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Lithuania: Avoidance actions and good faith – what to observe when doing business with Lithuanian companies

Recent Lithuanian case law confirms that businesses ought to be very cautious and take active steps before entering into transactions with Lithuanian companies potentially facing difficulties.

Otherwise, they risk having to return what they received from the transaction if insolvency proceedings are opened against the company and the administrator brings a claw-back claim.

Lithuanian insolvency administrators examine the debtor's transactions concluded within the 36 months before the opening of the proceedings. They must start avoidance actions against the debtor's counterparty if the conditions for an *actio pauliana* claim are met.¹ One of the conditions is the bad faith of the debtor's counterparty at the moment of the transaction. A counterparty acted in bad faith if it knew or should have known that the transaction would violate other creditors' rights. This is the case if it can be shown that the counterparty knew or should have known that the transaction will cause or aggravate the debtor's insolvency.²

The Lithuanian law presumes the good faith of parties to a transaction. This presumption applies also to *actio pauliana* cases. However, recent court practice appears to result in a shift in the burden of proof, as courts tend to tolerate superficial allegations by the claimant administrator that the counterparty knew about the debtor's (imminent) insolvency. It is then left to the defendant counterparty to prove that it had acted in good faith and had performed actions required by current court practice. For this, the defendant must show that it checked and analyzed the publicly available information that might



have shed light on the financial situation of its business partner. This includes checking the pledge, mortgage, arrest and the commercial registers. From the latter the most recent available financial statements should be obtained. At least for long standing relationships courts also require the counterparty to discuss with its business partner about the financial situation, such as obligations towards other creditors, obligations secured by pledge or mortgage and their maturity dates and the status of pending court cases.³ Some judgments seem to indicate that the pledge on all the debtor's assets can be in itself sufficient for the court to conclude that the counterparty acted in bad faith when entering into the transaction with the debtor.⁴

Courts tend to apply these criteria in a rather formalistic way having little regard to whether meaningful information is or even could be obtained by adhering to the 'checklist'. For instance, pledging assets is standard practice necessary to obtain financing and does not necessarily indicate financial problems. Also, financial statements are of limited use for understanding the liquidity situation of a company, even more so if the statements are months or even years old. And asking your business partner if it faces insolvency is not necessarily likely to prompt an honest answer. Interestingly, in a recent decision, the court interpreted the mere

existence of credit risk insurance coverage to the detriment of the insured foreign creditor of the Lithuanian debtor rather than acknowledging that the insurer had monitored the financial standing of the Lithuanian debtor and at the time the disputed transaction was made had neither terminated the insurance coverage nor otherwise flagged warning signals.⁵

Therefore, companies are well advised to follow the 'checklist' developed by recent case law before entering into business transactions with Lithuanian companies. Otherwise, there is a considerable risk that in an *actio pauliana* case they (shift in the burden of proof!) cannot prove performance of the formal background checks. As a result courts are likely to conclude that the defendant company had acted in bad faith and decide the case in favour of the administrator. ■

Footnotes:

- 1 Courts declare a transaction void and apply restitution under *actio pauliana* rules if these conditions are met: (1) the creditor has a clear and unambiguous claim against the debtor, (2) the transaction at hand violates the rights of the other creditors of the debtor, (3) the debtor did not have a duty to enter into the transaction, (4) the debtor and the creditor were not acting in good faith since they knew or should have known that the transaction will be to the detriment of the rights of other creditors.
- 2 Decision of the Lithuanian Supreme Court (LAT) of 2 October 2013, civil case 3K-3-463/2013. Lithuanian Appeal Court (LApT) of 2016 October 13, civil case e2A-813-464/2016.
- 3 LApT, *ibid.*; LAT, *ibid.*
- 4 LApT; LApT, decision of 11 May 2017, civil case e2A-245-178/2017.
- 5 LApT, 13 October 2016, *ibid.*



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