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Should the System Favor Recovery Over Liquidation?

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Abstract

In early civilized societies, where a creditor's rights protection was absolute and prevailed over a debtor's rights, insolvency arrived in the aftermath of the insolvency of the latter, and could be fatal and cause irreparable harm.

Thus, in ancient Rome, if one became insolvent and unable to pay his debts, Roman law "permitted the debtor's creditors to dismember and distribute a debtor's body to the creditors in proportion to the amount of debts owed to each." It is rather hard to see how such harsh punishment helped to compensate these ancient Roman creditors for their loss.

Bankruptcy is also documented in East Asia. During the reign of Genghis Khan, there was a provision mandating death penalty for anyone who became bankrupt three times.[1]

For centuries in ancient Greece, if an individual was unable to pay his debts then he, along with his wife, children and servants could be forced into servitude as debt slaves of the creditor until the debt was paid off.[2]

It follows from the above-mentioned that, in civilized society, over a rather long period in history, laws have acted only to protect creditor interests and rights, and debtor rights have always or typically been of secondary importance, even if they in fact existed. Moreover, not only have entrepreneur's rights and lawful interests ever been taken into consideration, but also rights and lawful interests of other interested parties of current undertaking.

If the entrepreneur or the enterprise has met with failure, then unconditionally latter's property confiscation and/or disintegration followed- an individual has been physically destroyed or has been given to the slavery along with his family, and the company has been disintegrated and condemned to a non-existence and destruction.

Of course, concomitant with development of economic and socio-legal relations and for the benefit of economic progress, within bankruptcy institution the attitude toward debtor has been gradually changed as well; more humanist provisions were set out.

It is not accidental at all, that even in medieval church canons provisions for alleviating punishment strictness that had been applied towards creditors were widely discussed, which has been significantly changed over time.

Nevertheless, the bankruptcy, in essence and in fact, is still often identified with person's property confiscation and/or with institution liquidation, which, nowadays, is comparable with physical elimination of debtor at civilization daybreak.

Actually, the existence of bankruptcy institution is needful to observe as a new possibility for entrepreneur to reassess his own potential and possibilities for a start of a new undertaking.

The research of the subject matter represented below lays down issue of posing new legal mechanisms of separate systems directed to completion of financial recovery in the bankruptcy system acting in the RA.

[1] http://chapter11dallas.com/chapter-11-business-bankruptcy/definition-bankruptcy/

[2] http://bankruptcyresources.org/content/very-brief-history-bankruptcy-and-debt-west

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INTRODUCTION

At all times at the existence of civilized society the risk factor has been typical to entrepreneurial activity. In general, competition-based economic system has always presumed both successes and failures. Sometimes it happened so that numbers of objective and subjective reasons, typical to entrepreneurship, were reason for deterioration of financial condition and insolvency of entrepreneurs. In such conditions the bankruptcy institution, still from early times of civilization, was formed in order to provide dynamic development of the economy.

In fact, at all times of existence of civilized society and, in particular, free market system based societies the existence of laws and legislation providing defense for owners' rights has always had primary role. Therefore, laws and separate clauses of legislation regulating bankruptcy field, that supports to form bankruptcy institution are called to defend creditors' rights, and if the company is not able to be reorganized, then its assets should be distributed among its creditors, as prescribed by law- duly, fairly and in the foreseeable way.

The above is not to say that the bankruptcy legislation ignores the **rights and lawful interests of debtor**. Conversely, the free market system of economy, and parallel to it, concomitant with development of social relations the attitudes towards debtor inside bankruptcy institution has been changed significantly. Such disciples have eventuated, that believed to be one of the pivotal elements of bankruptcy institution: **moratorium**- freezing of creditors' demand satisfaction, and application of **sanatio** (financial recovery) system.

Nowadays, in free market economy-based societies the existence of bankruptcy institution is intended to reduce cases of bankruptcy of entrepreneurs as much as possible. Bankruptcy institution, first of all, is called to regulate relations between entrepreneurs and subjects who are engaged in civil law, labor and administrative relations with them that appear to be in insolvent condition, sometimes occurring in result of failures in the society's economic field.

Nevertheless, "The Market" has its own rules, which are often antipodal points of separate competitors' interests. Therefore, it is always worth refining all tools that will maximally give the chance to regulate free economy area without pain and without huge commotion.

After all, bankruptcy **is not a verdict and/or judgment**. It is not destruction; rather it is a downward movement occurring frequently during entrepreneurial activity. No matter how negative or harmful phenomenon it may be perceived by community, bankruptcy is a security zone for those who have failed in their undertakings. As a matter of fact, it is a chance to debug the past and start the new one. The failed undertaking should have at least the chance to be restructured. Entrepreneur should be given a chance to be reorganized and to render his effective services to community. Weak company's restructuring may result in maintenance of workplaces, health insurance projects and maintenance of savings, tax generation and will foster the development of micro and macro systems of economy. Recovered company is

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beneficial not only for its shareholders, partners and stakeholders, but also for its suppliers, clients, investors, creditors and debtors.

It is known that investors, particularly foreign investors, are prone to make investments. And creditors are ready to credit undertakings in such environment, where legislation and laws on insolvency fostering free economic relations are present, and that legislation and laws are acceptable, foreseeable and productive, and where risks are reduced to a minimum.

Market economy shall encourage entrepreneurs, maximally insure them from tremors and from multilateral influence of declining economy, and exactly the effective system of bankruptcy should be one of the instruments, by which it will be possible to protect rights and lawful interests of both entrepreneur and stakeholders of other parties of current enterprise.

At the same time, in the effective system of bankruptcy there should be such guarantees, which shall fully prevent abuses, counterfeits and frauds in the event of bankruptcy of the entrepreneur.

Today bankruptcy institution of RA is developed significantly. It is developed in a way that interests of all parties of the company are maintained and defended as much as possible.

Nonetheless, the fast growing world, emerging technologies, frequently changing and/or newly arising "rules of game" in free market economy relations, which, inter alia, often includes in them also unlawful behavior, set a demand against **lawmaker**. Therefore, it is a daily imperative to constantly amend current bankruptcy institution with novel law provisions and to clarify demands of all stakeholders included in the company, to define acceptable behavioral rules for each and to grant practical and productive guarantees.

So, free market economy dictates the existence of such bankruptcy institution that will provide not only creditor's and debtor's protection of rights and lawful interests, but also for stakeholders of the current undertaking, will not disrupt dynamic growth of the economy, in case of insolvency of the entrepreneur will establish such guarantees, which will prevent abuses, counterfeits and frauds in a full manner.

The choice of the topic, provided for research, is caused by abovementioned premises and requisitions.

Research objective and issues of the subject matter

Objectives:

- Organization, activity and development, as well as revealing the practical meaning of The Bankruptcy Institution in RA economic system,
- Peculiarities of implementing financial recovery projects in bankruptcy cases and their comparative analyses in free market relation-based countries,
- Assessment of effectiveness of insolvency of organizing temporary supervisors and supervisors' activity, as well as financial recovery procedures in RA economic system.

Issues:

- Posing mechanisms directed to investment of effective systems of bankruptcy in RA with results of comparative analyses of bankruptcy institution acting in the free market relation based countries,

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- Posing most effective solutions of legislative regulation of separate systems directed to implementation of financial recovery projects,
- Posing legal mechanisms directed to reducing corruption risks for protecting interests of entrepreneurs, as well as stakeholders in bankruptcy cases.

This thesis paper shall consist of an introduction, three chapters, a conclusion, a bibliography and appendices. The Introduction will present an overview on general characteristics of bankruptcy mainly in the Republic of Armenia. Chapter 1 is designed to present the essence and reasons of bankruptcy; historical evolution; socio-economical and legal grounds of origination of bankruptcy institution; the concept of bankruptcy; investment and development procedure of the bankruptcy institution in the RA economic system, Chapter 2 will present Practical and procedural peculiarities and comparative analyses of separate systems directed to implement financial recovery projects in free market relation based countries in bankruptcy cases; the effectiveness of separate systems, particularly the organization of temporary bankruptcy supervisors and supervisors' activity, as well as financial recovery procedures in RA economic system directed to implementation of financial recovery projects with results of application practice of bankruptcy institution, in practice, and, ultimately, Chapter 3 poses the most productive mechanisms directed to investment of effective systems of bankruptcy In the Republic of Armenia, based on results of comparative analyses of the bankruptcy institution acting in the free-market-economy countries; the most effective solutions of legislative regulation of separate systems directed to implement financial recovery projects, particularly organization of temporary bankruptcy supervisors and supervisors' activity, as well as financial recovery procedures; legal mechanisms directed to reduce corruption risks to protect interest of entrepreneurs, as well as of stakeholders in bankruptcy cases. Followed by a bibliography listing all the sources used for the paper, the Conclusion will succinctly outline main findings of the research. Appendices will comprise a sample questionnaire of surveys conducted and subsequent presentation of data collected.

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CHAPTER 1. THE DEVELOPMENT OF BANKRUPTCY INSTITUTION AND PRACTICAL MEANING IN FREE MARKET RELATION-BASED COUNTRIES, HISTORICAL OVERVIEW

1.1 THE ESSENCE AND REASONS OF BNAKRUPTCY; MAIN CONCEPTS OF INSOLVENCY (BANKRUPTCY)

In order to assess completion peculiarities of financial recovery plans in bankruptcy cases and effectiveness of organization of financial recovery procedure, and to reveal practical meaning of bankruptcy institute in RA economic system, let us firstly find out historically-formed necessity of bankruptcy institute in free market relation based countries.

The insolvency of business entity in market economy is a widespread phenomenon. Descriptors, which can cause insolvency of business entity, are briefly presented below. They may be classified as follows:[3]

- insufficient knowledge of market structure (demand) and overestimation of own capabilities,
- ineffectiveness of management system in entrepreneurial activity, which is explained by the lack of clear-cut strategy in organizational activity,
- orientation towards short term results in detriment of midterm and long term results
- low level of professional skills (professionalism) in a given entrepreneurial sphere,
- inaccurate creation of business partner relationship,
- improper use of pecuniary resource, credits and other investments,
- failure to make a cash receipt timely, accrued from the sale of goods,
- receivables, as a left out from circulation cash,
- civil, social and economic unfavorable developments.

By and large as insolvency assessment criterion of business entity can be considered the lack of funds payable to creditors.[4]

The insufficiency of debtor's property is also an important indicator for assessing insolvency, when payables exceeds the price of debtor's property (assets).[5]

Summarizing the abovementioned, the following conclusion can be drawn, the **insolvency** is a non-fulfillment of and impossibility (inability) to repay the financial obligation completely before the creditor for the specified time period due to insufficiency of cash flow (surplus funds) and assets coming from breach of production and/or sale organized by the entrepreneur or by the company.[6]

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[3] Nikulushkina, M (2010). Reasons for insolvency of the organization, Moscow State University of Technology and Management. Samara. http://bukvasha.ru/kontrolnaya/383533

[4] Ibid.

[5] Kravchenko, E (2003). Dissertation: Problems of protection and rehabilitation of the debtor at insolvency (bankruptcy) in the Great Britain, Germany, the USA, France, Russia (the Comparative-legal analysis). Moscow. 234 p., http://aldebaran.com.ru/publications/7488

[6] Economy. Explanatory dictionary (2000). INSUFFICIENCY, M .: "INFRA-M", Publishing house "Ves Mir" http://dic.academic.ru/dic.nsf/econ_dict/18628

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So, insolvency is a full or partial termination of fullfilment of financial obligations or non-fullfilment or partial fullfilment of payables, that are of mandatory payments, undertaken by the debtor, in the aftermath of insufficiency of cash. It can cause person's insolvency (in case of company also liquidation). Therefore, insolvency is the external indicator of the person's bankruptcy.

If the debtor cannot complete assumed obligations before his creditors, then his relative insolvency turns into absolute insolvency. The absolute insolvency is what exactly called **financial incapability (bankruptcy)**.[7]

So, the insolvency of business entity is a necessary condition for its **bankruptcy**.

It is a situation, when cash receipts from realization of goods and rendering of services do not cover all those expenditures, which were spent on producing, transportation, warehousing, maintenance and recycling of goods, and did not provide timely return of debts and payments to suppliers.[8]

It is also a situation, when, for satisfying creditors' demands, bankruptcy proceedings can be initiated by interested party based on a claim lodged with the court as defined by law. As we have already mentioned above, insolvency can lead individual and company to bankruptcy and in case of company also to liquidation.

But at the same time it is worth mentioning that **bankruptcy is an exclusive chance to repair and recover individual's or entity's solvency.**

1.2 HISTORICAL EVOLUTION OF BANKRUTCY INSTITUTION

From ancient times till nowadays the bankruptcy institution has passed through long way of development. From the outset being as a protection tool for owner-creditor's rights, in ancient times it mostly had a punitive role. The debtor was handed over to the creditor's judgment, and the latter might treat debtor as he/she wished.

In ancient Greece, for instance, the concept of "bankrupt" did not exist and if an individual was unable to pay his debts then he, along with his wife, children and servants were forced into servitude, so called "debt slaves" of the creditor, until the debt was paid off.[9] If a man owed and he could not pay, he and his wife, children or servants were forced into "debt slavery", until the creditor recouped losses via their physical labour.[10]

The bankruptcy institution was even harsher in ancient Rome, where if one became insolvent and unable to pay his debts, Roman law "permitted the debtor's creditors to

[7] The concept of bankruptcy. Methods of diagnosis and ways of recovering bankruptcy, http://www.grandars.ru/college/pravovedenie/bankrot.html

[8] Ibid.

[9] JON G. BROOKS | Published: OCTOBER 24, 2012, Bankruptcy Lawyer Blog- A (Very) Brief History of Bankruptcy and Debt in the West., http://www.bayareabankruptcylawyerblog.com/bankruptcy-in-general/a-very-brief-history-of-bankruptcy-and-debt-in-the-west/#_ftn2

[10] Wikipedia, History of bankruptcy law, https://en.wikipedia.org/wiki/History_of_bankruptcy_law [Accessed 5 Jan. 2017]

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dismember and distribute a debtor's body to the creditors in proportion to the amount of debts owed to each." It is rather hard to see how such harsh punishment helped to compensate these ancient Roman creditors for their loss.[11]

Bankruptcy is also documented in East Asia. According to al-Maqrizi, the Yassa[12] of Genghis Khan (1206-1227) contained a provision that mandated the death penalty for anyone who became bankrupt three times.[13]

In Islamic teaching, according to the Quran, an insolvent person was deemed to be allowed time to be able to pay out his debt. This is recorded in the Quran's second chapter (Sura Al-Baqara), Verse 281, which notes: "And if someone is in hardship, then let there be postponement until a time of ease. But if you give from your right as charity, then it is better for you, if you only knew."[14]

After the American Revolution, the framers of the U.S. Constitution specifically granted to Congress the power "To establish … uniform Laws on the subject of Bankruptcies throughout the United States." Nevertheless, despite the fact that the Constitution specifically granted Congress the power to establish a federal bankruptcy law, it did not do so until the first Bankruptcy Act of 1800, which applied only to merchants, was enacted in response to major financial panics arising in 1792 and 1797 as a result of speculation. In those days, so called "Debtor's prisons" were widely distributed, and as a result of applying that law many debtors had become imprisoned, including some "prominent citizens". Though it was set to expire in five years, Congress repealed it in 1803.[15]

The first modern Bankruptcy Act in America, sometimes called the "Nelson Act", was initially entered into force in 1898. The current Bankruptcy Code was enacted in 1978 by § 101 of the Bankruptcy Reform Act of 1978, and generally became effective on October 1, 1979. The current Code completely replaced the former Bankruptcy Act, the "Chandler Act" of 1938. The Chandler Act gave unprecedented authority to the Securities and Exchange Commission in the administration of bankruptcy filings. The current Code has been amended numerous times since 1978 with the most significant recent changes enacted in 2005 through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[16]

Also, it is worth mentioning that Article 1 of Protocol 4 of the European Convention on Human Rights prohibits the imprisonment of people for breach of a contract- "No one shall be deprived of liberty solely on the grounds of failing to meet a contractual obligation."[17]

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[11] JON G. BROOKS | Published: OCTOBER 24, 2012, Bankruptcy Lawyer Blog- A (Very) Brief History of Bankruptcy and Debt in the West., http://www.bayareabankruptcylawyerblog.com/bankruptcy-in-general/a-very-brief-history-of-bankruptcy-and-debt-in-the-west/#_ftn2

[12] The unpublished legal code attributed to Genghis Khan, founder of the Mongol empire.

[13] Bankruptcy, http://www.wikiwand.com/en/Bankruptcy

[14] History of bankruptcy law, https://en.wikipedia.org/wiki/History_of_bankruptcy_law

[15] Oliver, Peter (1998). Terror to Evil-doers: Prisons and Punishments in Nineteenth-Century Ontario. Toronto: University of Toronto Press. pp. 48–55.

[16] Wikipedia, Bankruptcy in the United States, https://en.wikipedia.org/wiki/Bankruptcy_in_the_United_States [Accessed 29 Mar. 2017]

[17] The Right to Liberty and Security, Article 14 of Charter of Human and Minority Rights and Civil Liberties, http://www.gov.me/biblioteka/1054904021.pdf

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. Turkey and the United Kingdom (due to concerns over British nationality law) have signed but never ratified Protocol 4. Greece and Switzerland have neither signed nor ratified this protocol.[18]

Summarizing the abovementioned the following conclusion can be drawn: conceptual changes of the bankruptcy institution are conditioned by the development of public and free economic relations and by the emergence of more civil (secular) society, and later as a consequence of development of capitalistic relations and of more practical approach in a market economy. And though the first one was earlier, the assertions, that public needs entrepreneur to be exempted from liability for protection and dynamic development of entrepreneurship, were too often. Of course similar arguments have no generality in forgiving the debt in favor of consumers and public, rather they aim to protect first of all physical safety of entrepreneurs. Right here bankruptcy institution acts as a protective tool from entrepreneurial risks for entrepreneur, defining limited liability for it in (corporate) law.

SOCIO-ECONOMICAL GROUNDS OF ORIGINATION OF BANKRUPTCY INSTITUTION.

The socio-economic basis of origination of bankruptcy institution is the **economic crisis**, which is typical to free market relations-based economy. The economic crisis is a consequence of disproportionate development of individual branches of economy. Crises are different by their nature, origination conditions and consequences. Professor E.M. Korotkov gives the following classification of the economic crisis:[19]

1. by their prevalence crises can be general and local. General crisis includes all socio-economical system, whereas local crisis only some part of it.

2. by their issue (problem) crises are dived into macro crises and micro crises. Huge volumes and prevalence of the issue are typical to macro crisis, but micro crisis include only one, separate issue, or group of issues.

3. by their structure crises can be economical, social, organizational.

Core reasons of emergence of crisis phenomenon of business entity are hidden just in the market economic system. In market economy, where only stronger can survive (stay alive), the crisis of individual undertakings is a natural phenomenon. Crisis of each business entity reflects its own rhythm of development. Each organization has its own development potential and implementation conditions thereof, which is subjected to cyclic development laws of whole socio-economic system.[20]

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[18] European Convention on Human Rights, http://schools-wikipedia.org/wp/e/European_Convention_on_Human_Rights.htm

[19] Korotkov, E. M. (2010), Anti-crisis management: a textbook, M .: INFRA-Moscow, http://studme.org/44300/menedzhment/ponyatie_krizisa_ekonomicheskoy_sistemy, p. 17

[20] Katasheva V, Didenko S, Krutiakova Yu, (2009), Anti-Crisis Management. http://www.rumvi.com/products/ebook/preview/preview.html

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Usually, crisis occurs to business entity during its development and production expansion and at preliminary stage of production decline. It is conditioned by the change of production volume and the sale of output, the increase in debit and credit debts, the working capital deficit.[21]

Crisis phenomena pass through several stages of development of crisis situation: economic insolvency (bankruptcy latent stage), financial instability, insolvency (actual bankruptcy) and officially declaring bankrupt.[22]

Knowing classification portents of crisis situation will enable timely revealing and finding ways to prevent them.[23]

The reasons of crisis can be both objective and subjective. Objective reasons are related to the need of modernization and reconstruction, whereas subjective reasons are related to wrong and incomplete management of the enterprise.[24]

In the aftermath of economic crisis business entities may get into a bad financial situation. That can be a consequence of both political and economic unsustainability, inconsistency in the implementation of economic reforms, unfavorable conditions of investment, lack of manufacturing orders, ineffective tax policy, absence of financing projects directed to support the enterprise, and poor management of the enterprise. All these mentioned things bring business entity to insolvency and eventually leads to its bankruptcy.[25]

At the same time, an objective process of competition-based market economy assumes permanent flow of funds into the most favorable spheres of economy, redistribution of property of ineffective business entities among ineffective business entities, optimizing production infrastructure and a way out from crisis situation.[26]

The crisis or crisis situation are premises of market economy. This not only decides the margin of economic development, but also contributes further development thereof. Accordingly, under conditions of market economy crisis situations are natural phenomena for acting individual enterprises. In result of it weak enterprises seize their existence, and more sustainable ones continue to grow.

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[21] Katasheva V, Didenko S, Krutiakova Yu, (2009), Anti-Crisis Management. http://www.rumvi.com/products/ebook/preview/preview.html.

[22] Gamza, V. A. The laws of development of the organization as objective causes of crises and early warning signals about problems in the firm, www.elitarium.ru/2007/07/18/signaly_o_problemakh_v_firme.html, http://studme.org/1597012221787/menedzhment/zakony_razvitiya_organizatsii_kak_obektivnye_prichiny_vozniknoveniya_krizisov

[23] Zharkovskaya, EP, Brodsky, BE, (2004). Anti-Crisis Management: A Textbook. - M .: Omega-L,. p.5.

[24] Avdoshina Z.A., (2006). Anti-crisis management: the essence, diagnostics, methods, http://www.cfin.ru/management/antirecessionary_managment.shtml

[25] Ibid.

[26] Ibid.

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An ultimate form of crisis situation is bankruptcy, where an enterprise is not capable to pay its debts from its accounts of financial sources (incomes) and to recover its solvency form its accounts of cash inflow.

In such cases bankruptcy becomes a main recovery instrument for economy, in general, and for enterprise, in particular.[27]

LEGAL GROUNDS OF ORIGINATION OF BANKRUPTCY INSTITUTION IN RA.

In state's legal system the existence of bankruptcy institution has great significance for both legislation and economy, since provisions of bankruptcy institution, first and foremost, are targeted to the protection of the property right. It is also important for elimination those business entities, who are not able to carry out sustainable and effective activity and, finally, it is important so as to recover financial position of those business entities, who encounter with temporary financial difficulties. All these contribute to improvements of economic system, prevention of crisis and restoration of the activity of insolvent companies.[28]

Nowadays the RA bankruptcy institution is regulated by following normative-legal documents:[29]

- RA Constitution (adopted in 05.07.1995, amendments adopted in 06.12.2015)
- RA Civil Code (adopted in 05.05.1998)
- RA Civil Procedure Code (adopted in 17.06.1998)
- RA Judicial Code
- RA Criminal Code (adopted in 18.04.2006)
- RA Law on "Bankruptcy" (25.12.2006)
- RA Law on "Bankruptcy of Banks, Credit Organizations, Investment Companies, Investment Fund Managers And Insurance Companies"
- European Convention on Human Rights and other international treaties
- Sub-legislative acts

Civil legislation and other legal acts regulate relations among persons, conducting entrepreneurial activity or with their participation.[30] It also gives definitions on entrepreneurial activity and business relations, grounds of origination of civil rights and

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[27] Endovitsky DA, Shcherbakov MV, (2007). Diagnostic analysis of the financial insolvency of the organization: Textbook - Moscow: The Economist, p. 16.

[28] Socio-economic and legal grounds for state regulation of insolvency (bankruptcy) in Russia, Gallimulina N.A., http://5fan.ru/wievjob.php?id=73740,

[29] The right to property is recognized and protected in the Republic of Armenia. Freedom of economic activity and free economic competition is guaranteed in the Republic of Armenia (Article 8 of RA Constitution). According to Article 31 of RA Constitution everyone shall have the right to freely own, use, dispose of and bequeath the property belonging to him/her. No one shall be deprived of property except for cases prescribed by law in conformity with the judicial procedure. According to Article 33.1 of RA Constitution everyone shall have the right to freedom of enterprise not prohibited by law. Abuse of monopoly or dominant position in the market and bad-faith competition shall be prohibited. Restriction of competition, possible forms of monopoly and their permitted sizes may be prescribed by the law.

[30] CIVIL CODE OF THE REPUBLIC OF ARMENIA Article 1.3 (adopted by the National Assembly of the Republic of Armenia on June 17, 1998), http://www.parliament.am/law_docs/070898HO247eng.pdf?lang=eng

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obligations and their principles of implementation, ways of protection of civil rights and so on.[31]

Bankruptcy cases are also governed by other RA legal acts.[32]

The examination of bankruptcy proceedings is carried out in first instance courts of general jurisdiction, bankruptcy cases are conducted by specialized judges, solely, examining bankruptcy cases.[33]

As was mentioned above, **Article 1 of Provision 4 of European Convention on Human Rights** has prohibited imprisonment for debt, which can be considered quite serious achievement. Hence, it is time for application of financial recovery plans to become primary in bankruptcy cases in institutional system of bankruptcy.

1.3 INVESTMENT AND DEVELOPMENT PROCEDURE OF THE BANKRUPTCY INSTITUTION IN THE RA ECONOMIC SYSTEM

After approving independent statehood, where free market relations became a basis for the development strategy in RA economy, the adoption of laws regulating those where highlighted. Those are the laws, which are called for regulating relations that befits the civil market, contributing the natural formation and development of in rem (property) circulation within economy.

Highlighting the role of bankruptcy institution in development of market economy and the cornerstone role thereof, in 17.12.2003 RA National Assembly adopted RA Law on "Insolvency (Bankruptcy)", which regulates relations related with insolvency of legal persons and private entrepreneurs.

Generally, in RA the legisltaion concerning to insolvency has been developed quite intensely, which was conditioned by selection of economy development strategy. Having in particular free market relations as a basis, exactly the dynamic development perspective of economy has dictated the adoption of the first law on regulating relations concerning to insolvency. In 15.06.1995 the RA law on "Bankruptcy of Entrepreneurships and Private Entrepreneurs" was adopted, which, after approving independent statehood, was the first attempt to regulate such kind of relations, that were invested in new, liberal economy, and that were alien to the legal system till then. Being the first law regulating bankruptcy relations in our society, it, needless to say, had number of drawbacks, that complicated the application thereof. The law, in particular, did not regulate procedural peculiarities of insolvency cases,

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[31] Ibid

[32] RA Civil Procedure Code sets forth litigation procedure of civil proceedings, including bankruptcy proceedings in RA courts. At the same time, the legislature has made an exception from the laws governing bankruptcy proceedings, the procedural legal rules in which differ from the legal rules defined by the RA Civil Procedure Code. The Code sets forth the scopes of persons having rights to lodge with the court, ground to initiate civil proceedings and principles of implementation of justice with mentioned cases, rights and obligations of litigation parties. RA Criminal Code sets responsibility for unlawful actions during bankruptcy, intentional and fraudulent bankruptcy. RA Law on "Bankruptcy" sets forth the implementation order of proceedings in bankruptcy cases, according to which conduct of bankruptcy proceedings are carried out prescribed by RA Civil Procedure Code, RA Judicial Code and present law.

[33] Article 4 of RA Law on making amendments and additions in the RA Law "On Bankruptcy", http://www.ombuds.am/resources/ombudsman/uploads/files/proposal/cce2279635ace6299d0647828e9b272f.pdf

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number of procedures were defective. Concurrently, the existence of the law enabled the implementation of competitive proceedings, which was a precondition for positive developments.

The RA law on "insolvency (bankruptcy) and financial recovery of legal persons, entrepreneurships not having status of legal person and private entrepreneurs" adopted on 03.12.1996 regulated insolvency procedures maximally detailed and was the most corresponding to the perspectives of economy development. The present law still had numerous drawbacks too. Particularly, the competition of present law and procedural norms of RA Civil Procedure Code, adopted on 1999, had already been forecasting the necessity of new law on insolvency.

In general, the law is fairly advanced and poses procedural productive mechanisms of bankruptcy.

Moreover, in 17.06.2016 the RA law on "Bankruptcy" was amended with new chapter, headlined as "Proceedings of Bankruptcy Risk". This chapter of the present law defined order of acceptance for proceedings of the application of bankruptcy risk lodged with the court by debtor, order of examination, discussing (elaborating, amending and etc), satisfaction of application in bankruptcy risk proceedings, court decision on approval of financial recovery plan and freezing (moratorium) consequences of satisfaction of creditors' claims, early termination and completion of financial recovery plan.

The present amendment made in the RA law on "Bankruptcy" enables business entities to undertake bankruptcy process in an earlier period, thereby preventing further expected real bankruptcy consequences. This is the way, which legally enables the deferment of implementation of obligations of the entrepreneurship before creditors. This is an exclusive chance for debtor to commence a process of the financial recovery plan without creditors' consent and without criteria defined by law.

At the same time, it is worth mentioning, that provisions concerning to proceedings of bankruptcy danger does not clearly answer to the question on which criteria debtors especially led by to carry out their right of filing an application with the court for initiating bankruptcy proceedings. On this we will talk in appropriate part.

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CHAPTER 2. The main issues of debtor's financial recovery system application during bankruptcy proceedings.

2.1. The essence and legal regime of financial recovery plan

In European continental countries entrepreneurial society has gone a step forward in the issue of regulating the bankruptcy, realizing that stimulation of circulation acceleration of the invested capital will favor in its economic interests' progress in much bigger amount, rather than the dubious moral satisfaction deriving from arresting the debtor. Consequently the new tool emerged in bankruptcy institution, and during examining bankruptcy cases in economic legislation, applications of recovery (healing, sanatio) and restructuration were provided over potential broke debtor. But change of social look over said problems lead to the point, that they started to take pity on the bankrupt, protect him by any way possible, many things were excused applying number of methods and ways (discount and remission of debts, due date extension of payment, application of recovery procedures- moratorium). Such humanitarian treatment resulted in situation, where many fraudulent entrepreneurs, by preparing wisely for bankruptcy, made use of ommissions and privileges existing in it for dishonest goals and end up with a situation completely favorable for them. As a consequence bankruptcy became "beneficial business". For those abuses advanced bankruptcy institutions (USA, UK, Germany, Sweden, and Italy) applied legislative traps and obstacles.[34]

In Old Russia the legislative norm, including insovelncy regulation norms, was «Russkaya Pravda»[35]. It stated the personal responsibilities of the debtor, sale of guilty debtor to debt slavery, debtor restructuring in case of innocent insolvency, the sequence of satisfaction of demands, it also stated that the merchant should not be subjected to criminal responsibility, if he has lost borrowed money or property due to shipwreck, military actions or fire, rather he was given a chance extending terms for repaying the debt owed, however this privilege was not extended on accidentally lost funds due to brawl or drunkenness. In this event that was regulated at creditor's disposition. The latter could forgive the debt, extend the payment, sell the property of the debtor or sell the debtor to peonage. In the event of

[34] National Research University "Higher School of Economics". Scientific and educational portal IQ (2001) . The Institute of Bankruptcies is becoming an increasingly popular economic mechanism, https://iq.hse.ru/news/177815702.html

[35] "Russian Justice" or "Russkaya Pravda" was the legal code of Kievan Rus, it was written at the beginning of the 11th century and was a main source of Old Russian Law, https://www.revolvy.com/main/index.php?s=Russkaya%20Pravda&item_type=topic

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malicious bankruptcy no privileges were granted to debtor and he turned to work as a vassal. From legal perspective whole property of vassal belonged to his lord.[36]

In 19 December, 1800 a "Charter on Bankrupts" was adopted, which in fact was divided in two parts- merchant (entrepreneurial) insolvency and nobleman (non-entrepreneurial) insolvency.[37] So, this charter envisaged restructuring of debt, signing peaceful post trial agreements with creditors, and also some period of time was granted to debtor by court for recovery of solvency. There has been established a system of priority for payments to creditors, and three types of bankruptcy has been defined- unhappy, reckless, malicious.[38]

On 23 June, 1832 "A Charter on Merchant Insolvency" was adopted, which superseded the "Charter on Bankrupts" of 1800.[39] Though significant amendments were not made in this charter, the main differences were clarifying monetary measures and sanctions. For example, the debtor could be arrested up to two years during bankruptcy processes, and after his deliverance he could be prohibited to launch business activity. The amount of not-compensated debt has been levied through his whole subsequent life, until it was completely repaid. In the event of intentional bankruptcy criminal claim has been instituted against debtor.[40]

Investment of recovering plan (sanatio) is a restructuring process, during which financial aid is granted to the debtor company to such an extent that would be sufficient to repay monetary liabilities and would contribute to rehabilitate solvency of the company. Financial recovery plan shall be deemed to be a complex of measures not prohibited by law that are applied towards debtor, in order to recover his solvency, as a result of which the debtor shall not be liquidated or no judgment will be made on the closure of the bankruptcy case with respect to a natural person by releasing him or her from performing obligations. [41]

Financial recovery plan is such a bankruptcy process, which is applied towards debtor with the aim of recovering his solvency and paying back debtor's liabilities.[42]

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[36] Karelina, S.A. (2008). Mechanism of Legal Regulation of Insolvency Relations, Moscow, p. 379

[37] The laws of the Russian Empire, the "Bankrupt Charter" of 19 Dec. 1800 (Law No. 19692, page No. 310), http://www.nlr.ru/e-res/law_r/search.php

[38] Unfortunate, Negligent and Malicious Bankruptcies, http://webcache.googleusercontent.com/search?q=cache:IZNN9VAcepUJ:www.xn--h1aahkxm.xn--p1ai/upload/iblock/e53/neschastnye_-neostorozhnye_-zlonamerennye.docx+&cd=1&hl=ru&ct=clnk&gl=am

[39] Shershenevich, G. F, (1912), Course of commercial law, Russian law, Vol. IV: Trading process. Competition process, § 188 Russian law, General concepts of insolvency. p. 127

[40] Kondratieva K, (2007). Administrative Law; Financial Right; Information Law, Administrative and Legal Framework for Securing the Financial Stability of Legal Entities in the Russian Federation. Moscow http://www.mosgu.ru/nauchnaya/publications/2007/abstract/Kondratieva_KS/

[41] Law on Bankruptcy of RA HO-51-N , Article 54,

[42] The financial recovery procedure is not a mandatory process in bankruptcy proceedings. It is conditioned by the stance of creditors. There is no limitation towards financial recovery plan; it enables the representative of the financial recovery plan to take any measure, not prohibited by law, in aftermath of which the debtor will completely pay off his payment obligations and not be liquidated.

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Financial recovery is considered to be an important nexus in bankruptcy process, which applies towards the bankrupt. In the event if the solvency of the debtor is recuperated during financial recovery and the claims of creditors are satisfied, the court closes bankruptcy proceedings and the debtor continues his regular activity as an independent business entity in civil-legal sphere. But in cases where during financial recovery the solvency of the debtor is not recuperated and the claims of creditors are not satisfied, a liquidation process starts against debtor through court's appropriate decision (Article 70 of the present Law).[43]

The essence and meaning of financial recovery is also manifested in that it mainly aims to provide complete satisfaction of claims of debtors.[44]

The Latvian law on insolvency prescribes, that if the organization has been caught up in a dire financial strait, then it can take to court on its own, one year recovery (sanatio) process shall be applied towards it, during which the firm is not declared bankrupt, his management is supervised by appropriate body, any type of interest or penalty accrual is ceased, as well as confiscated property of the firm cannot be sold until the end of the **moratorium**.[45] Article 5 of RA Law on "Bankruptcy" prescribes two-month period from the moment of detecting impossibility for returning whole debts of debtor to file an application on self-insolvency with the court, though in this case the emphasis is on liquidation, rather than on recovery.

The main law regarding bankruptcy of legal entities, individual entrepreneurs and persons in Armenia is "The Law on Bankruptcy". The Law was adopted by the National Assembly of RA on December 25, 2006 and effective from 10th of February, 2007.

Financial recovery plan is defined by Article 59 of RA "Law on Bankruptcy". The legislator has defined a time period of the financial recovery plan, which may not exceed 24 months, unless its effective duration has been extended in the manner prescribed by this Law. The following measures may be carried out within the framework of the financial recovery plan[46]:

(a) sale of the whole or part of the debtor's property;
(b) transfer of the debtor's property to creditors through settlement/set-off;
(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;

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[43] Scientific-practical commentary on RA Law on "Bankruptcy (Insolvency)", 2003, p. 91 http://www.hmanoukian.com/files/old/210.pdf
[44] Scientific-practical commentary on RA Law on "Bankruptcy (Insolvency)", 2003, p. 92 http://www.hmanoukian.com/files/old/210.pdf
[45] Latvian Law On Insolvency of Undertakings and Companies, 17 Apr. 1997, http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN018387.pdf
[46] Article 59 of RA Law on "Bankruptcy", 2006, http://www.parliament.am/legislation.php?sel=show&ID=2881

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(i) receiving a new loan;
(j) undertaking new investments;
(k) reorganisation of the debtor;
(l) issuing new shares or buy-back;
(m) other measures not proscribed by law.

The process of financial recovery can be divided into following stages:

- Submission of financial recovery plan (Article 49 of the present Law)
- Discussion of financial recovery plan (Article 51 of the present Law)
- Voting of financial recovery plan(Article 52 of the present Law)
- Approval/acceptance of financial recovery plan (Article 53 of the present Law)

Before defining the order of submission of financial recovery plan, it is worth mentioning that financial recovery plan should comprise following mandatory conditions[47]:

a) Repayment time schedule of liabilities towards secured, unsecured and other groups' creditors, order of completion of payments against creditors' claims
b) The order and extent for releasing, deferring or reformulating debtor's liabilities.
c) Order of completion, terms and content of measures prescribed by law for recovering debtor's solvency, in case of continuing debtor's activity bases for chances of increase of satisfying creditors' claims, and composition of selling property in case of selling debtor's property.
d) Order and extent of remuneration of Administrator and other specialists, debtor's manager and compensation of administrative costs- necessary for completing financial recovery plan

Without creditor's written agreement the financial recovery plan cannot provide other satisfaction sequence of claims of that creditor than provided by this law. If the current creditor has not given other written agreement, then in result of provided financial recovery plan no one of the creditors should emerge in a less favorable situation than if the debtor has been liquidated.[48]

The financial recovery plan cannot contradict the RA law and violate other persons' rights.[49]

If pledged property before claim of secured creditor(s) is to be used during implementation of financial recovery plan, then secured creditor's(s') agreement on discussion or approval for financial recovery plan is mandatory.[50]

The legislator has defined composition of respresenting parties of financial recovery plan as follows:[51]

- debtor

[47] Article 61, RA "Law on Bankruptcy"
[48] Ibid, part 2
[49] Ibid, part 3
[50] Ibid, part 4
[51] Article 60 clause 1, RA "Law on Bankruptcy"

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- Administrator
- creditors possessing at least 1/3 of secured claims
- creditors possessing at least 1/3 of unsecured claims
- individuals possessing at least 1/3 of charter capital of debtor

The court can extend submission term of the plan with another 30 days by the motion of the person having right to submit financial recovery plan.[52]

The financial recovery plan is an offer that is submitted to the court, which poses certain compulsory obligations towards the person who have submitted such plan. Members of creditors' meeting accept such offer at their own risk, which has to be approved by the court.[53]

The legislator has defined "**discuss"** and "**vote"** order on financial recovery plan.

After receiving financial recovery plan the court makes a decision, within two days, to leave the financial recovery plan without discussion, if it does not comply with reuirements defined by the present law. Before making a decision the court can require to submit expert's conclusion on plan from the person who represents the plan.[54]

If after receiving financial recovery plan the court does not make a decision within two days to leave the financial recovery plan without discussion, then it notifies Administrator, debtor and all creditors known to it about existence of the financial recovery plan in the court and about their right to get acquainted with the plan.[55]

The Administrator summons a meeting to discuss financial recovery plan (plans), to which the debtor is being invited. The meeting should be summoned not later than 20 days after expiration of time period, defined by this law or by the court decision on extending time period for submission of financial recovery plan.[56]

The information about summoning a meeting should be promulgated in the press that publicizes data about state registration of legal persons, indicating name of the person submitting the plan(s) and year, moth and date of holding the meeting.[57]

According to Article 63 part 1 of RA "Law on Bankruptcy" in case of discussing more than one financial recovery plan voting of all plans should be carried out during one meeting.

Except creditors with secured claims, creditors with claims of founders of the debtor (participants, shareholder, members or partners) and creditors with claims of RA government and community budget, only creditors with authorized claims can take part in voting process.[58]

[52] Article 60 clause 2, RA "Law on Bankruptcy"
[53] Mukuchyan T., Manukyan H., Comments of RA "Law on Insolvency (Bankruptcy)" , Yerevan 2005, p. 204
[54] Article 62 of RA "Law on Bankruptcy"
[55] Ibid
[56] Ibid
[57] Ibid
[58] Article 63 of RA "Law on Bankruptcy"

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The financial recovery plan shall be considered approved, if clear majority of creditors' voices have voted in favor of acceptance thereof, on which the meeting makes a decision.[59]

If more than one plan is being voted, then they are being voted by their priorities. According to the first part of the following article, after acceptance of the financial recovery plan other plans are not voted.[60]

In case of submitting more than one financial recovery plan regardless of their quantity their voting should be carried out within one meeting.[61]

The legally effective decision of the court on approving the final list of creditors' claims is present by the day of summoning creditors' meeting for financial recovery plan. Therefore, only those creditors can take part in the voting of financial recovery plan, whose claims are approved by the court decision.

If the meeting decides to accept the financial recovery plan and if it is in complience with the RA "Law on Bankruptcy", then it will be approved by the court decision. Otherwise the court makes a decision on denying the financial recovery plan and liquidating the debtor.[62]

If after approval of the financial recovery plan new claims of creditors are submitted to the court, then within one-month time period new financial recovery plans or ammendments of approved plan can be submitted to the court. New financial recovery plans or ammendments of approved plan are submitted to and approved by the court as prescribed by law.[63]

The Administrator shall submit a report on completion of the finanacial recovery plan to the court after the expiration of time period of the financial recovery plan, but no later than 15 days.[64]

The followings shall be attached to Administrator's report:[65]

a) financial report of the latest reporting period of the debtor.

b) the registry book of creditors' claims indicating satisfied claims

c) certifying documents of satisfaction of creditors' claims.

After receiving report on completion of financial recovery plan the judge appoints a session within no later than two weeks and no early than one week, informing Administrator, debtor and creditors about that at least three days ago.[66]

If the number of creditors is more than 10, then the proper notification for them is considered to be the statement about the venue of session and date promulgated in the press publicizing data about state registration of legal persons.[67]

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[59] Ibid
[60] Ibid
[61] Ibid
[62] Article 53 of the RA Law on "Bankruptcy and Financial Reorganization of Legal Entities, Enterprises Lacking Legal Entity Status, and Entrepreneurs", 1996,
[63] The Law "On Bankruptcy" on Making Amendments and Supplements of the Law, 17.06.2016
[64] Article 69 of RA "Law on Bankruptcy"
[65] Ibid
[66] Ibid
[67] Article 74 of RA "Law on Bankruptcy"

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The non-appearance of Administrator, debtor and any of creditors shall not be a ban for holding a session.[68]

With results of Administrator's report on the completion of the financial recovery plan and creditors' objections regarding the completion of the financial recovery plan, the court shall adopt:[69]

a) a judgment on approving the Administrator's report on the completion of the financial recovery plan and closing the bankruptcy case, if the claims of creditors have been satisfied,

b) a decision on rejecting the approval of the Administrator's report on the completion of the financial recovery plan and liquidating the debtor, if the claims of the creditors have not been satisfied.

The financial recovery plan shall be over at the expiration of specified date.

During the whole period of completing the financial recovery plan the Administrator just has the authority to supervise the activity within the frameworks of the debtor's plan. But measures, including satisfaction of claims, prescribed by the original project are carried out by the manager of the debtor. Therefore, in order to submit the report the administrator will need detailed reports (tax reports, accounting reports, statistical reports, other mandatory reports prescribed by law) of debtor on satisfaction of completed measures and claims.

The report of Administrator shall comprise results of measures prescribed by financial recovery plan, data and proofs on results of completion of claims' satisfaction timetable, the list of unsatisfied claims.[70]

The registry book of claims, adjacent to the report that is to be submitted to the court, shall comprise Administrator's note on the extent of satisfied and unsatisfied claims.[71]

Creditors can bring up objections to the court on closure of financial recovery plan before court session.[72]

In summoned court session the court adjudicates the case and assesses the groundedness of Administrator's report, and when objections arise, the court adjudicates also that objections.[73] With results of adjudication the court makes a decision.[74]

The legislator has also defined the possibility of early closure of financial recovery plan.

When the claims of creditors are satisfied prior to the expiry of the financial recovery plan, the Administrator shall submit a report to the court on early completion of the financial recovery plan. In case the report on early completion of the financial recovery plan is approved, the bankruptcy case shall be subject to closure.[75]

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[68] Article 69 of RA "Law on Bankruptcy"
[69] Ibid
[70] Scientific-practical commentary on RA Law on "Bankruptcy (Insolvency)", 2003, p. 108 http://www.hmanoukian.com/files/old/210.pdf
[71] Ibid
[72] Ibid p. 119
[73] Ibid p. 109
[74] Ibid p. 143
[75] Article 67 of the Law "On Bankruptcy"

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Where the claims of creditors are not satisfied at the moment of submitting the report, the court shall reject the approval of the Administrator's report, and the financial recovery plan shall continue.[76]

Where the report submitted by Administrator in bankruptcy case is approved, the bankruptcy case shall be subject to closure, on which the court makes a decision.

In the given context we may note the Article 86 of Russian Federation Federal Law On "Insolvency (Bankruptcy)", which defines the early completion of financial recovery, in particular, mentioned provision sets forth that in the event of the debtor's repayment of all creditors' claims provided for by the debt repayment schedule, before the expiry of the financial recovery period established by the arbitration court, the debtor shall submit a report on the early termination of financial recovery.[77]

It should be noted that in this case in contrast to domestic legislation the obligation to submit the report is assigned to debtor, not to Administrator.

Only the debtor can submit a financial recovery plan of a natural person.[78]

The financial recovery plan of a natural person is approved by the court, if it complies with the requirements set forth by the present law. The maximum time period for financial recovery plan of the natural person cannot exceed 4 years.[79]

The financial recovery plan of the natural person is not voted by creditors.[80]

Prior to the approval by the court of the financial recovery plan, the debtor may make amendments thereto, as well as extend or reduce the effective period of the financial recovery plan, change the procedure for making payments and other conditions.[81]

Summarizing the abovementioned the following legal issues can be split up:

Defining the deadline for financial recovery plan, which in essence restricts the debtor's right to fully implement the recovery.

If we consider that, that bankruptcy procedure is not only intended to kick out a nonviable entrepreneur, but also to create premises to rehabilitate the company and at some extent the bankruptcy procedure is considered rehabilitating procedure, then at any stage of bankruptcy the right to submit financial recovery plan should be reserved, which may favor recovery to the debtor.

The financial recovery plan shall be considered approved, if clear majority of creditors' voices have voted in favor of acceptance thereof.

The mentioned may cause negative consequences for creditors having relatively greater claim and breach rights of those, who are not agree with the financial recovery plan, though other creditors, whose extent of the claim is less and who agree with the plan (there may also be malicious agreement) merely due to the circumstance, that they are quantitatively

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[76] Ibid

[77] Federal Law No. 127-FZ of October 26, 2002 (amended on July 3, 2016) "On Insolvency (Bankruptcy)", Article 86. Early termination of financial recovery

[78] Article 94.1 of the RA Law on "Bankruptcy"

[79] Article 36.2 of the Law on making amendments and supplements in the RA law "on Bankruptcy"

[80] Article 94.3 of the RA Law on "Bankruptcy"

[81] Article 94.5 of the RA Law on "Bankruptcy"

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greater in case of clear majority financial recovery plan can be adopted, in aftermath of which other creditors may likely appear in a less favorable situation.

Therefore, vote of all creditors for adopting financial recovery plan becomes necessary, since the mentioned plan tackles interests and rights of all creditors.

Our domestic legislation set forth that financial recovery plan is not voted by creditors in case the debtor is a natural person, even when it directly tackles creditors' rights and interests.

Therefore, where debtor is a natural person, financial recovery plan should be discussed and voted by creditors, as it is possible not to derive from creditors' interests and comprise less favorable conditions for creditors.

Application of such procedure as financial recovery towards natural person may often be deemed unjustified, due to its completely different content of objectives and problems.

It is worth to see, that the system of financial recovery is applied in **American model** of Bankruptcy Institution, which is aimed at protection of debtor's interests, meaning that the priority is given to the recovery of the debtor and/or maintaining entrepreneurial activity.

Therefore, by mentioned principle financial recovery chance of debtor legal person and debtor natural person is justified.

CHAPTER 3

3.1 Effectiveness of activity of bankruptcy system in countries having market-economy.

What bankruptcy system is about? It is, first of all, a protection of property rights of creditor from dishonest debtor during bankruptcy. It means that in order to provide performance of payment obligations before creditors it is necessary to exclude withdrawal of liquid assets present in the enterprise by dishonest debtor, to make the bankruptcy process controllable and transparent. Provisions of RA Law on "Bankruptcy" are aimed at provision of the mentioned issue to the maximally possible extent. To achieve that goal the legislator has granted wide authorities to court, temporary bankruptcy administrator, bankruptcy administrator and creditors within bankruptcy process. Along with that, the law has not disregarded rights and interests of the debtor as well, giving him a chance to be reorganized and recover his solvency by restructuring creditors' debts.[82]

Accordingly, it is necessary to understand, what problems, globally, has the legislature set for itself, to what extent does the acting law solve state-strategic problems implemented in socio-economic system. Judging by structure of the law and by the scope of authorities granted to subjects of bankruptcy system, a conclusion can be drawn that for legislature the key objective is the protection of proprietary rights (in rem) and interests of owner-creditor, and do it within the shortest possible time. But it is another issue, to what extent it is necessary and effective at micro-meso-macroeconomic levels. Here is the most important question, which shall be resolved by the legislature in free market economy-based countries,

[82] RA Law on "Bankruptcy".

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not only to provide the dynamic development of the economy, but also to solve socio-economic, demographic and political issues.

It is known that, recognizing insolvent business entity bankrupt ends up with either winding him up or satatio (representing and performing financial recovery plan). In essence, choosing any of them can be assessed as anti-crisis measure. The important thing is to create an effective and productive protection of interests of all subjects of the bankruptcy system, in case of liquidation of the enterprise, that has been recognized bankrupt and its financial recovery and reconstruction.

This is exactly where the legislature shall assess risks, which emerges in case of abovementioned dilemma. But, endowing court with the authority to recognize business entity bankrupt, the legislature, simultaneously, has imposed function on the court not typical to it. That is, to make economically grounded decision in bankruptcy cases concerning implementation of further processes. It appears that in bankruptcy proceedings the sole mechanism to protect parties' interests is a subjective opinion of the judge, who is possibly, lacks skills of assessing financial position of the enterprise and foreseeing subsequent developments or is not sufficiently aware of the mentioned issue. Whereas in order to make decision on winding up the enterprise, the court, first of all, shall assess sufficient grounds submitted for liquidation of the enterprise, or in order to manage financial recovery plan, the court must be able to assess plan's effectiveness by applying special methods.

It should also be understood, whether bankruptcy administrators, whom the legislature has endowed with pretty wide authorities, are aware at the sufficient extent of socio-economic strategy of the country and all nuances of enterprise performed at different spheres of economy, or their capabilities are limited to performing elementary mechanism of distributing funds obtained from sales of debtor's property? Whether he is capable to virtually analyze the financial position of debtor, real reasons of bankruptcy of latter, also financial, economic and investment activity of debtor and his situation in commodity market?

Or, are creditors, who are entitled to demand timely and full implementation of debtor's obligations, ready to waive their demands on getting short-term satisfaction, giving due to countries' global strategy directed to socio-economic development.

A good example to illustrate is how recovery procedures are carried out in bankruptcy proceedings in US, according to provision of US Code on "Bankruptcy". This Code sets forth five different processes in bankruptcy proceedings, from which the most widespread ones are procedures of winding up the enterprise (Article 7 of the Code) and reorganization thereof (Article 11 of the Code).[83] The latter is similar to financial recovery of the enterprise. During reorganization of the enterprise the debtor continues possessing his property and implements economic activity. But at the same time in order to discuss the reorganization plan of the enterprise he is obliged to submit that plan to creditors. Subsequently the mentioned plan is submitted to the court for confirmation, and if confirmed the debtor makes payments

[83] Rasin A, (2010). "Pavda and Epshtein"- Mergers and Acquisitions. Moscow, http://www.arbitr.ru/press-centr/smi/27742.html

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(generally annually) to the trustee over a period of time, usually at least three years, and the trustee distributes the payments to creditors (Chapter 12 of US Bankruptcy Law).[84]

Similar procedure of reorganizing the enterprise has been applied, for instance, over General Motors Corporation, which was considered as a US automobile giant, and over Nortel Networks Corporation, one of the biggest manufacturers of telecommunication equipment in North America.[85]

It is worth mentioning, that by considering specifications of separate spheres of economy, the US Code on Bankruptcy regulates the implementation of financial recovery plan in different spheres of economy. A good example is the provisions of law concerning implementation process of financial recovery plan within bankruptcy proceedings in agriculture, farmer, and economy.

[84] Martin A. Frey. Introduction to bankruptcy law, fifth edition

[85] Belyaeva, T. (2003). Financial recovery plan: features, risks, examination, Federal Service of Russia for Financial Recovery and Bankruptcy. № 7, p. 19.

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3.2 Effectiveness of activity of separate systems directed to implementation of financial recovery plan in market economy based countries

Financial recovery is one of the means of debt restructuring and recovering debtor's insolvency. Nevertheless, considering the fact that the Law, effective from 1978, has not experienced any serious amendments, evidences that US creditors are indifferent to the issue of recovering the insolvency of debtor. [86]

It is worth mentioning, that in practice financial recovery cases are applied very seldom and very carefully, considering incompleteness of the applicable mechanism. For instance, according to statistics, provided by the Ministry of Economic Development of the Russian Federation (RF), 30.000 bankruptcy proceedings are being initiated annually, but unlike US, financial recovery process rarely finds its application. Typically, assets of the company are being sold through auction, and the company is being liquidated.

So, back in first half-year 2014, only 31 of 16.976 bankruptcy cases entered in RF arbitrary court implemented financial recovery plan, from which in 5 cases debtors paid off creditors' debts.[87]

To compare, in 2014 from all bankruptcy cases initiated in US, over 27.000 implemented liquidation process towards enterprises, and only 8.700 passed through recovery process.[88]

According to provisions of Chapter 11 of the US Bankruptcy Code bankruptcy process often enables American enterprises to continue their activity, restructure debts and get out of an insolvent situation in a "new look", as motor-vehicle manufacturers General Motors Corporation and Chrysler Group did.[89]

Making efforts to draw attention to them, business entities have achieved a great success in number of countries, including Republic of Armenia.

As we have mentioned, 17.06.2016 amendments, made in RA Law on "Bankruptcy", enables business entities to undertake financial recovery process at earlier stage of insolvency without creditors' consent and without criteria set forth by law, thereby preventing actual bankruptcy risk expected in the future.

At the same time, a question arises about the particular criteria by which debtors are guided in exercise of their right to apply to the court for instituting bankruptcy proceedings

[86] US Law on "Bankruptcy"
[87] Galimullina N.A., (2014). Socio-economic and legal basis for state regulation of insolvency (bankruptcies) in Russia.
[88] Ibid
[89] Ibid

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and whether debtors are able to assess their actual financial position at the point of applying to the court.

Analyses show that one of the reasons of inefficient application of financial recovery plan is the late submission of application to the court on recognizing debtor bankrupt. Actually, these applications are submitted to the court both by debtors and creditors only then, when chargeback and all other possible measures have been exhausted already a long time ago, and all of the debtor's property has fully been realized.

From this perspective an instructive example is the mechanism applied in RF, which has enabled enhancing the implementation efficiency of financial recovery plans in bankruptcy institution system.

So, adoption of the RF law on "Insolvency (Bankruptcy)" enabled the creation of federative service in bankruptcy cases, which from the very beginning set itself the following main tasks:[90]

- elaboration and implementation of measures directed to financial recovery of the insolvent enterprises,
- implementation of state policy directed to prevent the bankruptcy,
- elaboration and implementation of measures directed to provide analyses on financial position of companies and supervision of their payment and settlement discipline maintenance.

The assessment of financial-economic situation of the enterprise by the abovementioned service is implemented for two purposes:

- efficiency of the activity of the enterprise (enterprise as a business entity),
- liquidation of the enterprise (enterprise as a possible risk bearer of bankruptcy).

Financial analysis of enterprise's situation enables to detect the bankruptcy risk and timely undertake necessary measures directed to its financial recovery.

Summarizing the above, it could be concluded that the RF, as a free market-based country, encourages at the state level the recovery and the further functioning of as many bankrupt enterprises as possible. That requires liquidation processes in bankruptcy proceedings to be replaced with rehabilitation processes and put the accent on implementation of financial recovery plan of the enterprise.

[90] The RF Law on "Insolvency (Bankruptcy)".

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3.3 Legal Mechanisms Directed To Implement Financial Recovery Plan In Bankruptcy Proceedings And To Reduce Corruption Risks.

The primary objective in bankruptcy institution is the improvement of legislative mechanisms, so that bankruptcy proceedings are maximally directed to implementation of financial recovery plans of the enterprise.

Considering this circumstance and the abovementioned RF practice, and also the effective application necessity of provisions of the law concerning bankruptcy risk set forth in RA Law on "Bankruptcy", I offer to add new provisions in RA Law on "Bankruptcy", which will clearly define criteria guiding debtor to implement his right to go to the court for initiating bankruptcy proceedings. Thus, the grounds prescribed by law for instituting imminent bankruptcy proceedings may be submitted and the criteria may be assessed by the service (or private services) established for that purposes.

If the said service is state-owned, then it can set itself the same tasks that factually are set on the RF acting service.

In case of private service, in order to prevent insolvency, provide stability of the company's activity and its competitiveness in the market the following obligations (prescribed by the contract of service provision) might be set on it:

- analysis and assessment of the financial-economic state of the enterprise,
- assessment of probable risks of insolvency,
- elaboration and implementation of measures directed to financial recovery of the insolvent enterprise,
- elaboration and implementation of plans directed to restructure and financial recovery of insolvent enterprise,
- collecting necessary financial means for implementing financial recovery plan, including foreign investors and so on.

The service can also carry out monitoring and assessment, as well as business-consultation of company's activity and market developments of company's activity scope.

Also, the possibility of success of implementation of financial recovery plans in bankruptcy cases mostly depends on will and legal awareness of beneficiaries in bankruptcy proceedings.

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Giving consent for and submitting an offer to the court to extend time period of implementation of the plan is an exclusive jurisdiction (authority) of creditors' assembly.[91] A question arises on how many bankruptcy cases, heard in RA courts, creditors' assembly has given its approval for financial recovery plans submitted by debtors. According to statistics of bankruptcy cases examined in RA courts, financial recovery plans in bankruptcy proceedings constitute only 12-13%.[92]

Another example would be the fact that the Law on Bankruptcy envisages the unanimous consent of creditors as a condition for approval of the financial recovery plans by the court under the imminent bankruptcy proceedings.[93]

And to what extent the bankruptcy Administrator is interested in exercise of financial recovery plan of the enterprise? The issue of liquidating the bankrupt enterprise or submitting the financial recovery plan mostly depends on latter's discretion as well, conditioned by number of objective and subjective reasons (producing capacity of the enterprise, property condition of debtor, price and liquidity, claimants' agreements, choice of way to carry out bankruptcy process as fast and efficiently as possible, personal or other interest and so on).[94]

The above provisions, that set forth such an important issue for Administrator, as his remuneration is, may have a serious impact on decision-making for problem solving in bankruptcy cases.

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[91] Clause 4 of Article 33 of the RA Law on "Bankruptcy"

[92] Soukoyan, A. A., (2017). Interview with the bankruptcy judge, Court of General Jurisdiction of Kentron and Nork-Marash Administrative District. Statistics on financial recovery of bankrupt enterprises in the RA. Also, several issues were discussed during interview.

Partial analysis of implementation efficiency of financial recovery plan in bankruptcy cases in free market economy based countries allows assessing differences of current countries' approaches to the same issue. Thereby we can understand each one's strategy directed to development of economy.

If in one case the law on bankruptcy, in order to approve the financial recovery plans in imminent bankruptcy proceedings by the court, considers unanimous consent as a mandatory condition, then in the other case not only will such agreement be no longer required, but also bank guarantee will not be required, as a method for ensuring the exercise of debtor's obligations.

Furthermore, analyzing the provision of RA Law on "Bankruptcy", according to which "it's enough to have debtor's financial recovery plan in compliance with the Law's requirements and Administrator's positive conclusion about credibility of present information in financial recovery plan and probability of plan's implementation", outlines the future of financial recovery plan of the enterprise in a highly questionable way.

It is known that the bankruptcy process starts from analysis of financial position of the enterprise, which aims to foresee bankruptcy probability. A question arises on whether or not the bankruptcy Administrator has got adequate knowledge and skills to carry out necessary analysis. Therefore, is Administrator's positive conclusion, concerning credibility of information available in financial recovery plan and probability of exercising the plan, sufficient condition for creditor to give his consent on exercising financial recovery plan of the enterprise? Shall a document be considered fundamental, which only states about probability of exercising the plan, and not about firmly implementation of it?

[93] Սնանկության մասին ՀՀ օրենքի 15.3 հոդվածի 3-րդ մաս, http://snank.am/page/HHORENQ12_NEW

[94] Particularly, 2nd and 3rd parts of Article 30 of RA Law on "Bankruptcy" set forth amount and terms of remuneration of Administrator in case of financial recovery of debtor.

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Also, it should be noted that regulation of implementation of bankruptcy proceedings was given by legislature to maximally reduce abuses of rights and corruption risks of the parties.

The debtor may be recognized bankrupt by court's decision.[95] Powers granted to courts by the Law, to implement proceedings of bankruptcy or imminent bankruptcy, is necessary conditions to implement bankruptcy proceedings. Powers granted to courts by Law are called to refrain litigation from abuses of rights of the parties.

So, if debtor, creditor or Administrator is duly noticed on time and venue of court session, then his non-appearance shall not be a prohibition to examine the imminent bankruptcy application.[96]

RA Law on "Bankruptcy" sets forth the order of appointing temporary bankruptcy Administrator by the court.[97] Or, the provision that sets forth the procedure for nominating bankruptcy Administrators by Self-Regulatory Organization of Administrators.[98]

In my opinion appointment of the Administrator by procedure prescribed by above provisions significantly reduces corruption risk and possibilities of abuses.

Even so, I think that the Armenian legislature shall draw corresponding conclusions and direct vector of legislative reforms under imminent bankruptcy proceedings and bankruptcy proceedings to financial recovery plans of business entities in favor of all beneficiaries under given enterprise and in favor of dynamic development of economy.

Rights and lawful interests of parties to insolvency proceedings, as well as the efficient development of the economy at all the levels and the best way to settle the socio-economic, and why not the political, demographic and other important issues is the promotion of entrepreneurship, the state support thereto. It should also be considered that the exercise of financial recovery plan of the enterprise would be the most effective in imminent bankruptcy (insolvency) prevention stage, when it is yet possible to maximally provide fair balance of interests of creditors and debtors. Hence, it would be expedient to invest the RF practice, on which we have elaborated above, in RA bankruptcy system. Moreover, the efficiency of activity of private institutions, exercising financial recovery plans, could be pretty high, considering the fact that relations of business entities have contractual nature, where parties decide scope of their rights and liabilities by their own.

[95] Clause 1of Article 3 of the RA Law on "Bankruptcy"
[96] Clause 1of Article 15.3 of the RA Law on "Bankruptcy"
[97] Clause 2.1of Article 13 of the RA Law on "Bankruptcy"
[98] Clause 5 of Article 22 of the RA Law on "Bankruptcy"

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CONCLUSION

Summarizing practical meaning, efficiency and development perspectives of financial recovery plans under bankruptcy (insolvency) cases we come to a conclusion that in modern free market relations based civil societies, including RA economy system, dynamic development of the economy demands new approach to relations of subjects of law. While acknowledging the priority of the right to property, it should be stated that nowadays the guarantee for sustainable development of the economy is the protection of not only their rights and lawful interest but also rights and lawful interests of business entities and other beneficiaries of that undertaking.

Entrepreneurship should be protected against shocks, which, first of all, is mostly conditioned by adoption of legislation promoting economic progress, part of which comprises adoption of laws aimed at introduction of effective mechanisms securing the efficiency of the bankruptcy system. New legal mechanisms of individual systems directed to implementation of financial recovery plan inside the bankruptcy institution should be aimed not only at the protection of creditors' rights, but also at the protection of debtors' rights and lawful interests.

Under circumstances of free market relations of modern economy efficient system of financial recovery acting inside the bankruptcy institution may affect significantly on micro, meso and macroeconomic levels. The exercise of financial recovery plan can provide continuity of activity of business entity and job retention at the enterprise, protect business interests of shareholders, partners and creditors, support tax generation, establish guarantees to prevent fraud and abuses.

Indeed, the institution of bankruptcy is to be considered as integrity of conditions, rules, norms and tools, the primary objective of which is the preservation of the enterprise through implementation of financial recovery plans, in order to provide stability of economy.

In an attempt to suggest more effective mechanisms directed to the introduction of the bankruptcy system and, in particular, an efficient system of financial recovery in the RA, the research concluded, based on the results of studying the practical efficiency of similar systems

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in free market economies, that one of the main reasons of inefficient application of financial recovery plans is the late commencement of the process of recognizing a debtor as bankrupt.

It has also been mentioned that in an attempt to address the concerns related to this fact, the legislature made substantial amendments to the RA Law "On bankruptcy" on 17 June 2016, supplementing the law with a new chapter titled "Imminent bankruptcy proceedings", which defines the procedure for examination of imminent bankruptcy applications filed with the court by the debtor.

The research discussed as an exemplary mechanism the one applied in the RF, which helps enhance the efficiency of implementing financial recovery plans, when the analysis of the financial condition of the enterprise allows to detect the bankruptcy risk and to undertake timely and necessary measures directed to its financial recovery.

In view of the Federal Service of Financial Recovery of the RF, the research attempted to justify the necessity of creating a similar institution in the RA. Thorough arguments were mentioned why especially it is necessary to create such an institution. In particular it was noted that in free market economy based country, such as Armenia, it is desirable and necessary, that liquidation processes under bankruptcy cases were changed into reconstruction processes and accents were put on exercising financial recovery plans of enterprises, and as a primary objective was mentioned the improvement of legislative mechanisms in the bankruptcy institution.

For that reason the efficiency of activity of separate systems in U.S. directed to implement financial recovery plan was examined. Also it was stated that US Code on "Bankruptcy" allows business entities' to undertake financial recovery process in an earlier period of insolvency without any consent of creditors and without any criteria set forth by law, thereby preventing further expected bankruptcy consequences.

So, considering the abovementioned and the experience of the practical application of the RF, as well as the necessity of effective application of law provisions concerning imminent bankruptcy proceedings defined by the RA Law on "Bankruptcy", addendum of new provisions was offered. The mentioned would clearly define criteria which would guide debtors to exercise their right to file with the court to institute bankruptcy proceedings. Thereby, the research suggests that the grounds prescribed by law for instituting imminent insolvency proceedings may be submitted and the criteria may be assessed by the private service(s) established for that purpose and vested by law with necessary powers.

Moreover, it would be more expedient that said service(s) be private, which will allow imposing on them stability of enterprise's activity of provision of services prescribed by law, responsibilities attempting to provide competitiveness in the market and prevent insolvency, and also other additional responsibilities.

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Considering economic policy conducted by the government in current stage, it would be justified to vest mentioned service by authority to apply to the court by their own initiative for instituting imminent bankruptcy proceedings.

It has been shown that while implementing legislative reforms in bankruptcy system it is necessary that the Armenian legislature focuses on imminent bankruptcy proceedings, namely on financial recovery plans of business entities. This will be in the interests of all beneficiaries of that undertaking and might contribute to dynamic development of the economy. It would be expedient and necessary to create a corresponding institute in the RA to carry out the implementation process of financial recovery plans. In contrast to the self-regulatory institution of bankruptcy, whose activity is typically aimed at distributing funds received from sale of the property of business entity recognized as insolvent, the existence of the proposed institution exclusively pursues the aim of ensuring the reorganization and continuity of activities as a result of financial recovery of the enterprise. The abovementioned legislative reforms can significantly change development dynamics of the economy in the RA bankruptcy system.

It has been found that one of the best promotions for development of the economy in the RA may appear to be the introduction of more productive mechanisms of implementation of financial recovery plans under bankruptcy proceedings. Particularly, the protection of rights and lawful interests of parties to proceedings under bankruptcy cases can be maximally efficient at the stage of prevention of the insolvency (bankruptcy) risk, when it is yet possible to maximally provide the fair balance of interests of creditors and debtors. Therefore, attempted to enhance the efficiency of implementation of financial recovery plans at the mentioned stage of activity of the enterprise, amending the legislation concerning the bankruptcy system with new, institutional provisions, considering mentioned proposals, have no alternative.

Therefore, there seems to be no alternative to amending the legislation on the bankruptcy system with new, institutional provisions, taking account of abovementioned proposals, with the view to enhance the efficiency of implementation of financial recovery plans at the mentioned stage of activity of the enterprise.

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