

Global Restructuring & Insolvency Guide

Azerbaijan

Overview and Introduction

Azerbaijan has two separate insolvency regimes: one for non-bank companies and private entrepreneurs; and another for banks. This Guide discusses both regimes. Although independent Azerbaijan's first insolvency act was adopted in 1994, to date there have been few insolvency or restructuring proceedings.

Applicable Legislation

The insolvency of non-bank companies and private entrepreneurs is regulated by the law of Azerbaijan *On Insolvency and Bankruptcy* dated 13 June 1997 (the "**Insolvency Law**"). The insolvency of banks is regulated by the law of Azerbaijan *On Banks* dated 16 January 2004 (the "**Banking Law**"). Insolvency and bankruptcy of investment funds and insurance companies are governed by the Law of the Republic of Azerbaijan *On Investment Funds* and the Law of the Republic of Azerbaijan *On Insurance Activity*, along with the Insolvency Law.

Insolvency of Non-Bank Companies

Bankruptcy Proceedings

Under the Insolvency Law, an insolvent entity (debtor) itself or its creditors may commence bankruptcy¹ proceedings by filing an insolvency application with a court. In "exceptional" cases, the debtor may commence non-judicial bankruptcy proceedings. The Insolvency Law, however, does not indicate what constitutes an "exceptional" case and, in practice, it appears that this provision is rarely, if ever, used.

In the event of the commencement of bankruptcy proceedings in court, after the court schedules the first hearing, the applicant must publish two notices of the hearing at least seven days before the scheduled hearing date. The court may also require notice to be given to creditors by other means.

In the event of the commencement of non-judicial bankruptcy proceedings, the debtor must give notice to all creditors of the first meeting of creditors. The creditors' meeting must be held within three weeks of the debtor's resolution to commence bankruptcy proceedings. Notice of the meeting must be sent to all known creditors by registered mail not later than two weeks before the meeting and published twice in an official periodic publication, with the second notice published not later than one week before the meeting.

An entity is deemed insolvent if it: did not satisfy a legitimate creditor claim within two months of the claim; is not able to make payments required by law; or is not able to pay its debts as they fall due. An insolvent entity may submit a bankruptcy application to a court pursuant to a resolution of the entity's management body.

After consideration of the case, the court may issue a resolution:

- Declaring the debtor insolvent and appointing a bankruptcy trustee;

¹ The Insolvency Law uses the words "insolvency" and "insolvent" with respect to a debtor and its status (e.g. insolvent debtor, debtor's insolvency) and "bankruptcy" with respect to procedural issues (e.g. bankruptcy proceedings, bankruptcy application).

- Appointing a temporary bankruptcy trustee² or prolonging such appointment; or
- Refusing to declare the debtor insolvent.

After a debtor has been declared insolvent, the bankruptcy trustee convenes the initial meeting of creditors by giving notice to all known creditors of the debtor. The meeting must be held within 15 days of the court's insolvency resolution.

Upon commencement of bankruptcy proceedings, i.e. the filing of a bankruptcy application with a court or adoption by the debtor of a resolution on commencement of non-judicial bankruptcy proceedings, the debtor may not dispose of any assets for its commercial activity, to fulfil its obligations, or for any other reason without the prior authorisation of the court, bankruptcy trustee or temporary bankruptcy trustee.

Upon the court's insolvency declaration, claims against the debtor may be asserted only within the framework of bankruptcy proceedings. At any time during the bankruptcy proceedings, the debtor may request that the court suspend the proceedings and consider a rehabilitation plan. A court-approved rehabilitation plan may not exceed two years.

Cherry-Picking

The court-appointed bankruptcy trustee is authorised to represent the debtor and manage its estate. He is given discretion to endorse the debtor's profitable contracts (making them effective) and to terminate the debtor's unprofitable contracts. Although a bankruptcy trustee is vested with this "cherry-picking" power, any termination of the debtor's unprofitable contracts must be made in compliance with the requirements of Azerbaijani law. Specifically, the Insolvency Law allows a creditor whose contracts with the debtor have been terminated by the bankruptcy trustee to assert a claim for the damages caused by termination. The creditor, however, is treated as an unsecured creditor.

Priority of Claims

In the event of liquidation in bankruptcy, the debtor's assets are distributed in the following order of priority:

- Costs associated with conducting the bankruptcy proceedings (including notice publication, court and bankruptcy trustee expenses);
- Claims of the debtor's workers for injury or death during working hours;
- Claims of the debtor's workers for allowances, benefits and wages for the six-month period prior to the insolvency declaration;
- Claims for local and state taxes and payments for mandatory state insurance for one year prior to the announcement of insolvency; and of credit institutions and non-residents related to unsecured loans and interest thereon;
- Claims of other unsecured creditors;
- Claims of the debtor's owners.

Secured creditors may obtain satisfaction of their claims outside bankruptcy proceedings and, therefore, do not feature in this waterfall.

Claims submitted after the expiration of the period established for submission are only paid after the satisfaction of timely claims. Claims with a higher priority must be satisfied in full before lower ranking claims may be paid. In the event that the proceeds from the sale of the insolvent debtor's assets are

² A temporary bankruptcy trustee may be appointed by the court prior to declaration of the debtor's insolvency as an interim measure, to ensure that the debtor does not illegally dispose of assets prior to a declaration of insolvency, and conduct an initial financial analysis of the debtor's financial situation.

insufficient to satisfy all claims of equal priority, all claims with the same priority are satisfied *pro rata*. Claims not paid due to the insufficiency of funds are deemed extinguished, except where the insufficiency is caused by the debtor's illegal actions or unnecessarily concluded contracts. The assets of a debtor remaining after all creditors' claims are paid are distributed to the debtor's owners.

Secured Claims

A secured creditor may satisfy its claims outside bankruptcy proceedings by reclaiming the property subject to its security interest within 14 days of actual notice of such proceedings. If it fails to do so, however, the secured property is included in the debtor's estate and the secured creditor may only seek satisfaction of its claims on an equal footing with general *unsecured* creditors.

A claim to recover secured property must be submitted to the bankruptcy trustee. At the secured creditor's option, the bankruptcy trustee must satisfy the secured claim by:

- Selling the collateral at auction or by other means, and paying the secured claim from the proceeds;
- Transferring ownership of the collateral to the secured creditor; or
- Selling the collateral to a third party as directed by the secured creditor.

Set-Off

If it is discovered during the bankruptcy proceedings that the debtor owes or will owe unpaid debts to another person as a result of transactions entered into before the declaration of the debtor's insolvency, and that such other person has existing, future or conditional debt obligations to the insolvent debtor, then such mutual debts are set off if such debt obligations were incurred before the commencement of bankruptcy proceedings and are expressed in a monetary amount or have a monetary equivalent. If it is not possible to precisely determine the money equivalent of a debt or debt obligation, the equivalent is estimated by the bankruptcy trustee. Such satisfaction of claims by set-off is subject to the order of priority set out above.

Clawback

A bankruptcy trustee may apply to a court to invalidate the debtor's transfer of property, including money and securities, if:

- The transfer or pledge of property occurred while the debtor was insolvent;
- The transfer or pledge of property occurred within 90 days prior to the commencement of the bankruptcy proceedings; or
- The creditor is a related party³ and the transfer or pledge of property occurred within one year prior to the commencement of the bankruptcy proceedings.

Insolvency of Banks

Temporary Administration Imposed by the Central Bank

The Central Bank of Azerbaijan (the "CBA") must commence temporary administration in respect of a bank if:

- The aggregate capital of the bank falls to 25% or less of the minimum aggregate capital established for banks by the CBA, or its adequacy ratio falls to 3% or less;

³ Related parties of a borrower are: any legal entity owning or controlling 25% of the debtor's capital; any subsidiary, branch or representative office of the borrower; any director of the borrower, including any person removed from the management of the debtor within one year prior to the commencement of the bankruptcy proceedings; or a partner in any form of partnership.

- The bank is not able to pay its obligations as they become due;
- An application is made for the commencement of bankruptcy proceedings against the bank; or
- The bank's license is revoked on the grounds specified in the Banking Law.

Additionally, the CBA has the right to impose a temporary administration in a number of other cases, including the bank's breach of prudential requirements, requirements of the Banking Law or normative acts of the CBA, and non-compliance with the limitations set out in the bank's licence. A temporary administrator appointed by the CBA substitutes for all governing bodies of the bank for the period of the temporary administration (up to one year with a possible extension of up to six months) and, among other things, has the right to:

- Consent in writing to transactions on behalf, or for the account, of the bank (in the absence of which such transactions are invalid); or
- Terminate or amend the bank's agreements, considering the bank's investment, and alter commission fees and interest and their periods in the bank's agreements.

However, subject to general civil law grounds for invalidating agreements, there is nothing in the Banking Law which would grant a temporary administrator the right to terminate or invalidate, or apply to a court or other authority for termination or invalidation of, the bank's other agreements.

During a bank's temporary administration, upon the CBA's application, a court may impose a moratorium on the bank's discharge of its payment obligations.

Bankruptcy Proceedings

A court may commence bankruptcy proceedings in relation to a bank on any of the following grounds:

- The CBA determines that the bank's aggregate capital is less than 25% of the minimum aggregate capital established for banks by the CBA, or its adequacy ratio is below 3%;
- The bank is not able to fulfill its financial obligations when they become due; or
- The bank is not able to fulfill its outstanding financial obligations when they are demanded by creditors.

Upon the court's declaration of a bank's insolvency, a liquidator is appointed for the bank.

Priority of Claims

The assets of an insolvent bank are distributed among its creditors in the following order of priority:

- Subrogation claims of the Deposit Insurance Fund;
- Costs and expenses of bankruptcy proceedings, including remuneration of a temporary administrator and liquidator;
- Claims of employees for damage to health or life sustained during work;
- Claims of employees and former employees in connection with allowances and wages payable for a period not longer than six months prior to a court's declaration of the bank's insolvency;
- The bank's obligations in connection with a temporary administrator's management and financial rehabilitation proceedings;
- Mandatory payments to the budget and mandatory state social insurance payments for a period not longer than one year prior to a court's declaration of the bank's insolvency; and
- Claims of unsecured creditors.

Claims with a higher priority must be satisfied in full before lower ranking claims may be paid. In the event that the bank's funds are insufficient to satisfy all claims with equal priority, then all claims with the same priority are satisfied *pro rata*.

Claims of secured creditors are satisfied outside the order of priority at the expense of funds realised from the sale of collateral. Secured claims not satisfied in such fashion are satisfied in the order of priority set out above.

Set-Off

Mutual claims between an insolvent bank and its creditors may be set off, subject to the order of priority set out above. The Banking Law prohibits the set-off of a bank's illegally incurred obligations and claims and obligations arising after a court's decision on commencement of bankruptcy proceedings. Unlike the Bankruptcy Law, the Banking Law does not establish the terms of set-off; accordingly, a court may apply the general rules applicable to set-offs as set forth in the Civil Code.⁴

No Clawback

The bankruptcy chapter of the Banking Law, unlike the Bankruptcy Law, does not contain a provision on invalidation of a bankrupt bank's agreements or transfer of property which occurred prior to the commencement of bankruptcy proceedings. Therefore, subject to the general civil law bases for invalidating agreements, a bank liquidator would not be able to terminate or invalidate, or apply to a court or other authority for the termination or invalidation of, the bank's agreements.

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⁴ Under section 540 of the Civil Code of the Republic of Azerbaijan dated 28 December 1999, outstanding counterclaims between two parties may be terminated by set-off. Set-off is also possible if a claim of one of the parties is not yet outstanding but that party agrees to the set-off. Thus, the requirements for set-off are that the counterclaims be mutual and outstanding.