

# Personal insolvency in Lithuania: a status quo update

Sebastian Okinczyc reports on key changes which aim to help individuals get back on track sooner



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## The Law on personal insolvency in Lithuania (the “Law”) came into force in March 2013, following its adoption in May 2012.

In light of the newly proposed amendments we find ourselves at a more than suitable time to draw a few initial conclusions on the introduction of the consumer insolvency in Lithuania.

The amendments now proposed are mainly focused on a proper implementation of the European Commission’s Recommendation on a new approach to business failure and insolvency (2014/135/EU) (the “Commission Recommendation”) in Lithuania. Accordingly, the key issues proposed by the Government would be as follows:

- (1) Shortening the time-frame of bankruptcy proceedings (from up to five to a fixed term of three years).
- (2) The possibility for an individual to retain certain types of real estate during bankruptcy.
- (3) Differentiation of creditors into groups.
- (4) The possibility for the individual in bankruptcy to assume new financial obligations during bankruptcy proceedings.

We shall briefly present the initial developments in relation to personal insolvency since its introduction in Lithuania, the lessons already learned, if any, and the reasoning and contents of the amendments currently proposed to the Law as well as, to the extent possible, the broader implications thereof.

## Virginity lost

Following years and years of all sorts of mixed feelings in relation to personal insolvency, in 2012 Lithuania finally adopted its own Law allowing individuals to undergo personal insolvency, rather than have to move abroad to be able to benefit from such a solution, with Latvia and United Kingdom having been the most popular destinations for personal insolvency prior to the adoption of the Law.

Since the Law came into force on 1 March 2013 more than 700 individuals have chosen to undergo the personal insolvency procedure in Lithuania. Considering the country’s population this is clear proof that such a regime was necessary. Furthermore, as indicated by the Ministry of Economy of Lithuania in the *travaux préparatoires* to the currently proposed amendments discussed further below, it is estimated that many more individuals may be interested in going through personal insolvency in Lithuania, but the lack of legal certainty in certain areas discourages them from doing so.

## Lessons of (dis-)honesty learned?

The purpose of the Law was formulated as providing the means for the restoration of solvency of honest individuals and businessmen, ensuring satisfaction of creditors’ claims and finding the right balance between the rights of the debtor and the interests of his creditors.

Accordingly, insolvency of an individual is declared when

he/she is insolvent and there are no grounds for denying him/her the right to petition for insolvency. An individual is deemed insolvent when he is unable to discharge his liabilities exceeding 25 minimum monthly wages, approved by the Government of the Republic of Lithuania, as they mature.

Simplifying the grounds when a personal insolvency case can be denied, they can be formulated as follows:

- (1) When before the insolvency is declared it turns out the individual is not in fact insolvent (as defined by the Law).
- (2) When the individual has been dishonest and became insolvent as a result of entering into transactions detrimental to the interests of the creditors.
- (3) When the individual became insolvent because of his addictions (gambling, alcohol substance abuse, etc.).
- (4) When the individual became insolvent because of his certain criminal activities.
- (5) When the individual underwent a personal insolvency procedure less than ten years ago.
- (6) When the individual is a member of an unlimited liability legal entity undergoing bankruptcy.

In a landmark decision taken in November 2014, interpreting the “dishonest debtor” criterion above, the Supreme Court of Lithuania stated that an individual’s honesty must be verified from two perspectives – firstly, whether he was honest when initiating the insolvency case, and, secondly, whether he

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was honest while becoming insolvent.

The petitioner is to be deemed to be dishonest when the circumstances in relation to the origins of his debts as well as his behaviour with his finances, or any other related issues give grounds to conclude he deliberately allowed the debts to form in order to have the unsatisfied creditors' claims eventually written off. Therefore, dishonesty may be declared based on both the specific activities (knowingly undertaking obligations one is not going to fulfil, misleading one's creditors as to one's financial stance, etc.) as well as on the lack of efforts to settle the debt, resulting in the individual becoming insolvent.

An individual who had been too passive and not taken enough measures to improve his solvency is to be considered as dishonest when it is established that the individual did in fact comprehend the situation, but intentionally failed to improve it.

However, with reference to the factual background of the landmark case mentioned above, where the individual (a lady) quit her job, refused each of the 19 (!) job offers suggested by the job centre, failed to prove she engaged in job-hunting, took short-term loans, increased her debts for residential amenities, failed to sell or lease her real estate and move into a smaller home and took no actions to rearrange her debt payments, nothing was considered to be sufficient to establish dishonesty and to deny personal insolvency. The lower instances' courts found the refusal of the numerous job offers to be material for establishment of a case of the debtor's dishonesty. They, however, were overturned by the Supreme Court which held that the mere existence of the aforementioned circumstances does not prove the debtor's dishonesty because other matters that might have been relevant (the economic crisis, the overall increase of unemployment, the real estate price volatility, the fact that the particular lady studied for a degree to eventually land a better paying job, etc.) should have also been considered.

Accordingly, since examination of all the material circumstances would also require the analysis of the factual situation, the Supreme Court, which only concerns itself with the matters of law, rather than those of facts, ordered a retrial at the court of appeal. Between the lines of the judgement, we can draw the most obvious conclusion – that the standard for establishing the debtor's dishonesty is high and the courts should be proactive in this kind of situation.

### Amendments proposed

Firstly, based on the lessons learned from the first three years of functioning of the Law, the amendments now proposed, while implementing the Commission Recommendation, also seek to fix certain drawbacks of the current personal insolvency regime in Lithuania.

In particular, the shortening of the period of implementation of the insolvency plan from three to five years shall hopefully minimise the still existent forum shopping, whereby individuals prefer to head abroad to undergo personal insolvency, since time frames there are shorter.

Further, studies in different countries tend to show an inverse correlation between the length of the established insolvency plan implementation period and the degree of success in its implementation. It seems obvious that a shorter insolvency period will allow the individuals to get back on track faster.

Secondly, the amendments now proposed, also on the basis of the recommendations of the International Monetary Fund and the experience of the foreign jurisdictions, would allow the insolvent debtor to retain certain mortgaged property, provided certain criteria are met.

Thirdly, following the Commission's Recommendation, the insolvency plan would be voted for in separate groups of secured and non-secured creditors. This proposal is also in line also with the Legislative Guide on Insolvency Law of the United

Nations Commission on International Trade Law (UNCITRAL). The decision on the approval of the plan would be deemed adopted when a simple majority of the creditors from both the secured and the non-secured creditors' groups whose claims represent more than half off all the claims of the particular group, respectively, vote in favour of the approval.

Fourthly, in order to allow the insolvent individual to engage in business activities, he/she would be allowed to take on certain new financial obligations for the conduct of such activities. Such a situation would hopefully allow to satisfy the creditors' claims in a greater extent, since the profit received would be added to the bankruptcy estate.

Finally, certain more minor adjustments are suggested to simplify the sale of assets of the bankruptcy estate: in particular, an auction of the mortgaged property can take place (currently all the mortgaged property must be sold via auctioning), but only if the value of the property is higher than the auction's expenses and if the agreements for the sale-purchase of both movable and immovable properties, as well as the sales through auctioning would not need, pursuant to the proposed amendments, to be concluded before a public notary.

### Conclusion

The introduction of the personal insolvency regime in Lithuania has been long overdue, forcing individuals with financial difficulties to move abroad where they were able to take advantage of such solutions. Now that the Law has been introduced and operating for almost three years, debates continue whether it achieves the desired balance between the rights of debtors and creditors. Anyway, it is without question that the amendments currently proposed will indeed improve the regime. ■



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