comparing Article 60 of the RA Constitution with the provisions stipulated by Article 249 of the RA Civil Code, the RA Constitutional Court considers it necessary to address the constitutional legal content of the institution of "deprivation of property." In particular, by the Decision DCC-903 of 13.07.2010, the RA Constitutional Court reaffirmed the following main components of deprivation of property, namely:

"- in the case of deprivation of property, a gratuitous termination of the right to property of the owner takes place **against the will and consent of the latter**;

- deprivation of property is applied as a measure of responsibility;

- in the case of deprivation of property, a simultaneous termination of the powers of the owner to own, use and dispose of the property takes place, without guarantee of continuity."

In legal relations concerning the levying execution on the collateral in extrajudicial procedure, in connection with the expression of the will and consent of the owner of property, it is necessary to state the following:

Firstly, by concluding a pledge agreement, the pledgee gives her/his consent to a possible termination of the right to property in respect of the collateral belonging to her/him in case of failure to perform or improper performance of the obligation secured by the pledge,

Secondly, the pledgee gives her/his consent to the possibility of levying execution on the collateral and realizing it in extrajudicial procedure, in case of failure to perform or improper performance of the obligation secured by the pledge. Moreover, according to Article 249 of the RA Civil Code, such consent can be given both under the pledge agreement and in the form of a separate agreement concluded between the pledgee and the pledgor,

Thirdly, prior to the levying execution on the collateral in extrajudicial procedure by the pledgee, the pledgor has the opportunity either to take measures to fulfill the obligation secured by the pledge – and thereby prevent the loss of the ownership right of the pledged property – or to challenge the legitimacy of extrajudicial execution in court.

In the first two of the above-mentioned three situations (which may coincide in the case of provision in the pledge agreement of the conditions for execution in extrajudicial procedure), the will of the owner of the pledged property is manifested through active actions, i.e.

through the conclusion of a relevant contract or agreement, and the commission of such active activities is an obligatory term. In the third situation, the will of the owner can be expressed by passive actions when, having learned about the execution on the collateral in extrajudicial procedure, she/he does not take any actions prescribed by law to terminate the execution in extrajudicial procedure.

In the latter case, from the viewpoint of protection of the right to property guaranteed by the RA Constitution, the legal regulations of ensuring and effective protection of the rights of the owner are of particular importance.

The RA Constitutional Court states that in the context of the challenged Article, the protection of right to property is closely interrelated with the right to judicial protection. Analyzing the provisions of the challenged Article, it is necessary to single out the following legal guarantees for securing the rights of the owner with respect to the collateral:

1) The proper notification of the pledgor about levying execution on the collateral in extrajudicial procedure (notification of execution),

2) The possibility of challenging in court the legitimacy of execution in extrajudicial procedure,

3) Levying execution on the collateral in extrajudicial procedure within two months after serving the notification of execution to the debtor,

4) The realization of the collateral by the pledgee at a reasonable market price applied at the moment.

On the other hand, Article 249 of the Code establishes a number of obligations of the pledgor, in particular: the court may suspend the process of levying execution on the collateral, "in case the pledgor provides the collateral value to recover the possible losses of the pledgee." Considering this provision in the light of Articles 10 (Guaranteeing Ownership), 60 (Right of Ownership), and 61 (Right to Judicial Protection and the Right to Apply to International Bodies of Human Rights Protection) and 78 (Principle of Proportionality) of the RA Constitution, the Constitutional Court finds that it disproportionately complicates the possibility of the pledgor to suspend the execution in extrajudicial order, since for the suspension it obliges the pledgor to provide guarantee not in the amount of possible losses of the pledgee,

but in the amount of the collateral. In some cases, the amount of the collateral may several times exceed not only the amount of the basic obligation secured by the pledge, but also the amount of possible losses of the pledgee. In terms of such legal regulation, the realization of the right – provided for by law – to suspend the process of levying execution on the collateral mainly becomes unrealizable.

7. The RA Constitutional Court states that the legislative requirement of proper notification of the pledgor by the pledgee (notification of execution) is not an end in itself and has the objective of ensuring the realization of other rights of the pledgor. In particular, the requirement of notification is intended to provide another right of the pledgor, stipulated by Article 252 of the RA Civil Code, according to which: "Debtor or pledgor, who is a third person, shall have the right to terminate the levy of execution on and realization of the collateral at any time before the sales thereof, by fulfilling the obligation secured by pledge or the part thereof the fulfillment of which has been made in default. The agreement limiting that right shall be null and void."

In addition, stipulating by the legislator of the obligation on proper notification of the pledgor by the pledgee pursues the aim of guaranteeing the right of the pledgor to judicial protection.

In this aspect, the RA Constitutional Court finds that Part 2 of Article 249 of the RA Civil Code should be applied in the context of ensuring the rights of the pledgor, stipulated by the aforementioned norms, otherwise the exercise of the rights – provided to the pledgor according to the legislation – of challenging the legitimacy of the execution or terminating the execution will not be effective and will not follow the requirements of the RA Constitution.

On the other hand, in the second and third paragraphs of Part 2 of the challenged Article, the legislator considers the debtor and not the pledgor as the addressee of the appropriate notification. In particular, "After the notification of execution has been properly served to the **debtor**, the pledgee shall have the right to take the collateral into her/his possession (if it is a movable property), as well as to take reasonable measures for preserving, maintenance of the collateral and ensuring its safety. The pledgee shall, by virtue of this Code, have the right – subject to Article 195 of this Code – to realize the collateral

through direct sales or public biddings on behalf of the pledgor, two months after serving the notification of execution to the **debtor**, unless the pledgor and the pledgee have agreed on another procedure for realizing the collateral."

According to the abovementioned regulation, the pledgee shall properly notify both the pledgor and the debtor about levying execution on the collateral, however the pledge shall have the right – by the force of law – to realize the collateral only two months after serving to the debtor.

Stipulation in the challenged Article – at the legislative level – of different addressees, i.e. the pledgor or the debtor might even not cause any problem, in case the pledgor and the debtor were always the same persons. However, the situation changes when the debtor and the pledgor do not coincide. According to Part 2 of Article 228 of the Code, "2. Both a debtor and a third person may be a pledgor."

It follows from the literal interpretation of the challenged Article, that unlike the case of notification of the debtor about the obligation secured by the pledge, in case of notifying a third person – as a pledgor – the day after serving the notification of execution to the latter, the pledgee obtains the right to realize the collateral through direct sales or public biddings.

It should also be noted that although, according to Article 345 of the RA Civil Code, the parties to the pledge agreement, i.e. the pledgor and the pledgee as the parties to the civil legal obligation, are called the debtor and the creditor, nevertheless, it follows from the logic of the challenged Article that the debtor is the party to the main obligation secured by the pledge.

In this regard, the legislator did not clearly and unequivocally regulate the issues whether in what terms after notifying the pledgor, the pledgee may have the right to realize the collateral. The challenged Article does not say anything about the pledgor or pledgors who are not debtors. Such regulations can raise a number of issues from the viewpoint of guaranteeing the fundamental right of a person to property. In particular, due to this uncertainty, the pledgors who are not debtors, in comparison with the pledgors who are debtors, do not enjoy equal terms of protecting their property. An unscrupulous debtor-pledgor who does not perform or improperly performs the obligation secured

by the pledge, shall be obligatorily notified of the execution, and only after two months the collateral may be realized, but the pledgor who is not a debtor might even not enjoy this opportunity, since the two-month period fixed by the challenged position concerns the debtor and not the pledgors. In addition, such regulation may deprive the pledgor, as a third party, of the opportunity to challenge in court the legitimacy of levying execution on the collateral, and in practice it may hinder the implementation of the right stipulated by Article 252 of the Code. This is also evidenced by the study of legal positions expressed in the Decisions of the RA Court of Cassation, rendered in the cases ԵԿԴ/2013/02/12 dated 28.11.2014 and ԵԱԴԴ/0529/02/13 dated 27.11.2015, where in both cases it is a question of proper notification of the pledgors in case of levying execution on the collateral under common joint ownership in extrajudicial procedure.

8. According to Part 1 of Article 10 of the RA Constitution, all forms of ownership shall be recognized and equally protected in the Republic of Armenia.

This constitutional provision includes two most important guarantees of the exercise of the right to property:

- The Republic of Armenia recognizes all forms of ownership, and
- The Republic of Armenia equally protects all forms of ownership.

According to Article 28 of the RA Constitution, everyone shall be equal before the law, and it follows from this, that all entities – who are in a similar situation – shall enjoy the guarantees and procedures provided for by law.

The principle of equality requires the Republic of Armenia that no distinction was made when protecting property owned by different entities within the same form of ownership.

According to Article 75 the RA Constitution, "When regulating fundamental rights and freedoms, laws shall define the organizational structures and procedures necessary for their effective exercise."

The challenged Article 249 of the Code concerns the procedure for levying execution on the pledged property without applying to court, which is a necessary procedure – through the loan agreement – for exercising the right of the owner to dispose of the legally acquired property at own discretion. However, such procedure must be

legitimate, and not violate the principle of equality of all before the law. Analysis of both the challenged provision and the law enforcement practice shows that **the uncertainty of legislative regulation does not provide an opportunity to clearly understand what procedural guarantees the pledgor, who is not a debtor, shall enjoy in connection with the notification of execution,** which makes ineffective the challenged regulation in connection with the pledgor, as a third party.

The RA Constitutional Court finds that from the constitutional legal content of the term "pledgor" prescribed in the first paragraph of Part 2 of Article 249 of the RA Civil Code, it follows that in the given legal relations the term "pledgor" refers not only to the pledgor-debtor, but also the pledgor acting in these relations as a third party. At the same time, from the constitutional legal content of the term "debtor" prescribed in the second and third paragraphs of Part 2 of Article 249 of the RA Civil Code, it follows that the term "debtor" refers not only to the pledgor-debtor, but also the pledgor acting in these legal relations as a third party.

The question is that, not including other pledgors in the wording "two months after serving the notification of execution to the debtor," the legislator does not clearly and unambiguously guarantee this two-month term for the pledgor, which violates the principle of equality of all before the law. As a result, the pledgor, as a third party, can not only be deprived of the right to terminate the levy of execution on and realization of the collateral through the fulfillment of an obligation secured by a pledge or through the fulfillment of the overdue part thereof, but also the right to challenge the legitimacy of levying execution.

Based on the review of the Case and being governed by Point 1 of Article 100 and Article 102 of the Constitution of the Republic of Armenia, Articles 63, 64 and 69 of the Law of the Republic of Armenia on the Constitutional Court, the Constitutional Court of the Republic of Armenia **HOLDS:**

1. Part 1 of Article 249 of the Civil Code of the Republic of Armenia is in conformity with the Constitution of the Republic of Armenia.

2. The first paragraph of Part 2 of Article 249 of the Civil Code of the Republic of Armenia is in conformity with the Constitution of the Republic of Armenia in the constitutional legal content of the term "pledgor" in this paragraph, according to which: the term "pledgor" refers not only to the pledgor-debtor, but also the pledgor acting in these legal relations as a third party.

3. The second and third paragraphs of Part 2 of Article 249 of the Civil Code of the Republic of Armenia are in conformity with the Constitution of the Republic of Armenia in the constitutional legal content of the term "debtor" in these paragraphs, according to which: the term "debtor" refers not only to the pledgor-debtor, but also the pledgor acting in these legal relations as a third party.

4. To declare the phrase "provided the pledgor provides security equal to the value of the collateral" in the first paragraph of Part 2 of Article 249 of the Civil Code of the Republic of Armenia contradicting Part 1 of Article 61 and Article 78 of the RA Constitution and void in regard to the part that the debtor can be obliged to provide security greater than the amount of possible damage to the pledgee.

5. Pursuant to Point 9.1 of Part 1 of Article 64 and Part 12 of Article 69 of the RA Law on the Constitutional Court, the final judicial act rendered against the Applicant is subject to review due to new circumstances, in accordance with the procedure provided for by law.

6. Pursuant to Part 2 of Article 102 of the Constitution of the Republic of Armenia this Decision is final and enters into force from the moment of the announcement.

Chairman **G. Harutyunyan**

July 19, 2016
DCC-1294