



WORKING WITH INSOLVENCY STAKEHOLDERS IN ARMENIA



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Armenia has been hit hard economically by the coronavirus pandemic and so supporting the development of an investor-friendly, transparent and predictable legal environment has never been needed more. Part of this is making sure that the country has an efficient, well-designed insolvency framework that can act as a safety valve for business failure and offer businesses a “second chance”. The EBRD’s Legal Transition Programme has been working with the Armenian authorities and Insolvency Court on ways to improve the court’s operations and effectiveness, as well as providing training for judges and insolvency practitioners.

Armenia is one of the smaller economies in which the EBRD invests, yet it is strategically important; a mountainous landlocked country of approximately three million people, Armenia borders Azerbaijan, Georgia, Iran and Turkey.

The EBRD began investing in Armenia in the early 1990s, and its investments span a broad portfolio of financial institution, energy, industry, commerce, agribusiness and sustainable infrastructure projects.

The EBRD’s current portfolio in Armenia is approximately €400 million, spread across some 60 projects. The private sector share of this portfolio is close to 90 per cent. In 2020 the EBRD committed in Armenia close to €160 million, of which almost 93 per cent was in the



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private sector. Of the €160 million, more than €50 million was earmarked for the banking and energy sectors in the context of the EBRD's Resilience Framework, which was set up to counter the impact of Covid-19 on the EBRD's regions.

Like many countries, Armenia was seriously hit by the pandemic. However, the economic and political situation was complicated further by military hostilities involving the Nagorno-Karabakh region. The IMF forecast 7.25 per cent negative growth for the economy in 2020. Lockdown measures have had a significant impact on business, including tourism, which plays an important role in generating revenues and attracts many of the Armenian diaspora. The Armenian government announced an assistance package valued at approximately US\$ 300 million (about 2 per cent of GDP) to mitigate the socio-economic issues related to the pandemic.¹ The country has also benefited from support from the International Monetary Fund.

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Against this backdrop, the work that the Legal Transition Programme has been doing in Armenia to support the development of an investor-friendly, transparent and predictable legal environment has never been more relevant. The severity and unprecedented nature of the 2020 economic crisis has highlighted the importance of an efficient, well-designed insolvency framework that can act as a safety valve for business failure and offer businesses a “second chance”.

Fortunately, the Legal Transition Programme has built strong relationships with the Armenian authorities and local stakeholders through an extensive programme of cooperation on insolvency law matters. Our work in this area began in 2017, following an agreement between the EBRD and the Armenian Ministry of Justice (MOJ), which was determined to invest time and effort in improving the country's insolvency framework and its ranking in the World Bank *Doing Business* report. We were supported by the Armenian Business Support Office, a body established to promote public-private dialogue and improve Armenia's business environment and investment climate.²

MAJOR REFORMS TO ARMENIA'S INSOLVENCY SYSTEM

In 2018, after extensive consultations with public and private stakeholders and the World Bank Group, we delivered a report to the MOJ containing recommendations on how to reform the insolvency framework. The report focused on two areas where reforms were most pressing: insolvency practitioners and court practice.

First, the report advised creating a more robust regulatory and supervisory regime for insolvency practitioners to address issues of malpractice. Often referred to as “trustees”, “administrators” or “liquidators”, insolvency practitioners play a critical role in insolvency systems around the world and help to administer the debtor's estate for the benefit of creditors.

Second, the report made recommendations on how to improve court rules and practice to tackle court overload and the widespread practice of



¹ <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19> (last accessed 15 January 2021).

² <http://www.bso.am/> (last accessed 15 January 2021).



open-ended appeals and challenges to court decisions. One such recommendation was to create a specialist court to manage insolvency cases and deliver a consistent approach to the interpretation of insolvency laws and rules.

The MOJ accepted many of our recommendations, and the Centre for Legislative Development, a body affiliated with the MOJ, drafted a series of widespread amendments to the country's Law on Bankruptcy.³

The government moved quickly on judicial reform. On 6 August 2018 the Supreme Judicial Council, an independent constitutional state body established in April 2018 and responsible for guaranteeing the independence of courts and judges, approved the composition of a new Insolvency Court and selected 12 acting judges. This was given effect on 10 August 2018 by a decree from the president of Armenia, which provided that the Insolvency Court would start operating from 1 January 2019 in accordance with the Judicial Code of Armenia. The authorities had a number of practical tasks to administer,

including locating a building for the court, furnishing it and engaging administrative staff.

Reform to insolvency legislation moved at a slower pace but on 26 December 2019 the Law on Bankruptcy was amended.

The amendments introduced major changes and improvements to the regulatory system for insolvency practitioners. For example, there are 97 active insolvency practitioners in Armenia, 12 of whom have passed retirement age and are only allowed to continue working on ongoing cases. The amendments liberalised the regulatory structure for these practitioners by allowing more self-regulatory associations of 20 or more insolvency practitioners to be created, beyond the existing self-regulatory organisation (SRO), which effectively has a monopoly on the profession. The changes also prevented the SRO from raising membership fees above a certain threshold, calculated on the country's minimum salary, without the MOJ's consent, to reduce the risk of the SRO fixing a high entry fee that would keep out new professionals.

³ Law of the Republic of Armenia H0-51-N of 25 December 2006 "On bankruptcy".

Significantly, the amendments gave the MOJ a central role in regulating the profession and provided that the MOJ would have the authority to supervise insolvency practitioners' observance of legal requirements, backed up with relevant disciplinary powers.⁴ At the same time, the amendments clarified and limited the SRO's responsibility regarding supervision of professional conduct.

Another important shift in the balance of powers between the MOJ and the SRO relates to the automatic appointment system for insolvency practitioners. This system, which applies to cases where the parties fail to reach agreement on the individual to be appointed, had been run by the SRO but had lacked transparency. Following the amendments, the automatic appointment system is now under the control of the MOJ, a more neutral body.⁵

The legislation also addressed insolvency practitioner training. Armenia now requires insolvency practitioners to cover a minimum of 24 academic units or 18 hours of training per year and makes the SRO responsible for providing training to its members and recording their participation in such training.⁶

On the procedural side, the reforms helped to make insolvency proceedings more efficient. Apart from confirming the role of the Insolvency Court, they provided for an electronic exchange of documents between the court, state and local authorities and the insolvency practitioners.⁷

Furthermore, they introduced the rule that all civil cases connected with the debtor in insolvency proceedings are heard by the Insolvency Court, reducing the previous lack of coordination within the judicial system. Other improvements relate to the appeals process.

The amendments also clarified the process for appeal of decisions made by the court during

examination of the insolvency case before the Court of Appeal and stipulated that appeals do not suspend the performance of any actions arising from such decision, unless the Court of Appeal determines that this would "inevitably give rise to grave consequences for the debtor or creditor".

Since the main legislative amendments came into effect, the Centre for Legislative Development and the MOJ have been busy developing secondary legislation and templates to standardise certain aspects of the insolvency process. There are now five pieces of secondary legislation covering mandatory training of insolvency practitioners, annual reporting on activities by the SRO and practitioners, the register of insolvency claims, financial analysis of the debtor and guidance on lists of property owned and co-owned by the debtor.⁸ The Insolvency Act allows for further secondary legislation in a number of key areas, including applications for a qualifying test and enrolment by insolvency practitioners before the MOJ.

"With a new online training platform for insolvency judges, Armenia has become a benchmark for future projects of this kind."



⁴ Article 27.1. Supervision over administrators and self-regulatory organisation of administrators.

⁵ Article 22. Selection and appointment of the administrator.

⁶ Article 26.1. Training of administrators. More detail is contained in Order N 104-N dated 12 March 2020, on Determining the Procedure of Yearly Mandatory Trainings of IOHs.

⁷ For example in relation to the court's acceptance of the bankruptcy application (see Article 13 of the Law on Bankruptcy as amended).

⁸ In order of reference: Decree No. N-104-N (12 March 2020); Decree No. N-103-N (12 March 2020); Decree No. N-107-N (12 March 2020); Decree No. N-101-N (12 March 2020) and Decree No. N-102-N (12 March 2020).

PERCEPTIONS OF ARMENIA'S INSOLVENCY SYSTEM

While the range of insolvency amendments is significant, the timing of the reform means that organisations such as the OECD and the World Bank have not yet interpreted them in their reports on Armenia's insolvency framework.

A recent comparison of Eastern Partnership countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) in March 2020 by the OECD found that insolvency frameworks remain one of the weakest areas for Eastern Partnership countries, and for Armenia in particular.⁹ Moreover, the World Bank's *Doing Business 2020* report ranks Armenia 95th out of 190 economies for resolving insolvency, including indicators such as the time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework.¹⁰

These results do not reflect the efforts that the Armenian authorities have made in recent years to reform and improve the Armenian insolvency framework. Nevertheless, one major area where insolvency reform is still needed relates to the reorganisation and continuation of struggling businesses, as well as the liquidation of failed businesses.

This is deeply engrained in the OECD SME Policy Index, which is based on the principles of the European Union's Small Business Act for Europe.¹¹ It is also a principle upheld by the EBRD's Core Principles of an Effective Insolvency System, which advocate for the importance of insolvency procedures that support the reorganisation of debtor businesses.¹²

Indeed, there is a major trend within European Union national insolvency systems to support early attempts by the debtor at "preventive restructuring" following the publication in 2019 of the EU directive 2019/1023 on preventive restructuring frameworks. This trend conflicts with the existing ability of creditors in Armenia to enforce their security in insolvency proceedings aimed at financial rehabilitation of the debtor.

The EBRD's new assessment on business reorganisation, launched in September 2019, aims to present specific recommendations to the economies where the EBRD operates, including Armenia, on how to improve their legislation to use insolvency as a positive force for business rescue.¹³ This is vital for many businesses whose operations have been disrupted and whose profitability has been eroded because of the coronavirus pandemic.

Table 1: Progress in the bankruptcy and second chance dimension

Bankruptcy and second chance	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2020 scores	2.40	2.97	3.34	3.03	2.79	2.56	2.85
2016 scores	3.76	2.87	2.57	2.94	2.68	2.05	2.71
2020 scores*	2.73	3.23	3.21	3.20	2.69	2.38	2.91

*2016 methodology

Scores are initially derived as percentages (0-100) and then converted into a 1-5 scale with 5 being the highest-performing score. The methodology changed in 2020 hence the chart also reports 2020 scores based on the old 2016 methodology, as well as the new methodology, which includes an assessment of bankruptcy prevention measures. Source: OECD SME Policy Index: Eastern Partner Countries 2020: Assessing the Implementation of the Small Business Act for Europe.

⁹ <https://www.oecd-ilibrary.org/docserver/8b45614b-en.pdf> (last accessed 15 January 2021).

¹⁰ <https://www.doingbusiness.org/content/dam/doingBusiness/country/a/armenia/ARM.pdf> (last accessed 15 January 2021).

¹¹ See https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en (last accessed 15 January 2021).

¹² <http://pubdocs.worldbank.org/en/538701606927038819/ICRStandard-Jan2011-withC1617.pdf> (last accessed 15 January 2021).

¹³ www.ebrd-restructuring.com (last accessed 15 January 2021).

OPERATION OF THE NEW INSOLVENCY COURT

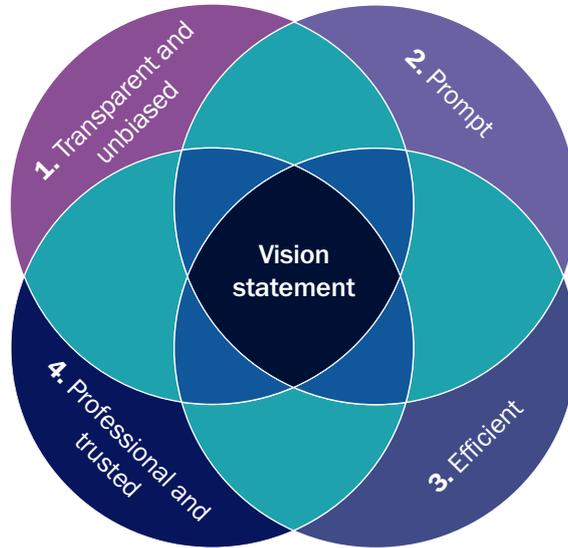
Apart from legislative changes, our work with the Armenian authorities has encompassed a number of capacity-building initiatives and outreach.

Soon after the Insolvency Court was established, we launched a project in partnership with the International Law Development Organization (IDLO) to help the court analyse and improve its operations and to deliver training to the court's insolvency judges, as well as judges in the higher instance courts.

Working closely with the Supreme Judicial Council and the Insolvency Court, we conducted a full operational analysis of the court and proposed an action plan to improve court processes. This was officially presented to interested parties and stakeholders in a webinar in June 2020.

Specifically, the team analysed the court's organisational structure, the institutional structure of the insolvency judicial system and reviewed the main operational processes. Benchmarking was conducted against court systems in Estonia, Germany, Russia, Slovenia, the United Kingdom and the United States of America to understand potential solutions and improvements.

“On the policy side, the EBRD's Legal Transition Programme worked closely with the authorities and national experts to create a vision for the Insolvency Court.”



Source: Armenian Insolvency Court Action Plan, 2020.

The key areas identified for improvement included:

- standardising insolvency documents, including a recommendation for the creation of an insolvency application template
- establishing an internal database for sharing decisions and information, together with tools for monitoring and managing any old or long-running cases
- upgrading court software to extract statistical information for reporting, coupled with other IT tools to improve IT security management.

An insolvency court, similar to an insolvency law, should strive to achieve certain key objectives. On the policy side, the EBRD's Legal Transition Programme therefore worked closely with the authorities and national experts to create a vision for the Insolvency Court.

The vision statement, illustrated above, was “To ensure Transparent and Unbiased judgments by providing Prompt, Efficient, Professional, and Trusted resolutions to insolvency cases”.

In summary, these qualities reflect the following:

1. **Transparent and unbiased:** all processes and decision-making in insolvency proceedings should be transparent and understood by all stakeholders in order to promote stability in commercial relations, enable creditors to assess risks and prevent disputes between parties.
2. **Prompt:** timely management of the insolvency process is essential to avoid undue disruption to a debtor business or distress in the case of a consumer and generally to preserve and maximise value for all stakeholders concerned.
3. **Efficient:** imposition of extensive costs on the insolvency estate should be minimised and procedures should be performed with minimal cost and maximum result.
4. **Professional and trusted:** all judicial proceedings should be conducted with high professional standards that are trusted by the community. The Insolvency Court should be perceived as an institution that ensures that the interests of all stakeholders are considered in accordance with the law.

While there is clearly significant work to be done by the Insolvency Court to improve its operations, there is also a sense of opportunity. If managed effectively, the court should help to reduce general instance court overload and the timeframe for insolvency case hearings. Having insolvency cases heard by a small group of specialist judges who are dedicated to overseeing insolvency proceedings can also have great benefits. Apart from ensuring more consistent court judgments, expertise and knowledge can deliver greater efficiency and timely conduct of insolvency proceedings.

CAPACITY BUILDING FOR JUDGES AND INSOLVENCY PRACTITIONERS

Our ongoing work with the Armenian authorities is now primarily in the area of capacity building and training. As a result of the coronavirus pandemic, we have had to be agile and adapt our plans from in-person training to an e-learning format. We have been fortunate that Armenia is quite a highly

digitalised society, with 64.7 individuals out of 100 recorded as using the internet according to UN data for 2020.¹⁴

Moving the training online has led to some delays but – in cooperation with IDLO – we have now finalised the judicial training modules, which will enable insolvency court judges and higher instances judges to hone their knowledge and skills. The modules will be launched in the coming months.

This project is the first comprehensive training programme by the EBRD for insolvency judges and the programme is highly innovative in both the content and breadth of training, covering not only legal aspects but also financial skills and knowledge, which are critical for assessing the financial standing of the debtor business and the feasibility of any restructuring plan. It focuses on international best practices as well as on domestic legislation and practice. We have built a strong team of leading national and international experts and trainers.

We are developing a similar programme now for insolvency practitioners, which will contain additional elements specific to the profession, including professional status, supervision and discipline, case management and reporting obligations.

All of these initiatives support ongoing investments in Armenia. With a new online training platform for insolvency judges that systematically incorporates national and international trainers and expertise, Armenia has become a benchmark for future projects of this kind. We hope to have the opportunity to continue our work with the Armenian authorities in the area of insolvency and address new, innovative approaches, including in the field of restructuring and reorganisation.



¹⁴ <http://data.un.org/en/iso/am.html> (last accessed 15 January 2021).