

The Baltics:

Corporate insolvency and restructuring proceedings compared

Edvīns Draba, Ignas Dargužas and Albert Linntam provide a brief comparative insight into corporate restructuring and insolvency regulation of the three Baltic states



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This overview provides a brief comparative insight into the corporate restructuring and insolvency regulation of the three Baltic states of Latvia, Lithuania and Estonia (excluding corporate subjects like credit institutions or insurance companies).

In Latvia both corporate insolvency and restructuring proceedings are mainly governed by the Insolvency Law adopted in 2010. The law was drafted taking into account recommendations of international creditors of Latvia at that time.

In Lithuania insolvency proceedings are regulated by the Law on Insolvency of Companies of the Republic of Lithuania adopted in 2001. Restructurings are regulated by the Law on Restructuring of Companies of the Republic of Lithuania adopted in 2001.

Corporate insolvency proceedings in Estonia are regulated by two separate acts of law: a) the Bankruptcy Act adopted in 2004, and b) the Reorganisation Act adopted in 2008.

Proceedings available

Latvia

In essence, Latvia follows the single entry model: there are insolvency proceedings as liquidation, whereas restructuring proceedings and out-of-court restructuring proceedings serve as restructuring. Information concerning restructuring and insolvency proceedings can be found on the Insolvency Register web site.

Insolvency proceedings

Corporate insolvency proceedings can be initiated by the debtor, a creditor (or a group of creditors), an insolvency practitioner in restructuring and a liquidator in the main insolvency procedure (to initiate secondary insolvency procedure).

In case of a creditor's insolvency application the illiquidity test is used to establish the debtor's insolvency. However, some features of the balance sheet test have been used in court practice to dismiss fraudulent insolvency applications.

The law prescribes that the debtor's property must be sold within six months. Secured creditors are not excluded from the insolvency proceedings and security must be sold by an insolvency practitioner as any other debtor's property.

The legal framework provides for a possibility to sell the debtor's business as a going concern. However, this option is rarely used in practice.

Restructuring proceedings

Restructuring proceedings are of the debtor-in-possession type under the supervision of an insolvency practitioner and can roughly be compared to US Chapter 11 proceedings. They grant full stay of enforcement and cram-down applicable to all creditors' claims (the only exception being administrative and criminal fines).

Restructuring proceedings must ensure that the creditors will gain more or at least as much as in the case of liquidation proceedings. There are no specific entry criteria for

restructuring proceedings except for showing that the debtor is facing financial difficulties or is about to face them. However, there is no requirement to prove these circumstances to the court. Only the debtor may apply for restructuring proceedings.

The debtor is then given two months to present a restructuring plan to the creditors, obtain their approval and submit the approved plan to the court. The voting takes place within two classes of creditors – secured and unsecured, with the required majority for the approval of the plan being simple majority among unsecured creditors and two thirds of secured creditors (considered by the amount of principal claims). This term can be further extended for another month, upon consent of the same majorities of creditors.

It is possible to envisage super priority for fresh money in case restructuring fails.

The maximum length of such proceedings is two years; however upon creditors' approval this term can be extended for another two years.

Out-of-court restructuring proceedings

A company has also the possibility to apply for out-of-court restructuring proceedings. Unlike regular restructuring proceedings, the debtor should negotiate with creditors and obtain their approval for the restructuring plan confidentially, prior to filing a restructuring application with the court.

It should also be noted that a debtor already implied in insolvency proceedings may apply for a transition to restructuring.

Lithuania

Insolvency proceedings (serving as liquidation) can be executed in a judicial (formal) or a non-judicial (non-formal) way and in some cases simplified insolvency proceedings can be commenced. Restructuring proceedings are available as well.

Judicial insolvency

A judicial insolvency petition can be filed with the court by (i) a creditor/creditors; (ii) an owner/owners; or (iii) the head of the company's administration. A balance sheet test is used to establish the debtor's insolvency.

Non-judicial insolvency

When insolvency is commenced in a non-judicial way the court does not have legal powers to revise the creditors' decisions and they have ultimate control of insolvency proceedings. Non-judicial insolvency proceedings commence with a decision of a qualified majority (3/4) of creditors. If the consensus is reached, all issues in the course of insolvency proceedings are decided by the creditors' committee. However, this is an extremely rare case because (a) in order to initiate insolvency in a non-judicial way, there shall not be any ongoing property disputes where the debtor is involved; and (b) disputes are usually unavoidable during insolvency and it is particularly difficult to reach unified agreement by all creditors.

Simplified insolvency

Simplified insolvency proceedings are initiated by the court in case the debtor does not own enough assets to cover the costs of insolvency proceedings. The proceedings cannot last longer than one year from the date when an order to institute simplified proceedings has come into force. The court decides on all issues in the course of such insolvency proceedings. The creditors do not control the proceedings and meetings of creditors are not organised.

Restructuring

Restructuring proceedings aim at allowing companies with financial



difficulties and which have not yet discontinued their economic and commercial activities, to maintain and develop these activities, settle their debts and avoid insolvency. Only the debtor and his shareholders may file for restructuring. Prerequisites for restructuring are: existing financial difficulties or a real possibility for the onset of financial difficulties within three upcoming years. The debtor has to draft and present a restructuring plan to the creditors. The plan has to be approved by a majority of creditors and presented for the court's approval within six months after initiation of the restructuring case.

An insolvency practitioner performs supervisory function, whereas the debtor's management remains in charge of the debtor's business.

Estonia

Insolvency proceedings

According to the Bankruptcy Act, insolvency is the debtor's permanent inability to satisfy the claims of the creditors declared by a court ruling.

After the initiation of insolvency proceedings an interim insolvency practitioner is appointed by the court to assess the debtor's financial situation and preserve his assets.

If the insolvency petition is filed by the debtor, insolvency is to be presumed and the court will usually declare it. In the case of an insolvency application submitted by a creditor, insolvency can be established either by applying a cash flow or by a balance-sheet test.

In case the debtor's assets are insufficient for covering the costs of the insolvency proceedings and it is impossible to recover or reclaim the assets, a court shall terminate proceedings by a ruling without declaring insolvency. The creditors can avoid this scenario by paying a deposit covering the costs of the insolvency proceedings.

Insolvency proceedings commence with a declaration of insolvency by a court ruling, a notice on the debtor's insolvency is immediately published in the Official Notices. Insolvency proceedings exclude the possibility



LATVIA FOLLOWS THE SINGLE ENTRY MODEL: THERE ARE INSOLVENCY PROCEEDINGS AS LIQUIDATION, WHEREAS RESTRUCTURING PROCEEDINGS AND OUT-OF-COURT RESTRUCTURING PROCEEDINGS SERVE AS RESTRUCTURING





**IN LITHUANIA,
SINCE 1 JANUARY
2015 AN
INSOLVENCY
PRACTITIONER
IN INSOLVENCY
PROCEEDINGS
IS SELECTED
RANDOMLY BY
A COMPUTER
PROGRAM**



to apply for restructuring proceedings.

Restructuring proceedings

The restructuring proceedings are initiated by a court ruling if an application for restructuring has been submitted by the debtor. A prerequisite for restructuring is that sustainable management of the debtor is likely to be possible in the future. Upon commencement of the proceedings the court shall appoint a restructuring adviser. The main responsibility of the adviser is to assist the enterprise and its creditors in the restructuring proceedings, whereas the control of the enterprise shall be retained by the existing management.

Insolvency practitioners

Latvia

Insolvency practitioners are a regulated profession. They are licensed by the Association of Certified Insolvency Practitioners. There are certain prerequisites for licensing, including formal training conducted by this association and a professional exam.

In insolvency proceedings, insolvency practitioners are appointed according to a roster. The Insolvency Administration (state institution performing

supervision of restructuring and insolvency proceedings) juxtaposes the list of debtors in respect of which insolvency proceedings have been initiated with the list of insolvency practitioners and nominates a candidate to this position. The purpose of this system is to ensure the accidental nomination of insolvency practitioner candidates. Therefore, experience and other qualities are not evaluated.

In restructuring, the debtor may propose an insolvency practitioner who must obtain approval of the same majorities of creditors required for the approval of the restructuring plan. If the creditors do not approve the insolvency practitioner proposed, the Insolvency Administration nominates another candidate according to a roster. In out-of-court restructuring, the approval of an insolvency practitioner is mandatory for the commencement of restructuring proceedings.

Lithuania

Insolvency practitioners are a regulated profession in Lithuania, as well. In order to obtain an insolvency practitioner's license certain requirements (education, qualification exam, professional indemnity insurance, good

reputation, etc.) have to be fulfilled.

Since 1 January 2015 an insolvency practitioner in insolvency proceedings is selected randomly by a computer program, taking into account: (i) the size and activities of the debtor and (ii) the work experience and track record of the insolvency practitioner etc.

Estonia

Only licenced members of the Chamber of Bailiffs and Insolvency Practitioners may fulfil the duties of insolvency practitioners in insolvency proceedings. After granting the right to act as an insolvency practitioner, the management board of the Chamber shall enter information on the person in the list of insolvency practitioners.

Approval of an insolvency practitioner appointed by the court ruling shall be decided by the first general meeting of creditors. If none of the creditors appear at the meeting, the insolvency practitioner appointed by the court is deemed to be approved by the meeting. Alternatively, the general meeting of creditors may appoint a new insolvency practitioner, whose approval shall be decided by a court ruling.

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Submission of creditors' claims

Latvia

In insolvency proceedings, creditors may submit their claims to the insolvency practitioner within one month of the entry regarding the company's insolvency recorded in the Insolvency Register. The insolvency practitioner does not have a duty to inform creditors on the commencement of insolvency proceedings (except for known creditors located in other EU Member States) and the creditors have to check the Insolvency Register website.

A creditor can submit his claim after the deadline, although not later than six months from the date of the entry in the Insolvency Register, but no later than the day when a plan for satisfaction of creditor's claims is prepared (whichever of these dates occurs earlier). After expiry of this term the creditor loses his rights to claim.

In restructuring, the debtor must include all creditors' in the restructuring plan himself and the creditors do not have to claim.

Lithuania

The court sets a deadline of no less than 30 days, but not exceeding 45 days from the entry

into force of the court ruling to initiate insolvency proceedings within which the creditors have the right to file their claims. The court shall have the right to accept for confirmation creditors' claims which have been submitted late provided that the court recognises the reasons for missing the deadline as important.

The same rules and deadlines apply in respect of restructuring proceedings.

Estonia

Creditors are required to submit their claims within two months after the publication of the notice on the debtor's insolvency in the Official Notices. Claims shall be defended at a general meeting of creditors which shall be held no later than six months after the publication of the notice on insolvency.

A claim is deemed to be accepted at the creditor's meeting if neither the insolvency practitioner nor any of the creditors have any objections thereto.

A restructuring plan is accepted if at least one-half of all the creditors who represent at least two-thirds of the total amount of claims vote in its favour. The time limit for creditors to submit objections to the restructuring plan is stipulated in a court ruling but shall not exceed sixty days.

Avoidance actions

Latvia

The general period for transactions concluded by the debtor prior to insolvency is three years. Prerequisites for a transaction being avoided are losses incurred by the debtor (such as in case of undervalue transactions) and knowledge of the losses by the counterparty. (There is no requirement to prove knowledge of the losses if the transaction has been concluded within four months prior to insolvency.)

Knowledge is presumed in case of transactions concluded with related persons. In addition, the law vests with the insolvency

practitioner rights to reclaim payments made by the debtor prematurely within six months prior to insolvency, if, at the same time, other payment obligations were not honoured in time.

Lithuania

An insolvency practitioner must examine transactions entered into by the debtor within a period of at least 36 months before the initiation of insolvency proceedings and challenge the transactions which are contrary to the objectives of the debtor and/or which could have led to its insolvency. If the court establishes that the insolvency is fraudulent, the insolvency practitioner must review all transactions concluded within 5 years prior to the initiation of insolvency proceedings.

Estonia

A transaction can be avoided if it was concluded within one year prior to the appointment of an interim insolvency practitioner and provided that the other party knew or should have known that the transaction damages the interests of the creditors. In turn, the period for transactions is three years if the debtor intentionally damaged the interests of the creditors by the transaction and the other party to the transaction must have been aware of the damage.

Knowledge of the damage to the creditors' interests is presumed in case the other party to the contract was a related person to the debtor. Furthermore, a transaction can be set aside if it was concluded within five years and if the other party to the transaction was a person related to the debtor. The Bankruptcy Act establishes special rules for avoidance of gratuitous contracts, contracts dividing joint property, real estate transactions etc. ■



IN ESTONIA, A TRANSACTION CAN BE AVOIDED IF IT WAS CONCLUDED WITHIN ONE YEAR PRIOR TO APPOINTMENT OF AN INTERIM INSOLVENCY PRACTITIONER

