IN THE NAME OF THE REPUBLIC OF ARMENIA

DECISION
OF THE CONSTITUTIONAL COURT OF THE REPUBLIC OF ARMENIA

ON THE CASE OF CONFORMITY OF PARAGRAPH 2 OF PART 2 OF ARTICLE 90 OF THE RA LAW ON BANKRUPTCY WITH THE CONSTITUTION OF THE REPUBLIC OF ARMENIA ON THE BASIS OF THE APPLICATION OF "MOUSSALER PRINTING HOUSE" LLC

Yerevan **January 27, 2015**

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

with the participation (in the framework of the written procedure) of the representative of the Applicant: S. Tsakanyan, representative of "Moussaler Printing House" LLC,

representative of the Respondent: H. Sargsyan, official representative of the RA National Assembly, Head of the Legal Department of the RA National Assembly Staff,

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

examined in a public hearing by a written procedure the Case on conformity of Paragraph 2 of Part 2 of Article 90 of the RA Law

on Bankruptcy with the Constitution of the Republic of Armenia on the basis of the application of "Moussaler Printing House" LLC.

The Case was initiated on the basis of the application submitted to the Constitutional Court of the Republic of Armenia by "Moussaler Printing House" LLC on July 17, 2014.

Having examined the written report of the Rapporteur on the Case, the written explanations of the Applicant and the Respondent, having studied the RA Law on Bankruptcy and other documents of the Case, the Constitutional Court of the Republic of Armenia **ESTABLISHES:**

1. The RA Law on Bankruptcy was adopted by the RA National Assembly on December 25, 2006, signed by the RA President on January 22, 2007 and came into force on February 10, 2007.

Paragraph 2 of Part 2 of Article 90 of the RA Law on Bankruptcy prescribes: "In such case suspensions provided for by Parts 4 and 5 of Article 13, and Part 3 of Article 19 of this Law shall be eliminated from the moment of closure of the case. Meanwhile, the financially recovered person shall be exempt from all those obligations deriving from the claims not having been submitted within the scope of the closed bankruptcy case, and such creditors shall be deprived of the right to submit claims in the future against the financially recovered person, with the exception of cases as provided for by Parts 3 and 4 of this Article."

2. The procedural background of the Case is the following: on 01.02.2013 the Applicant submitted a claim to the Court of General Jurisdiction of Armavir Marz against "Armavir Milk Factory" CJSC for levying execution in the amount of 1.073.940 AMD (Civil Case No. ԱՄԴ/0068/02/13).

On 20.06.2013 the Court, adopting the debt of the respondent company in the amount of 1.073.940 AMD, made a decision to reject the claim based on the provisions of Part 2 of Article 90 of the RA Law on Bankruptcy, stating that the debtor "Armavir Milk Factory" CJSC was declared bankrupt, then financially recovered; and the Applicant did not submit a claim to be included in the list of the

creditors of the bankrupt company by the procedure and scopes provided by the law.

3. The Applicant finds that the challenged provision contradicts Articles 8, 31 and 18 of the RA Constitution, since no legally stipulated objective grounds necessary for deprivation of the right to property are available in the challenged provision, and such regulation in itself leads to making judicial acts without ensuring precise judicial procedure for the claimant and without providing a possibility for protection of rights and interests of the latter. On the Applicant's judgment, taking into account the challenged legal regulation, the court considering the case on bankruptcy makes a judicial act on the bankruptcy case ipso facto releasing the person declared bankrupt then financially recovered, from the liability of fulfillment of prior obligations, which in itself comprises provisions on deprivation of the right to property (including cash and obligations in rem) of the person not party to the case. In future it leads to the following: the person, who, for objective reasons, was not informed of the judicial proceedings against the debtor's bankruptcy proceeding that also concerned her/him, actually is deprived of the legally protected opportunity of protection of the right to property, and no other legal remedy is available, which would provide the creditor with the opportunity of protection of rights by any means stipulated by Article 14 of the RA Civil Code. The Applicant also finds that not being in the know about the announcement of bankruptcy of the creditor company and not submitting an application in accordance with the RA Law on Bankruptcy may not be taken as grounds for deprivation of the right to property, since it is clear that "There is no imperative norm in the Republic of Armenia" which obliges the parties of civil circulation everyday to follow the press or the currently operating www.azdarar.am website and moreover read each publication and line of the latter, and this is not realistic. According to the Applicant the challenged legal norm entails inconsistency also with the generally accepted rules of civil-law circulation, i.e. the principles of the RA Civil legislation (Article 3 of the RA Civil Code), since in this situation by the general manner the person is allotted a period for implementation of protection of

her/his rights (institution of statute of limitations) and in the framework of the latter the person may freely choose any behavior stipulated by the law or not prohibited, and at the same time another norm unfairly and indirectly restricts that opportunity. The Applicant also finds that the regulation of the norm of the RA Law on Bankruptcy specifically contradicts also the provision of Paragraph 2 of Part 2 of Article 90 of the RA Law on Bankruptcy, since it causes the appearance of certain adverse effects for the person without provision of the case or cases of violation of the obligations directly stipulated by the law, otherwise, an obligation directly not defined by the law is imposed on the person by that norm, i.e. to follow all the publications in the press and "www.azdarar.am" website.

4. Objecting the arguments of the Applicant, the Respondent finds that the challenged provision is not a violation of the right of inviolability of ownership, and stipulating such provision is conditioned by the necessity of implementation the principles of legal certainty and predictability in the framework of bankruptcy proceedings. Based on the results of the study of Part 1 of Article 23 of the RA Law on Compulsory Enforcement of Judicial Acts, Part 1 of Article 1227 of the RA Civil Code as well as the civil-law institution of statute of limitations, the Respondent concludes that according to several other legal regulations stipulated by the RA legislation, in case of failure to submit a claim against the debtor within the prescribed time limit the creditor will also be deprived of such opportunity, and as a result the right to property of the creditor is actually restricted. However legislatively stipulating the mentioned time limits may not be described as violation of the right of inviolability of ownership, on the contrary stipulating these limits follows from the constitutional principle of legal certainty, and envisaging such regulations aims at ensuring timely and proper exercise of the rights and duties of the parties of civil-law circulation and the stability of civil-law relations. The Respondent finds that in case of absence of such regulation, it may open up possibilities to submit previously not filed claims against the financially recovered company, and re-initiation of bankruptcy proceeding may follow the debtor's

financial recovery, and the latter may make the package of measures implemented within the scope of the financial recovery plan applied to the debtor and lead to overload of the judicial system, as well as prejudice business environment. According to the Respondent, in case the creditor does not apply to the debtor in the course of bankruptcy proceedings with a request to fulfill the current obligations with respect to her/him, the creditor by her/his actions in itself exercises debt forgiveness, and in that case also from the perspective of the law it is not emphasized, whether the creditor did not file such claims because of not being informed or renouncing the debt indeed.

5. The Constitutional Court states that according to the materials of the Case, the application of the provision (stipulated by the challenged paragraph of the Law) "...and such creditors shall be deprived of the right to submit claims in the future against the financially recovered person, with the exception of cases as provided for by Parts 3 and 4 of this Article" with respect to the Applicant incurred unfavorable consequences for the latter.

For revealing the issue of constitutionality of the above-mentioned provision, the Constitutional Court finds it necessary to consider the challenged regulation firstly in the light of the right to property of the person guaranteed by the RA Constitution and Protocol No. 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms.

According to Article 8 of the RA Constitution, "The right to property shall be recognized and protected in the Republic of Armenia."

According to the case-law of the European Court of Human Rights, within the meaning of Article 1 of Protocol No. 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms, not only the existing possession but also the legitimate expectation to acquire possession shall be deemed property (in particular, the Judgment of 11 June 2009 in the Case of Trgo v. Croatia).

The Constitutional Court states that it becomes clear from the Application and the materials attached to the Application that in the bankruptcy case the Applicant signed a contract with the debtor on

providing paid services, according to which the Applicant provided printing services to the debtor, and the debtor assumed a duty to pay for those services but did not fully perform his duties. Therefore, the Applicant had legitimate expectation to receive the relevant possession for the provided services.

The challenged regulation exempts the debtor from the obligation of fulfillment of the obligations after the process of financial recovery, with several exceptions (Parts 3 and 4 of Article 90 of the Law).

Article 345 of the RA Civil Code, titled "Concept of obligation and grounds for the arising thereof," states: "1. By virtue of obligation one person (debtor) shall be obliged to perform an action to the benefit of another person (creditor) — that is, to pay money, transfer property, perform works, deliver services, etc. — or abstain from performing a certain type of action, and the creditor shall have the right to demand from the debtor to fulfill her/his obligation.

2. Obligations shall arise from a contract, as a consequence of causing damage and from other grounds referred to in this Code."

Part 4 of Article 90 of the RA Law on Bankruptcy prescribes that the debtor may not be declared exempt from:

"(a) alimony payments;

(b) payment of arrears hidden from tax authorities within one year preceding the moment of declaring bankrupt;

(c) obligations arising from injuries inflicted to health and life;

(d) obligations arising from compensation of damage caused by criminal offence."

Based on the results of the systems analysis of the above-mentioned articles, as well as the RA Civil Code, the Constitutional Court states that the legislator exempts the financially recovered party from the obligations mainly following from contracts, and the best part of contractual obligations in the framework of civil legal relations, according to the object of obligation (to pay money, transfer property or perform work, supply services, or abstain from certain actions), has both proprietary and non-property nature.

The RA Constitutional Court has repeatedly touched upon the issues of legitimacy of restrictions on the right to property of the person. In particular, by the decisions DCC-903 and DCC-1073, the Court expressed the position that Article 31 of the RA Constitution stipulates four separate circumstances of restrictions on exercise of the right to property:

a) restrictions on the exercise of the right to property with prohibition of causing damage to the environment, infringing the rights and legitimate interests of other persons, the public and the State (second sentence of Part 1 of Article 31),

b) deprivation of property (Part 2 of Article 31),

c) compulsory expropriation of property for the needs of society and the State (Part 3 of Article 31),

d) restrictions on ownership right over land with respect to foreign citizens and stateless persons.

The Constitutional Court referred to the constitutional legal content of the concept "deprivation of property" in the Decision DCC-630, in which the Court characterized deprivation of property as a compulsory action following from liability. Based on the mentioned characterization as well, the Constitutional Court stated that the main mandatory elements characteristic of the institution of deprivation of property are as follows:

- in case of deprivation of property, ownership right to the given property is irretrievably terminated against the will and consent of the property owner,
- deprivation of property is applied as a means of liability,
- in case of deprivation of property, the powers of the property owner to possess, use and dispose of the given property are simultaneously and completely terminated without guaranteeing continuity.

Examining the unfavorable consequences for the Applicant within the framework of the above-mentioned legal positions, the Constitutional Court states that the challenged norm of this Case does not anyhow concern subjecting the person to liability, therefore also deprivation of property.

By the decision DCC-1073 the RA Constitutional Court expressed the legal position that the legislator conditions the exercise of the right to property by the prior necessity of ensuring certain public values. Those are: the environment, the rights and legitimate interests of **other persons**, the public and the State. Such approach aims at ensuring reasonable balance between the rights of the property owner and the rights of other persons and public interests, recognizing the ownership right of the person on property guaranteed but not absolute.

By the decision DCC-735 of 25.02.2008 the Court also expressed the following legal position: "The institution of bankruptcy aims at providing the bona fide and dutiful creditor with the opportunity to restore her/his regular activities and overcome financial difficulties, as well as ensuring restructuration and financial reorganization of insolvent companies and restoration of their viability, and at the same time **ensuring the protection of the interests of creditors."**

The Constitutional Court states that the challenged regulation might be directed at the protection of the rights and legitimate interests of the debtor **only in the course of bankruptcy proceeding,** which includes also the financial recovery aimed at preserving the party /considered a debtor/ from the claims submitted against her/him by the creditors, in order that the debtor's solvency be restored, the debtor fully participated in civil circulation, and this cannot be justified after the closure of bankruptcy case with the same purposes, i.e. financial recovery of the debtor, when the financially recovered company becomes a full-fledged participant of civil circulation and civil-law relations. Stipulation of the concept "financial recovery plan" applied in the law also indicates of the latter, according to which: the financial recovery plan shall be deemed a complex of measures not proscribed by law and applied to the debtor for restoring the solvency thereof, as a result of which the debtor will not be liquidated or no judgment will be made on the closure of the bankruptcy case with respect to a natural person by releasing her/him from performing obligations (Article 59).

6. Analysis of the provision "Meanwhile, the financially recovered person shall be exempt from all those obligations deriving from the

claims not having been submitted within the scope of the closed bankruptcy case, and such creditors shall be deprived of the right to submit claims in the future against the financially recovered person, with the exception of cases as provided for by Parts 3 and 4 of this Article" stipulated by Part 2 of Article 90 of the RA Law on Bankruptcy states that:

1. not only the financially recovered person shall be exempt from all those obligations conditioned by the claims not having been submitted within the scope of the closed bankruptcy case, but also by virtue of right such creditors shall be deprived of the right to submit any claim (including through judicial procedure) in the future in regard to the part of the mentioned obligations against that person, where such claim does not follow from the possibility of exercise of the right to appeal as prescribed by Part 5 of Article 90 of the Law.

2. exceptions are also available:

a/ where the bankruptcy case has been closed within six months from the moment of entry into legal force of the judgment on declaring bankrupt, the debtor shall not be exempt from all those obligations deriving from the claims not having been submitted within the scope of the closed bankruptcy case,

b/ by virtue of law, the debtor may not be exempt from obligations such as alimony payments, payment of arrears hidden from tax authorities within one year preceding the moment of declaring bankrupt, obligations arising from injuries inflicted to health and life, obligations arising from compensation of damage caused by criminal offence.

Within the framework of the above-mentioned legal and logical approach the following two questions have no answer from the viewpoint of guaranteeing the principle of the rule of law:

1. how should we act in the case where, due to objective circumstances, the person did not submit claims within the scope of the bankruptcy case?

2. whether there is no discrimination where the creditors are deprived of the right to submit claims in the future against the financially recovered person, but there is an exception in respect of performing tax obligations.

Those questions may be answered in the issue of comparative analysis of a number of other articles of the law at issue. In particular, it regards Articles 19, 33, 34, 42, 46, 69, 74 and 89 of the RA Law on Bankruptcy. The analysis of the legal regulations stipulated by those articles states that:

1. a relevant announcement available on the official website of public notifications of the Republic of Armenia (http://www.azdarar.am) shall be considered to be a proper notification for the creditors (Article 34),

2. if the creditor, regardless of the reason, did not participate in the first Meeting of Creditors, s/he shall forfeit the right of vote,

3. as prescribed by Articles 29, 33, 42, 46, 52, 69 and 87 of the Law, the study of the procedure of preparing, keeping and approving the register of claims of creditors states that no precise obligation is imposed on the debtor in regard to filing her/his duties with respect to the creditors. All those creditors who for some reasons were not informed of the relevant announcement available on the official website of public notifications of the Republic of Armenia (http://www.azdarar.am) or they are not considered as creditors having registered the largest claim in the total number of claims, shall be deprived of legal opportunities of further protection of their rights.

The Constitutional Court finds that such legal regulation not only comprises legal danger of violation of the creditors' rights, but also corruption risks are high. Firstly, the debtor, filing a petition in bankruptcy, shall be obliged to precisely present the real picture of own obligations. This should also except the hiding of the property by the creditors or its groundless decrease, and the latter is also emphasized in Point 9 of the summary and Point 36 of the main Report of the World Bank (2014) on the Solution of the issue of bankruptcy in the Republic of Armenia.

The register of claims of creditors should be prepared in accordance with the mentioned legal picture, and by virtue of right, it should include all those obligations legally recognized by the debtor, and it should not make the discretionary approach absolute. Legislative regulation should mostly be based on the ap-

proach that the bankruptcy administrator must first of all act in accordance with the information provided by the debtor, and this may result in certain obligation also for the creditor. Moreover, **all those creditors who, for objective reasons, were not informed of the relevant announcement available on the official website of public notifications of the Republic of Armenia (http://www.azdarar.am), in future must have the right to judicial remedy.** Otherwise, not only their rights, stipulated by Articles 18 and 19 of the RA Constitution, are violated but also the constitutional principles of comparability and proportionality are infringed in respect of the exceptions stipulated by Part 4 of Article 90 of the Law.

The Constitutional Court considers it necessary to emphasize that for the interested parties being properly notified of the course of bankruptcy proceeding is an essential condition for the protection of their rights /conditio sine qua non, i.e. a term without which it cannot be possible/, without which it cannot be possible to guarantee the effective protection of their rights. Therefore, the legal regulations of the institute of notification must not be formal, but must be aimed at detecting all creditors of the party (debtor) in the course of bankruptcy proceedings, and protecting their rights guaranteed by the Constitution and the laws. For this purpose, the legislator must provide for **a procedure for registration of obligations and effective notification** of the debtor, and this will, in practice, rule out the situations where the interested persons, for objective reasons, were not informed of the bankruptcy proceeding. The problem is that the creditor must receive proper notification of the initiation of bankruptcy proceedings and the necessity of filing claims. The debtor must provide precise and complete information on her/his obligations by the procedure stipulated by the law.

The Constitutional Court does not consider it legitimate also to selectively release the debtor — declared financially recovered in the framework of bankruptcy proceedings — from the obligations, since the challenged legal regulation provides for a differentiated approach between the state, as a creditor of tax obligations, and natural or legal persons as creditors of other type obligations.

Based on the review of the Case and being governed by the requirements of Article 100, Point 1 and Article 102 of the Constitution of the Republic of Armenia, Articles 19, 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. To declare the provision "...and such creditors shall be deprived of the right to submit claims in the future against the financially recovered person, with the exception of cases as provided for by Parts 3 and 4 of this Article" stipulated by Paragraph 2 of Part 2 of Article 90 of the RA Law on Bankruptcy systemically interrelated with Part 4 of the same Article, so far as it does not stipulate any exception in the **cases recognized by the court as valid reasons** for the creditors who had not submitted claims within the scope of the closed bankruptcy case, as well as stipulating disproportional restriction of protection of the rights of the latter, contradicting Article 18 of the Constitution of the Republic of Armenia and void.

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

Chairman **G. Harutyunyan**

January 27, 2015
DCC - 1189