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Lithuania:
Draft Law on the Insolvency of Legal Entities

In order to consolidate bankruptcy and restructuring processes into a single statute, to combine the bankruptcy and restructuring professions into one, to resolve the issue of self-governance of this combined profession and to clarify the interpretation of the provisions of the bankruptcy and restructuring laws, the Draft Law on the Insolvency of Legal Entities (hereinafter – the Draft) was prepared in Lithuania in 2018.

In preparing the Draft, it was established that historically the law presented many deficiencies: the percentages paid to creditors were extremely low; the bankruptcy process took too long; the regulation of the profession of insolvency administrators was inadequate; and the administrative expenses and the administrator's remuneration lead to extended legal disputes as a result of which an insolvent legal entity suffered excessive litigation expenses and delays. The Draft therefore includes the following new ideas:

Enlargement of the concept of insolvency

The definition of insolvency is probably the most controversial issue of the Draft. Currently, insolvency is perceived as the state of an undertaking when overdue liabilities exceed half of the value of assets according to the balance sheet. The Draft provides a more modern definition of a company's insolvency as being its unability to fulfil overdue obligations and/or its having liabilities in excess of the value of its assets.

It is feared that if this definition of insolvency is included in the law, the risk of bankruptcy will arise for any undertaking temporarily unable to trade profitably, as even temporary negative results could be the basis for the initiation of insolvency proceedings. For this reason, some business organisations and lawyers propose to retain the old definition of insolvency fearing a significant rise in the number of Lithuanian enterprises becoming insolvent. In addition, in Lithuania it is believed that newly founded companies usually operate at a loss in the first few years, and the proposed change would result in companies having to initiate bankruptcy proceedings prematurely.

> THE DEFINITION OF INSOLVENCY IS PROBABLY THE MOST CONTROVERSIAL ISSUE OF THE DRAFT

Agreement on assistance to overcome financial difficulties (hereinafter – "Agreement on Assistance")

The Draft introduces the new pre-insolvency Agreement on Assistance by creating the preconditions for solving financial difficulties without involving the court: as many actions as possible could be carried out during the restructuring stage and the court would only be implied where it is necessary and proportionally, in order to protect the rights of the creditors and the interests of the other parties affected by the restructuring plan.

Administration of enterprises without assets

To deal with legal entities which do not have sufficient assets to cover court and administrative expenses, such bankruptcies are usually administered by the bankruptcy administrators at their own expense. Creditors rarely agree to initiate such processes at their own expense and it is proposed that the court will open a bankruptcy case only if the petitioner pays a deposit specified by the court to cover the bankruptcy administration costs within a period not exceeding 14 days.

Change of rank of the creditors' claims

To encourage attempts at restructuring that require additional capital to be injected, it is proposed that the claims of creditors who provide financing for the restructuring of companies would rank equally with former employees and creditors. If the restructuring fails, such a proposal would affect the rights of the former employees since their potentially recoverable amounts from the company's assets would be significantly reduced. The claims of the other creditors, including tax authorities, would rank after, so that the State would lose the priority right of claim in bankruptcy proceedings.

Administrators as a sole profession

Another important novelty is the merger of the professions of bankruptcy and restructuring administrators into a sole profession, that of insolvency administrators. It is proposed to change the current insolvency administrator system by creating an effective self-governing body of insolvency administrators, i.e. the Chamber of Insolvency Administrators of Lithuania, whose functions would include the organisation and implementation of qualification examinations for insolvency administrators, the organisation and control of professional qualifications and the establishment of principles of professional ethics and of rules for their enforcement. The harmonisation of the state supervision of insolvency administrators and the delegation of certain functions to a professional organisation would lead to more effective implementation of each function. It is preferred that the profession itself should set professional ethics standards and take care of their enforcement, rather than the State.

The preparation of the Draft was prompted by the European Commission Recommendation 2014/135/EU of 12 March 2014 on a new approach to business failure and insolvency, the World Bank "Doing Business" report and the findings of the relevant public authorities of Lithuania.

It is planned that the Draft and the accompanying legal acts could be adopted by the Seimas (Parliament of Lithuania) in the autumn session of 2018. The |Draft itself states that its entry into force is expected on 1 May 2019 (with the exception of relevant provisions, the entry into force of which is expected from 1 January 2022). ■