Non-Official Translation

IN THE NAME OF THE REPUBLIC OF ARMENIA
DECISION OF THE CONSTITUTIONAL COURT OF
THE REPUBLIC OF ARMENIA

ON THE CASE OF CONFORMITY OF PART 2 OF ARTICLE 47 OF THE LAW OF THE REPUBLIC OF ARMENIA ON BANKRUPTCY WITH THE CONSTITUTION ON THE BASIS OF THE APPLICATION OF "RAMSES" LLC

Yerevan May 26, 2020

The Constitutional Court composed of H. Tovmasyan (Chairman), A. Gyulumyan (Rapporteur), F. Tokhyan, A. Tunyan, A. Khachatryan, H. Nazaryan, A. Petrosyan,

With the participation of (in the framework of the written procedure)**:**

Representatives of the applicant "Ramses" LLC: A. Tevanyan and M. Manukyan,

Respondent: K. Movsisyan, official representative of the National Assembly, Head of the Legal Support and Service Division of the National Assembly Staff,

pursuant to Article 74, Clause 1 of Article 168, Clause 8 of Part 1 of Article 169 of the Constitution, Articles 22, 40 and 69 of the Constitutional Law on the Constitutional Court,

Examined in a public hearing by a written procedure the case on conformity of Part 2 of Article 47 of the Law of the Republic of Armenia on Bankruptcy with the Constitution on the basis of the application of "Ramses" LLC.

The Law of the Republic of Armenia on Bankruptcy **(hereinafter – the Law)** was adopted by the National Assembly on 25 December 2006, signed by the President of the Republic on 22 January 2007 and entered into force on 10 February 2007.

Part 2of Article 47 of the Law, titled: **"Property of the Debtor and its Disposal"**, stipulates:

"After declaring the debtor bankrupt and before adopting a decision on liquidation thereof, the supervisor of the debtor shall act upon the consent and under control of the administrator. The

supervisor of the debtor shall be prohibited to dispose of the property of the debtor or carry out any operation that creates liability in rem for the debtor without the permission of the administrator".

After the adoption of the Law, Article 47 was amended by the Law HO-235-N of 23.06.11 and the Law HO-105-N of 17.06.16.

The case was initiated on the basis of the application of "Ramses" LLC submitted to the Constitutional Court on 28 November 2019.

Having examined the application and the explanations of the parties in the case, other documents of the case, as well as having analyzed the Law and a number of relevant legal acts, the Constitutional Court **FOUND:**

1. Applicant's arguments

The Applicant considers that Part 2 of Article 47 of the Law, as interpreted by the Civil Court of Appeal of the Republic of Armenia, disproportionately restricts the right of the supervisor of the debtor to apply to the court and the right to a fair trial to protect the rights of the debtor declared bankrupt, and, therefore, contradicts Article 28, Part 1 of Article 61, Part 1 of Article 63, Articles 78 and 79 of the Constitution. The Civil Court of Appeal, interpreting the disputed provision, found that both in a court of general jurisdiction and in a bankruptcy court, the debtor cannot dispute the outcome of an auction organized by the bankruptcy administrator acting on his behalf, and in the event of such a request, the bankruptcy administrator cannot act as a respondent.

Comparing Part 2 of Article 47 of the Law with a number of other articles of the Law, the applicant believes that there are mutually exclusive situations. In particular, in one case, after the debtor is declared bankrupt, the court attaches his property, and the administrator carries out the disposal of the property in accordance with the judicial authorization and the sale program approved by the meeting of creditors. In another case, after the debtor is declared bankrupt and the property of the latter is attached, the bankruptcy administrator may authorize the debtor to conclude transactions for the disposal of the property, without taking into account the property sale program and the judicial authorization.

The applicant believes that, according to the current legal regulations of the Law, a situation arises that that the supervisor of the debtor can dispose of the debtor's property only with the

permission and/or with the consent of the administrator; moreover, it follows from Part 4 of Article 47 of the Law that any transaction involving the disposal of property entered into by the supervisor of the debtor, without the consent of the bankruptcy administrator, is void.

The applicant notes that the control by the bankruptcy administrator over the actions of the supervisor of the debtor and entering into transactions by the supervisor of the debtor involving the disposal of property, with the consent of the bankruptcy administrator, counterbalance each other. In other words, the bankruptcy administrator may authorize the supervisor of the debtor to conclude transactions involving the disposal of property without taking into account, inter alia, the attachment of the property by the court in accordance with Article 19 of the Law, and at the same time monitor the alleged bad faith actions of the supervisor of the debtor in the event that bad faith may be shown also by the bankruptcy administrator.

According to the applicant, not all actions of the bankruptcy administrator can be appealed in the course of bankruptcy proceedings, and also in the event of an appeal against the actions of the bankruptcy administrator and recognition of the actions or inaction of the latter as unlawful, the restoration of the violated rights of the person is not fully ensured.

The Applicant insists that the disputed legal norm does not serve the purposes of legal certainty and proper administration of justice, prevents a person from reaching the consideration of his case on the merits by a competent court, and also does not pursue a legitimate aim; as well as there is no reasonable ratio of proportionality between the aims pursued insofar as, due to the consent of the bankruptcy administrator (mutatis mutandis), the possibility of bringing him into action as a defendant is restricted, as well as the right to judicial protection to restore the violated rights is violated.

2. Respondent's arguments

The respondent finds that the financial recovery of the debtor is one of the pivotal elements of bankruptcy proceedings, which aims to provide an opportunity for a bona fide and responsible debtor to overcome financial difficulties, restore his normal activities, at the same time ensuring the protection of creditors' interests.

According to the respondent, due to the peculiarities of the bankruptcy proceedings, after the adoption of the application for declaring the debtor bankrupt, a number of restrictions shall be applied to the debtor. These restrictions are not an end in itself; they are aimed at preventing a significant

decrease in the debtor’s property in the bankruptcy process, with the aim of ensuring proportionate satisfaction of creditors’ claims according to the priority established by law, which is carried out under the supervision of the court.

The respondent notes that it follows from a systemic analysis of the current provisions of the Law that, in addition to exercising supervision, the administrator shall have the right to alienate the debtor's property by direct transaction with the permission and under the control of the court.

Having studied the international experience, the respondent found out that in many countries, the state authorized body controls bankruptcy administrators and brings them to disciplinary responsibility. In addition, the laws of certain countries expressly provide for the exercise of control over bankruptcy administrators by the court.

According to the respondent, when interpreting the disputed provision, it is taken into account that the performance of the administrator’s actions presupposes judicial control, which aims to protect the debtor’s property from any alienation not prescribed by the Law or legislation of the Republic of Armenia and, at the same time, to ensure fair and equal satisfaction of the creditors’ claims.

As a result of a comparative analysis of the current legal regulations, the respondent concludes that the attachment of the property in a bankruptcy case is aimed at ensuring further satisfaction of creditors' claims and does not pursue the goal of excluding the alienation of property.

The respondent finds that Part 2 of Article 47 of the Law is in conformity with the Constitution and in no way contradicts the rights to equality of all before the law, judicial protection, a fair trial, and the principles of proportionality and certainty, since within the framework of the regulated legal relationship it makes more efficient the process of proper performance of the debtor’s obligation to pay.

3. Procedural background of the case

The applicant - the supervisor of the debtor in the bankruptcy case, submitted a claim to the Court of General Jurisdiction of Yerevan with the request to declare void the auction of real estate and the sale and purchase agreements concluded as a result of this, and the state registration of rights executed on their basis, involving, inter alia, the bankruptcy administrator as a respondent. By the decision of 7 February 2019, this Court returned the statement of claim with the motivation that it falls under the jurisdiction to the bankruptcy court, and referring to Part 2 of Article 4 of the Law, which, in

the version in effect at the time of the adoption of the decisions in the applicant's case, established: “All civil disputes arising in relation to the debtor’s rights and the objects included in the property of the debtor in the bankruptcy case, in which the debtor acts as a respondent or a third party acting on the respondent’s party, are considered in the framework of the same bankruptcy case”. By the decision of 20 March 2019, the RA Civil Court of Appeal upheld the said Decision of the first instance court. Further, with the same claim, the applicant applied to the Bankruptcy Court, which also, referring to Part 2 of Article 4 of the Law, by the decision of 16 April 2019, returned the statement of claim with the motivation that in his application the applicant indicated the bankruptcy administrator as a respondent. By the Decision of 27 May 2019, the Civil Court of Appeal of the Republic of Armenia, referring, inter alia, to Part 2 of Article 47 of the Law, expressed the legal position that the submitted claim is not subject to consideration either in the framework of a bankruptcy case or in a civil process, since the bankruptcy administrator acts on behalf of the debtor, and a situation occurs when the debtor is both the plaintiff and the respondent. In both cases, the Court of Appeal noted that the decision shall enter into force as from the date of its adoption and is not subject to appeal.

4. Circumstances to be ascertained within the framework of the case

The Constitutional Court notes that, in the courts considering bankruptcy cases, the provision challenged by the applicant has not yet been applied in his case by a judicial act on the merits, and the applicant challenges the constitutionality of the mentioned provision in the interpretation by the law enforcement practice, which makes it possible to dismiss the claim that he submitted to the court. Taking into account that the applicant, in essence, raises the issue of restricting the debtor's right to judicial protection, due to the uncertainty of legislative regulations regarding the disposal of the debtor’s property in bankruptcy cases, the Constitutional Court accepts the challenged provision for consideration from the perspective of its compliance with Part 1 of Article 61, Part 1 of Article 63 and Article 79 of the Constitution and considers it necessary to clarify the following:

1) Taking into account the interpretation by the law enforcement practice, does the disputed provision violate the fundamental rights of the debtor in the bankruptcy case to judicial protection and a fair trial?

2) From the perspective of ensuring the debtor’s rights to effective judicial protection and a fair trial, does the disputed provision comply with the constitutional principle of certainty of restricting fundamental rights and freedoms?

5. Legal assessments of the Constitutional Court

5.1. The Constitutional Court notes that the purpose of the bankruptcy process is to form guarantees, on the one hand, for the proportional satisfaction of creditors' claims, and on the other hand, to stabilize, in such cases, the debtor's property status (restoration of the debtor's solvency) and to ensure the duration of his economic activity.

The Constitutional Court reiterates the legal position expressed in the Decision DCC-735 of 25 February 2008, that "the purpose of the bankruptcy institution is to provide an opportunity for a bona fide and responsible debtor to resume his normal activities, overcome financial difficulties, as well as to ensure reconstruction and financial reorganization of insolvent organizations, resume their viability and **at the same time ensure the protection of the creditors' interests**", and the Constitutional Court emphasizes that in each case, the interests of various stakeholders, including debtors, must be taken into account in the bankruptcy process.

According to Part 1 of Article 3 of the Law, the debtor may be declared bankrupt by a court judgment at own initiative (application for voluntary bankruptcy) or upon the claim of the creditor (application for compulsory bankruptcy), if the debtor is insolvent. Together with initiating proceedings on the bankruptcy petition, the court appoints an interim bankruptcy administrator, and after the entry into force of the decision on declaring the debtor bankrupt, the court immediately appoints a bankruptcy administrator and terminates the powers of the interim administrator.

The powers of the bankruptcy administrator are established by Article 29 of the Law, according to part 3 of which, the administrator shall act on behalf of the debtor and at his own responsibility while exercising the powers defined by Law. The administrator, inter alia, appeals to the courts on behalf of the debtor on issues subject to resolution in court, he is involved in those proceedings of the debtor in which the latter acts as a plaintiff, respondent or a third person making independent claims (without a power of attorney) with respect to the subject of the dispute on behalf of the debtor, and monitors the performance of the duties of the supervisor of the debtor.

5.2. In a number of decisions, the Constitutional Court addressed the principle of legal certainty, in particular, noting that:

1) “The norm cannot be considered as a “law” if it is not formulated clearly enough to allow natural persons or legal entities to bring their behavior in line with it; they must be able to foresee the consequences to which this action may lead” (DCC-753);

2) “… As one of the fundamental principles of the rule of law state, the principle of legal certainty also presupposes that the actions of all subjects of legal relations, including the holder of power, must be foreseeable and legitimate” (DCC-1213).

Taking into account the above-mentioned assessments, in order to assess the certainty of the disputed provision of the Law, it is necessary to pay attention to the circumstances to what extent the rules of conduct prescribed therein are *precise* and *certain*; and whether they do not lead to misunderstanding, and to what extent the consequences of their implementation are foreseeable.

According to Article 47 of the Law disputed in the present case, after declaring the debtor bankrupt and before adopting a decision on liquidation thereof, the supervisor of the debtor shall act upon the consent and under control of the administrator, and upon the permission of the administrator may also take actions to dispose of the debtor's property or other actions that lead to a property obligation for the debtor; and after the decision on liquidation has been made, he is deprived of the rights to dispose and manage the property. That is, the legislator has distinguished between two separate stages of bankruptcy proceedings, for which, depending on the objectives and goals of the certain stage, the legislator has prescribed different regulations, which, in itself, does not cause any legal uncertainty.

With regard to the applicant’s assertion that, as a result of the disposal of the property by the debtor with the permission of the administrator, it is allowed to sell the attached property without the judicial authorization (thus making meaningless the role of the court), it should be noted that the attachment of the debtor's property is carried out within 7 days after the adoption of the decision on liquidation of the debtor (Part 1 of Article 71 of the Law), and the authority to dispose of the property by the supervisor of the debtor with the permission of the administrator *concerns the period before the decision on liquidation is made*; therefore, there are no contradictory or, in other words, vague regulations also in this aspect.

5.3. In the light of the principle of the rule of law, the fundamental rights to judicial protection and a fair trial guaranteed by Part 1 of Article 61 and Part 1 of Article 63 of the Constitution require a

person to have *effective* judicial remedies that will enable him to bring a relevant claim before the court and protect his rights.

According to the case law of the European Court of Human Rights, the requirements of Article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms regarding the right to a fair trial also apply to bankruptcy proceedings (Ismeta Bacic v. Croatia, no.43595/06, 19.06.2008, § 19; Capital Bank AD v. Bulgaria, no.49429/99, 24.11.2005, § 86 etc).

From the perspective of fundamental rights to judicial protection and a fair trial, the disputed provision of the Law should be considered within the framework of procedural guarantees regarding bankruptcy proceedings, which should be aimed at comprehensive and balanced protection of the rights and interests of all parties involved in bankruptcy proceedings.

Thus, Article 4 of the Law, titled "Subject-matter Jurisdiction over Bankruptcy Cases", establishes that bankruptcy cases shall be handled in courts of general jurisdiction (hereinafter - the court). In court, bankruptcy cases shall be handled by a specialized bankruptcy judge alone. In the framework of a bankruptcy case, the same judge also considers civil cases as separate civil cases in disputes arising in relation to property and rights included in the property of a bankrupt debtor, subject matter of a secured right belonging to a third party, contracts concluded with the participation of the debtor and the creditor, including on measures to ensure the fulfillment of obligations, and on disputes affecting the ability to satisfy the claims of creditors. According to Part 6 of Article 20 of the Law, these decisions may be appealed.

The debtor and the creditor may appeal before the judge trying the bankruptcy case against the actions or inaction of the administrator. The appeal may be brought before the court within 10 days from the day when the appellant has learnt or should have learnt about the infringement of his right.

The procedure for appeal and the responsibility of the administrator are regulated by Articles 31-32 of the Law.

Referring to the applicant's assertion that the legislator, in accordance with the general rule, established legal regulations regarding bringing the bankruptcy administrator to property liability, nevertheless, did not stipulate any provision (through a special rule) on the material liability of the bankruptcy administrator, the Constitutional Court states that in Part 1 of Article 25 of the Law, the

legislator has established **the obligation of the administrator to insure his civil liability for the damage caused to persons participating in the bankruptcy case**. According to Part 2 of the same Article, the debtor or creditor, having incurred damages through the fault of the administrator, shall be regarded as the beneficiary of the sum insured. If the court finds, that **the beneficiaries have suffered damage through the fault of the administrator, the compensation thereof shall be carried out from the insured sum of the administrator, and if it is insufficient - from the property of the administrator**.

5.4. According to Article 75 of the Law, **the sale of the debtor's property shall be carried out by the administrator** in accordance with the sale program presented by him based on the results of the inventory and approved by the creditors' council, and if the council is not formed, by the creditors' meeting, and with the permission of the court **through public tenders** or **direct transactions**.

Although **the administrator carries out** the sale of the debtor's property **independently, it must be mandatory preliminarily agreed upon with the meeting of creditors**, which, in turn, approves the property sale program. In addition, **the judicial authorization is also required for the sale of property**.

In accordance with Part 1 of Article 76 of the Law, in order to sell the debtor's property through public auction, the administrator must file a motion with the court notifying the creditors of it three days prior thereto. The motion must indicate the location of the property, the description thereof, **the initial price offered at auction**, the date of holding the auction, and **property appraisal report** (or the opinion in case of appraisal by an independent appraiser) **shall be attached to the motion**.

According to Part 2 of the same Article, **within a seven-day period the creditors shall be entitled to file a written objection with the court against the administrator's motion on authorizing the sale of the debtor's property by public auction and to offer a higher initial price** by making a deposit to the special bankruptcy account to the extent of five percent of the initial price offered by the administrator for the property sale, which shall not be more than five million AMD; and if more than one creditor has filed an objection, the realization of the property through public auction shall be authorized at the highest initial price offered. On the eighth day following the receipt of the administrator's motion, the court shall adopt a decision on authorizing the sale of the property, unless any of the creditors has filed an objection, or authorizing the sale of the property at the price offered by

a creditor by declining to satisfy the administrator’s motion, or rejecting the administrator’s motion, if the administrator has not observed the requirements prescribed by this Law.

The Constitutional Court considers that **the bankruptcy administrator, having a fairly wide range of powers and having sufficient independence, nevertheless, in actions to assess and sell the debtor's property, is burdened (limited) by the judicial authorization and the approval of the creditors' meeting**. It follows from the above that the legislator has created sufficient guarantees to control the actions of the administrator and to avoid possible arbitrariness.

5.5. In view of the above, the Constitutional Court states that **the legislator has established legal regulations, through which, initially, the legislator, for objective reasons, minimized the possibility of arbitrariness on the part of the administrator in the course of the sale of the debtor's property through public auction**.

Article 23.1 of the Law stipulates the rules of conduct for the administrator. According to this, the administrator, inter alia, must ensure a respectful and impartial attitude towards the debtor and creditors, and contribute to building trust among the administrators.

The analysis of the Law shows that the Law does not envisage the absolute freedom of the administrator to dispose of the debtor's property at his own discretion, and all costs incurred at the expense of the debtor's property must be reasonable, necessary and justified.

However, the failure (inaction) or improper, unfair performance by the bankruptcy administrator of a number of actions within the framework of his powers, in particular, the unfair inventory and protection of the debtor's property can lead to serious violations associated with the formation of insolvent estate included in the property in the bankruptcy case, and further disposal of the property, which, in turn, can lead to violation of the rights of participants in the bankruptcy process, causing damage to the debtor and creditors.

The property interests of the debtor and creditors may be contradicted by the conclusion of the bankruptcy administrator of such possible transactions that do not contribute to the restoration of the debtor's solvency and the payment of the creditors' debts in sufficient amount, since they have led to a reduction in the total value of the debtor's assets; for instance, the sale of the debtor's property at a price significantly below market value, especially in cases where the difference between the transaction price and market value is significant.

The Constitutional Court considers that in such cases, by virtue of the Law, the participants in the bankruptcy process, including the debtor, are entitled to apply to the court for the protection of their interests, and the disputed provision of the Law is not an obstacle to the exercise of his rights to judicial protection and a fair trial.

Based on the review of the case and governed by Clause 1 of Article 168, Clause 8 of Part 1 of Article 169, and Article 170 of the Constitution, as well as Articles 63, 64 and 69 of the Constitutional Law on the Constitutional Court, the Constitutional Court **HOLDS:**

1. The provisions of Part 2 of Article 47 of the Law of the Republic of Armenia on Bankruptcy are in conformity with the Constitution in the interpretation that these provisions do not hinder the exercise of the debtor's rights to judicial protection and a fair trial.

2. Pursuant to Part 10 of Article 69 of the Constitutional Law on the Constitutional Court, the final judicial act issued in respect of the applicant shall be subject to review in the manner prescribed by law on the basis of a newly revealed circumstance, since Part 2 of Article 47 of the Law of the Republic of Armenia on Bankruptcy was applied to the applicant in an interpretation other than prescribed in Clause 1 of this Decision.

3. Pursuant to Part 2 of Article 170 of the Constitution this Decision shall be final and shall enter into force upon its promulgation.

Chairman **H. Tovmasyan**

May 26, 2020
DCC -1542