The Legal 500 Country Comparative Guides

Armenia: Restructuring & Insolvency

This country-specific Q&A provides an overview to restructuring & insolvency laws and regulations that may occur in Armenia.

For a full list of jurisdictional Q&As visit here

Contributing Firm

Concern Dialog Law Firm

Authors

Artur Hovhannisyan
Counsel, Attorney
The Legal 500
artur.hovhannisyan@dialog.am

Silva Asatryan
Attorney
silva.asatryan@dialog.am

Arshaluys Berberyan
Junior Associate
arshaluys.berberyan@dialog.am

1. **What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?**

Generally in Armenia for securing the fulfilment of obligations, there are several types of security, also related to movable and immovable property.

For immovable property, the main security is a mortgage, which is a pledge of immovable property (as well as a pledge of a right to land development or a right to purchase immovable property in a multi-apartment or subdivided building under construction).

As to movable property, we have not only the pledge but also the withholding of debtor's property. In case of the latter a creditor, who holds the property subject to be transferred to the debtor or the person indicated thereby, shall have the right — in case of failure by the debtor to fulfil the obligation of paying for that property or compensating the expenses incurred by the creditor in relation thereto and other damages — to withhold the property until the fulfilment of the respective obligation. The order of satisfaction of claims, in this case, is similar to pledge, as the claims of a creditor withholding a property shall be satisfied from its value in the volume and under the procedure envisaged for the satisfaction of claims secured by a pledge.

In case of pledge of movable property we have 6 types: (1) security deposit;(a pledge where the collateral passes to the possession of the pledgee shall be deemed to be a security deposit) (2) pledge of property handed over to a pawnshop; (3) pledge of rights; (4) pledge of monetary means; (5) hard pledge; (the pledge the collateral of which is left with a pledgor under the lock of the pledgee or with marks attesting the pledge, as well as the collateral left with a pledgor or the right of pledge to which is registered as prescribed by law)(6) pledge of goods in circulation.

As about the formalities, the withholding of the property doesn't suppose the conclusion of the contract, and it is based on the relations already existing between parties.

The contract of mortgage shall be concluded in writing, with the signature of pledgor and pledgee, as well as of debtor, when a pledgor is not a debtor, and when an agreed expression of the will of three and more parties is needed for the conclusion of such contract — with the signatures of other parties, by drawing up one single document. In case of issuance of mortgage-backed securities based on a prospectus, the contract of mortgage may be concluded through an exchange of instruments. The contract of mortgage shall be notary certified. The right of pledge under the contract of mortgage shall be subject to registration.

As about generally the pledge, the contract of pledge shall be concluded in writing. Failure to observe the rules of conclusion in writing, of notary certification and of registration shall lead to invalidity of the contract of pledge. Such a contract shall be null and void.

2. **What practical issues do secured creditors face in enforcing their security (e.g. timing issues, requirement for court involvement)?**

   As practical problems that secured creditors face in enforcing their security could be the following

   1. Challenging the validity of the transaction, on which is based the claim. For that reason, the registration of the claim can take a long time.
   2. The inflation of collateral during the long procedure of bankruptcy
   3. The damage of the collateral by the debtor in which possession is the it
   4. The inflation of the price of the property on each auction in case of selling the property through public biddings

3. **What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?**

   A) The Armenian legislation gives two types of insolvency: Balance-sheet insolvency and factual insolvency.

   Factual insolvency is if the debtor has delayed, for 60 or more days, the fulfillment of indisputable payment liabilities, which exceed 1000-fold of the minimum monthly salary as defined by law, and if the mentioned delay continues at the moment of making the judgment.

   In case of balance-sheet insolvency the liabilities of the debtor exceed the value of the debtor’s assets in the amount of 1000 fold or more minimal salaries as established by law according to an estimation conducted on the basis of accounting rules in case of a legal person, and according to an estimation conducted on the basis of estimation standards, in case of a natural person. The value of assets shall not include the value of those assets which may not be levied in execution in accordance with the law.

   In Armenia there are other regulations for Banks, credit organizations, investment companies, investment fund managers and insurance companies.

   This type of organization shall be considered insolvent if:

   a. it has exhausted 50 percent or more of its core capital;
   b. It is unable to meet the legitimate claims of its creditors;
   c. The aggregated score of its indicators is below the threshold established by the Central Bank Board; or
   d. It regularly fails to comply with mandatory reserve requirement provided for by the law.

   The standard for regularity shall be established by the Board of the Central Bank of Republic

of Armenia Central Bank and shall be the same for all these organizations operating in the Republic of Armenia.

The state or local self-government bodies shall be obliged to apply to the court with a claim of declaring the debtor bankrupt in the following cases and time limits:

(a) the respective competent state authority, within six months from the moment of revealing the liability in connection with the delay of payment of taxes, duties, customs, and other mandatory payments or fines arising from administrative actions;

(b) the head of community, within six months from the moment of revealing the liability in connection with the delay of payment of local duties or mandatory payments, as well as delay of fulfilling other liabilities in terms of cash claims of the community.

If in the course of compulsory enforcement of the judgment on levying execution on property it appears that, under the circumstance of enforcing levy of execution on all the property of the debtor for satisfying the claim of the creditor (claimant) through any enforcement proceeding (proceedings) of the compulsory enforcement service, the facts show that the property is insufficient into amount of 1000 or more minimal salaries for complete fulfillment of obligations, or in case of satisfaction of the claim of one creditor, the complete fulfillment of liabilities with respect to any creditor (claimant) will be impossible through the given or other enforcement proceeding (proceedings) due to the insufficiency of the property into amount of 1000 or more minimal salaries, the compulsory enforcement officer shall be obliged to suspend the enforcement proceeding (proceedings) immediately and offer to creditor or debtor to file an application with the court.

The debtor also has the obligation to file an application with the court. In case of failure to comply with the duty of applying to court the person that had this obligation, including also the debtor, that he also had, shall bear personal liability in rem.

4. **What insolvency procedures are available in the jurisdiction? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?**

In Armenia the insolvency is a ground for starting bankruptcy procedures or procedure of danger of bankruptcy. In bankruptcy procedures the general control is done by the administrator, which has a special qualification, in exclusion of investment funds, as in this case generally the powers of temporary administrator are exercised by its custodian.

The situation is a bit different for Banks, credit organizations, investment companies, investment fund managers and insurance companies. In this case the insolvency does not necessarily cause a bankruptcy procedure, as the decision is made by The Central Bank of the

Republic of Armenia, and If any of the insolvency grounds provided has been revealed the Central Bank, it can file bankruptcy claim with the Court, or Appoint the Head of Provisional Administration for reestablishing the solvency of the Organization. If the Central Bank files bankruptcy claim and the insolvency of this Organization is established by court, it is a subject to liquidation. It's important to mention that the appointment of administration does not limit the right to file bankruptcy claim if it becomes obvious in the period of Provisional Administration that by means of liquidation it will be possible to secure more assets of the bank than in case of continuation of Administration, or that it is impossible to reestablish stable solvency of the bank.

As the legal system of the Republic of Armenia has the characteristics of continental law, here we have the exact enumeration of legal requirements what is necessary to do and to present in bankruptcy procedure so here the Court has passive role. Generally it appraises the compliance and the sufficiency of presented documents. Of course it has some power, but its role is generally passive. For example the court appoints the (temporary) administrator, which candidature can also be presented by parties, approves the financial recovery plan etc, it generally controls the procedure.

As about the stakeholders, if they are creditors, they must present their claims according an order prescribed by law for satisfaction of their claims. Other stakeholders generally doesn't play any role.

As to the duration of the procedure, it's important to mention that it depends on the circumstances and situation.

5. **How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities)? Could the claims of any class of creditor be subordinated (e.g. equitable subordination)?**

In Armenia there are 3 types of claims, and dependent on the type, the satisfaction procedure varies.

Particularly there are secured claims, unsecured claims and secondary unsecured claims. The procedure can be a bit different for Banks, credit organizations, investment companies, investment fund managers and insurance companies, as these relations are regulated by a special law.

Generally, we can say that the priority is related to the legal status of creditors, and particularly the secured creditors have more favourable status.

In the case of unsecured claims, there is a special order of satisfaction

Creditors' claims shall be satisfied pursuant to the following ranking:

(a) remuneration of the Administrator and administrative expenses,

(b) claims of citizens, to whom the debtor bears responsibility for inflicting injury to the life or the health – by way of capitalization of the corresponding regular payments – as well as alimony claims (child, incapacitated parent, incapacitated spouse) against the debtor-citizen;

(c) claims deriving from employment contracts (including claims incurred within the period when the judgment on declaring the debtor bankrupt entered into force and up to the liquidation of the debtor) but not more than during six months preceding the moment of declaring the debtor bankrupt, payment of remuneration on copyright contracts and mandatory social payments deriving from the satisfaction of claims within this ranking, also social contribution and income tax related to satisfaction of these claims

(d) legal expenses;

(e) current tax liabilities related to the sale of the debtor's property, after the moment the judgment on declaring the debtor bankrupt entered into legal force

(e1) Before the final confirmation of list of creditors' claims the court can permit to assume new financial obligations according to administrator's, debtor's or creditor's request, but after the confirmation of final list it can be done only if creditor (meeting of creditors) agrees. All these financial liabilities are in this rank.

(f) unsecured claims, incurred from the moment the judgment on declaring the debtor bankrupt entered into legal force, as a result of operations (including the resumption of activity) carried out in the manner prescribed by this Law;

(g) claims of unsecured creditors, including liabilities incurred from tax payments, other mandatory payments, administrative fines with respect to the State Budget and community budgets of the Republic of Armenia except for claims of unsecured secondary creditors;

(h) claims of unsecured secondary creditors,

(i) claims of the debtor's founders (participants, shareholders, members or partners).

6. **Can a debtor's pre-insolvency transactions be challenged? If so, by whom, when and on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?**

    1. Not later than within six months after the confirmation of final list of claims of creditors,

the Administrator shall apply for recovering the following through judicial procedure:

(a) non-refundable (including non-cash) transfers of the debtor to persons affiliated to the debtor that were made during the five years preceding the declaration of the debtor as bankrupt;

(b) non-refundable transfers of the debtor to any third parties that were made during the three years preceding the filing of a bankruptcy application;

(c) any transfer (including non-cash) made during the 90 days preceding the filing of the bankruptcy application (within one year where the transfer was made to an affiliated person) to the creditor or for the obligation previously assumed in favor of the latter, at the moment of which the debtor was insolvent and the creditor has received essentially more than it would receive in a bankruptcy proceeding, in case of liquidation of the debtor;

(d) the damage caused to the debtor as a consequence of transactions, transfers and alienations of property during the three years preceding the declaration of the debtor as bankrupt, which results from the difference between the realization value of the property, service, work and the market value thereof at the time of performance of the transaction, except for the cases when the transaction has been concluded on the basis of public auction.

e)The collateral of the secured rightlevied in execution according to the agreement of netting or of security contract between the debtor and the creditor, if the following conditions are satisfied:

1) the agreement of the netting and (or) the contract of security had been concluded during the 90 days preceding the filing of the bankruptcy application

2) In the moment of the conclusion the bankruptcy or its probability was predictable for the debtor

3) The conclusion of that type of agreement or contract was not based on the interests of the debtor, and it is concluded only for removing the assets from bankruptcy procedure.

The administrator files an application for the above-mentioned claim, if them meeting of creditors had not decided on abstaining to file an application for certain claim. This type of decision can be made if because of filing this application the expenses incurred by the administrator will reasonably exceed the returning value.

When declaring the transaction invalid in the bankruptcy procedure, it is important to take into consideration the regulations connected to good-faith acquirers for protection of third persons’ rights.

7. **What form of stay or moratorium applies in insolvency proceedings against the continuation of legal proceedings or the enforcement of creditors' claims? Does that stay or moratorium have extraterritorial effect? In what circumstances may creditors benefit from any exceptions to such stay or moratorium?**

   The consequences of moratorium vary according the fact whether the bankruptcy application is accepted for proceedings, or not, and also whether we have the danger of bankruptcy or really bankruptcy. Generally, the satisfaction of all claims is suspended, but there are exceptions and certain possibilities.

   The moratorium shall not cover

   (a) levy of execution of alimony;

   (b) remuneration of the temporary administrator, administrative and other expenses necessary for current activities of debtor set by the intermediate allocation plan.

   (c) the subject of the secured right held by the secured creditor, if the court permits to sell this without applying to the court etc.

   The creditor that has secured rights to the debtor and they have agreement on realizing(selling) of the subject without applying to the court, can apply to the court for receiving that permission in case of announcement of bankruptcy, and after the permission he can do that.

   Upon the request of an interested person, the court shall make a decision on allowing the performance of certain activities during moratorium, where:

   (a) there is a need to provide equivalent protection;

   (b) the given property is not subject to sale (realization).

   2. Upon the request of creditor or debtor, the court shall – during the moratorium – permit settlement of cross liabilities of the same type.

   But generally, there are some limitations.

8. **What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play?**

The following measures may be carried out within the framework of the financial recovery plan:

(a) sale of the whole or part of the debtor’s property;

(b) transfer of the debtor’s property to creditors through settlement;

(c) pledging of debtor’s property;

(d) termination of unprofitable activities and change of sphere of entrepreneurial activity;

(e) amendment or termination of unprofitable transactions;

(f) debt restructuring (extending the terms for debt repayment, rescheduling, releasing from liabilities);

(g) debt refunding through securities;

(h) levy of execution on accounts receivable;

(i) receiving a new loan;

(j) undertaking new investments;

(k) reorganization of the debtor;

(l) issuing new shares or buy-back;

(m) The alienation, leasing, pledging or any other encumbrance of shares (stocks, property shares and other securities provided by law) in the debtor organization constituting the property of its participant (participants)

(n) other measures not proscribed by law.

9. **Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?**

Yes, but generally there are not special priorities provided by law.

10. **Can a restructuring proceeding release claims against non-debtor parties (e.g. guarantees granted by parent entities, claims against directors of the debtor), and, if so, in what circumstances?**

When an economic partnership is reorganized into a limited liability company, each full partner, while becoming a participant in the company, within two years shall bear a subsidiary liability with all its property for liabilities transferred from the partnership to the company. Alienation of the shares belonging to it by the former partner shall not release it from such a responsibility.

Generally we have financial recovery only if the debtor has become clean of the debts.

11. **Is it common for creditor committees to be formed in restructuring proceedings and what powers or responsibilities do they have? Are they permitted to retain advisers and, if so, how are they funded?**

The Administrator shall convene a meeting to discuss the financial recovery plan (plans) whereto the debtor shall be invited not later than within 20 days after the expiration of the date for submitting the financial recovery plan as specified by this Law or by a court decision on extension. Information on convening the meeting shall be published in printed media that publishes information on state registration of legal persons by stating the name (title) of the person presenting the plan (plans) and the date of convening the meeting.

In case of discussing more than one financial recovery plan, all the plans shall be voted for during one meeting.

Only those creditors with approved claims may take part in voting, except the creditors with secured claims, claims of the debtor’s founders (participants, shareholders, members or partners).

The Financial recovery plan is voted by secured creditors, if all creditors of the bankruptcy procedure are secured creditors. In case of monetary obligations related to the budget of the Republic of Armenia, the creditors can participate in voting of financial recovery plan in cases provided by the Government, but if these obligations are related to the community budget, the creditors can participate in voting and vote in favor of financial recovery plan, if there is the decision of the Community Council.

The financial recovery plan shall be deemed adopted when voted for by simple majority of creditors, whereon the meeting shall take a decision.

Where more than one plan is discussed, they shall be voted in accordance with the priority of

submission. The remaining plans shall not be voted after the financial recovery plan was adopted.

It means that the financial recovery plan of the debtor can be adopted and presented to the court if it has received the simple majority of votes of creditors.

Generally the meeting of the creditors does not include specialists, this power has the administrator, and the remuneration of these specialists is done at the expense of debtor.

As the administrator participates in the meeting of creditors, he can apply his power.

It is important to mention that there is not interdiction for creditors to have advisers at their own

expense.

The following shall fall within the exclusive jurisdiction of the Meeting:

(a) approval of the financial recovery plan and submitting a recommendation to the court on the extension of the implementation period of the plan;

(b) approval of the composition of the Board of Creditors and the early termination of powers of the Board or its individual members;

(c) adoption of its statute,

(d) adoption of other decisions falling within the exclusive jurisdiction of the Meeting as prescribed by this Law.

The Board shall not be formed where the number of creditors with registered claims is less than 10. In such cases, as well as in other cases when a board of creditors is not formed, the powers of the Board shall be exercised by the Meeting.

12. **How are existing contracts treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any ability for either party to disclaim the contract?**

Contractual obligations of property alienation may not be fulfilled from the moment the judgment on declaring the debtor bankrupt enters into legal force. In exceptional cases, upon the motion of the Administrator, the fulfilment of the debtor’s obligation of property

alienation may be authorized by the court decision based on the peculiarities of the debtor's activities, property, transactions and other circumstances.

When a person having purchased the property of the debtor, has obtained ownership right to the property prior to the complete settlement of the sale amount, the transaction shall be deemed complete in case of fulfilment of his or her obligation in full within a ten-day period after receiving the request of the Administrator.

If the debtor was constructor of multi-apartment house or subdivided building, and the building belonging to debtor is burdened with the right of third persons to purchase immovable property in a building under construction based on contract, in case of payment of final price by that person at the expense of bankruptcy in one month after the claim of the administrator, the administrator concludes an act of transfer on behalf of the constructor and transfers the right of property to that person on that separate unit.

3. Employment contracts of the debtor shall be rescinded in the manner prescribed by thelaborlegislation of the Republic of Armenia.
4. The party to the contract may require compensation for the actual damage incurredas a result ofearly rescission of the contract by filing a claim in the manner prescribed by this Law.

Where regular payments (by the debtor) are provided for by the contract, the Administrator may fulfil them only after the list of claims and the ranking of claims defined by this Law are approved by the court

Restrictions above-mentioned are not relevant to transactions and their execution, which extrajudicial realization is permitted by the court.

13. **What conditions apply to the sale of assets / the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets "free and clear" of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted? Are pre-packaged sales possible?**

Generally the bankruptcy legislation of the Republic of Armenia does not contain special interdictions to make a decision before or after the bankruptcy procedure about the sale of entire company or a part of it through one lot. If the administrator can organize the sale of the bankrupt company or of its part as active business, the price of the sale will be more than if the selling of property of the company is organized in separate lots.

The sale of assets/ of entire business/ can be through public auctions and also through direct sales. The Buyer acquires this property clear and free of claims and liabilities. For collateral of secured right we have special order of its realization, but there are certain conditions that must be satisfied.

If the secured creditor has not presented its application of realization of collateral through extrajudicial order, this property is treated as other properties and can be sold without the consent of the secured creditor.

The receivables of debtor are treated as other properties of the debtor and are a subject of sale as ordinary property.

14. **What duties and liabilities should directors and officers be mindful of when managing a distressed debtor? What are the consequences of breach of duty? Is there any scope for other parties (e.g. director, partner, shareholder, lender) to incur liability for the debts of an insolvent debtor?**

There are special situations when the debtor has the obligation to file bankruptcy application, and if the legal entity is in liquidation, the liquidation commission has the obligation to file bankruptcy application if it turns out that the price of its property is insufficient for satisfaction of creditors' claims.

As about the responsibility and liabilities, if the debtor (both legal entity and natural person) fails to file bankruptcy application, if it is obliged, in this case, this debtor (it can be also director, shareholder..) shall bear subsidiary responsibility with respect to the creditors for those liabilities of the debtor which have arisen after the expiration of the two month period after revealing the respective grounds.

15. **Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions?**

Generally, the bankruptcy procedure does not release the directors and other stakeholders from liability for previous actions and decisions. The administrator can also present a claim for compensation of damages against the director that has concluded transactions against the interests of legal entity before its insolvency.

16. **Will a local court recognise concurrent foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition? Has the UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments been adopted or is it under consideration in your country?**

Civil procedure code of Armenia has a special chapter about the recognition of the decision made by the foreign court.

UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments have not been adopted in Armenia

17. **Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction?**

    According to Armenian legislation any legal or natural person may be a debtor in bankruptcy proceedings, except for (a) the Republic of Armenia; (b) a community; (c) the Central Bank of the Republic of Armenia, (c) the Insurance Foundation for Servicemen.

18. **How are groups of companies treated on the restructuring or insolvency of one of more members of that group? Is there scope for cooperation between office holders?**

    Generally they don't have special legal status in these proceedings

19. **Is it a debtor or creditor friendly jurisdiction?**

    Armenian insolvency law tries to strike a good balance between the rights of debtors and creditors.

20. **Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the state play in relation to a distressed business (e.g. availability of state support)?**

    In practice the employer or appointed administrator can terminate the employment contract referring to bankruptcy procedure, but in bankruptcy procedure the termination of employment contracts is done according to labor legislation without violation of rights of workers.

21. **What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?**

    1. Failure to observe the reasonable terms of civil proceedings, which is in result of unreasonable appellation of court decision ad also unreasonable challenging of transactions that are grounds for bankruptcy.
    2. The unprofessionalism of administrators in bankruptcy procedure
    3. Ineffective mechanisms of administrators' responsibility
    4. The ineffective order of notification in bankruptcy procedure, as generally the notification about the bankruptcy is published in official website of public notifications, and the creditors may frequently not be aware of the bankruptcy for exercise their rights in prescribed terms.
    5. The little percentage of real financial recoveries, as we can say that Armenian legislation serves more to close the bankrupt entity, than to help it to recover.
    6. Increasing the professionalism of judges in bankruptcy field
    7. The observation of terms in bankruptcy procedure and avoidance from unreasonable

protractions of case

8. The elevation of efficiency of organization of administrators’ professional activity, for example the implementation of effective system of remuneration