Secondary insolvency proceedings in Lithuania

Frank Heemann and Karolina Gasparke report on a landmark case in Lithuania and ask, is the first pancake always spoiled?

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In a landmark case, Lithuanian courts for the first time opened secondary insolvency proceedings against a foreign debtor. The Lithuanian Court of Appeal ('Court') recently upheld the decision of the Court of first instance which opened secondary insolvency proceedings against a German debtor.[1]

The key question to be examined in this case was at which moment must the criteria for an 'establishment'[2] (as defined by the European Insolvency Regulation - 'EIR') exist for Lithuanian courts to have international jurisdiction to open secondary insolvency proceedings. Defining the decisive moment, the Court deviated from the court practice in other Member States, including the recent judgment of the UK Supreme Court in the well-known *Olympic Airlines* case.[3]

Facts

Main insolvency proceedings were opened against a German debtor in March 2014. Through its registered branch, the debtor had also operated in Lithuania. The German main proceedings were aimed at the liquidation of the debtor. Consequently, operations of the Lithuanian branch also ceased, by terminating the lease agreement for the premises used by the branch (March 2014), dismissal of the remaining employees (May 2014), termination of other agreements, realisation of assets and transfer of obligations under a working contract for works to a third party (30 October 2014).

More than half a year after the opening of the main proceedings in Germany, a Lithuanian creditor filed a petition to open secondary insolvency proceedings. At that time, the debtor had for a long time ceased its economic activities in Lithuania.

Grounds

The Court had to assess whether the debtor had an 'establishment' in Lithuania, i.e. '*any place of operations where the debtor carries out a non-transitory economic activity with human means and goods*'[4]. The debtor's operations in Lithuania had met these criteria when the main insolvency proceedings in Germany were opened. Yet, neither the petitioning creditor nor the Court asserted that the criteria for an 'establishment' were fulfilled when the petition for the opening secondary insolvency proceedings was filed in November 2014. Against this background the court had to decide which of these dates was the decisive one for determining the existence of an 'establishment'.

The Court applied a retrospective test holding the view that it was sufficient that the criteria for an 'establishment' had existed at the moment when the main insolvency proceedings were opened. The Court argued that if the decisive moment was not the moment of opening of the main insolvency proceedings then it would be unthinkable that secondary insolvency proceedings could be opened at all. In this context, the Court advanced that if the decisive moment was supposed to be later than the moment of the opening of the main insolvency proceedings, then the liquidator in the main proceedings could circumvent the right of the local creditors to request the opening of secondary proceedings by dismissing all employees and transferring all assets out of the country and thus, deliberately and to the detriment of local creditors, creating a situation in which the conditions for an 'establishment' were removed before a local creditor could file for secondary bankruptcy proceedings.

Comments

Unfortunately, the Court missed a good opportunity to provide a sound reasoning for its view on the decisive moment. This is lamentable for a number of reasons.

First, the Court's arguments for its view let one believe that the Court not fully heeded some fundamentals of insolvency proceedings and of the EIR. The fact that the liquidator in the foreign main insolvency proceedings dismissed the employees and sold the assets as quickly as possible was fully consistent with the duties of the appointed liquidator and the interests of the creditors in the main proceedings, including the Lithuanian creditors.

Oddly, in its reasoning the Court appears to paint the performance of duties by a liquidator in the foreign main insolvency proceedings as an attempt to deliberately circumvent local creditors' rights, with an aim to prevent the opening of secondary insolvency proceedings. What is more, the court

misjudged when it argued that the decisive moment for the existence of an 'establishment' must be the moment of the opening foreign main proceedings, because in this case it would be impossible to open secondary insolvency proceedings at all.

As the UK Supreme Court in its Olympic Airlines judgment pointed out, a liquidator might chose to '*continue the business with a view to its disposal*' or might otherwise perform an '*economic activity on the market*' while liquidating the company.[5] The Court, however, seems to have ignored the difference between these cases and cases like the one at hand, i.e. cases in which there is neither ongoing business nor any other economic activity of the debtor in the market after the opening of the foreign main proceedings.

Second, one can doubt that the opening of secondary insolvency proceedings was in line with the general objective of the EIR as laid down in Recital 2: "*cross-border insolvency proceedings should operate efficiently and effectively.*"

The Court placed much emphasis on the protection of the economic interests of local creditors. However, the Court did not address the obvious questions at all, such as if the economic interests of the local and other creditors were really served by opening additional proceedings approximately 18 months after the opening of the foreign main proceeding at a moment when all activities of the debtor had been directed at the liquidation of the local branch and when all that was left in Lithuania were some unsold assets.

The protection of the interest of creditors, including local creditors, can be doubted, as the opening of secondary insolvency proceedings usually causes significant additional costs, delays the winding-up of the debtor, and leads to confusion among the (local) creditors, all without bringing a clear added value for the creditors.

Whether the opening of secondary insolvency proceedings would contradict the general objective under the EIR, of an efficient and effective operation of the cross-border insolvency, was clearly not at all considered by the Court.

Third, in determining the decisive moment for the existence of the criteria of an 'establishment,' the Court took a different approach than that of the German[6] and UK[7] Supreme Courts, both of which, in recent judgments, held that an 'establishment' must exist at the moment when the local creditor files for opening of secondary insolvency proceedings.[8] Neither court applied a retrospective test like the Lithuanian Court of Appeal when focusing on the moment of the opening of the main insolvency proceedings.

The German and UK court practice had been brought to the court's attention. Nevertheless, in its reasoning the Court chose to completely ignore the court practice of the German Supreme Court while limiting its comments to the *Olympic Airlines* judgments of the UK courts, to making just the thin and rather tenuous remark that the facts of the two cases were different.

Fourth, the Court missed the opportunity to put its interpretation of the current EIR into context with the recast of the EIR[9] with its amended definition of 'establishment', i.e. '*any place of operations where a debtor carries out or has carried out in the three month period prior to the request to open main proceedings a non-transitory economic activity with human means and assets*'.[10]

True, the retrospective approach of the Court goes into the direction of the new EIR. Still, the Court in its decision did not consider the recast of the EIR in general, nor the discussions and the process leading to the amended definition of 'establishment' in particular.

Therefore, the fact that the Court's interpretation of the definition of 'establishment' of the current EIR comes close to the amended definition under the recast EIR seems to be coincidental, rather than the result of a careful interpretation of the current definition of the EIR.

Summary

In summary, the Court missed a good chance to provide a solid reasoning for its view that the existence of an 'establishment' in the sense of Article 2 lit. h) of the current EIR should be tested retrospectively by looking at the factual situation at the moment of the opening of the foreign main proceedings. The case illustrates the benefits that further studies on the opening of secondary insolvency proceedings might bring, like the one presented by Bernard P.A. Santen et al in the Eurofenix edition of autumn 2015. ■

Footnotes

1 Decision of the Lithuanian Court of Appeal (*Lietuvos apeliacinis teismas*) of 7 August 2015, case No. 2-1420-381/2015; decision of 20 May 2015 of Vilnius Regional Court (*Vilniaus Apygardos Teismas*), case No. B2-3000-803/2015).
2 Article 2 h) of Council Regulation EC 1346/2000 on Insolvency Proceedings ('Insolvency Regulation').
3 Judgement of the Supreme Court of the United Kingdom of 29 April 2015, SA [2015] UKSC 27.
4 Article 2(h) of the Insolvency Regulation.
5 Ibid 3, para 14.
6 Decision of German Supreme Court of 8 March 2012, No. IX ZB 178/11, NJW-RR 2012, 1455.
7 Ibid 3.
8 The German Supreme Court explicitly stated that the decisive moment was to be the moment of filing of the petition by the creditor to open secondary insolvency proceedings, cf. fn. 8 NJW-RR 2012, 1455. The UK Supreme Court did not explicitly comment on the decisive moment for an 'establishment', however based on the court's reasoning there is no doubt that it assessed the factual situation at the moment of *Olympic Airline's* Trustees' petition to open secondary insolvency proceedings, cf. fn.3 paras 13-15.
9 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceeding (recast), Official Journal L 141 /19, coming into force in June 2017.
10 Article 2(10) of the Recast Regulation.

WHETHER THE OPENING OF SECONDARY INSOLVENCY PROCEEDINGS WOULD CONTRADICT THE GENERAL OBJECTIVE UNDER THE EIR, WAS CLEARLY NOT AT ALL CONSIDERED

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