

# Lottery and liability:

## Recent developments in Lithuanian bankruptcy law

Frank Heemann and Karolina Grityte explain the rationale behind the new 'lottery' system



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**R**ecently enacted changes to the Lithuanian Enterprise Bankruptcy Law (EBL) as well as a fresh initiative by the country's Presidency to further amend the EBL merit a closer look.

At the beginning of this year important changes came into effect significantly altering the process of selecting administrators for enterprise bankruptcies. As before, the court opening bankruptcy proceedings against a company must also appoint an administrator. What is new is that as of 1 January 2015 the bankruptcy administrator is selected randomly by a computer program. Such a "lottery" might seem strange, in particular to Western European insolvency practitioners. In the eyes of Lithuanian lawmakers, however, this algorithm-based selection process ensures the independence

and objectivity of the appointed administrator while carrying out their functions.

Early in February 2015, the Presidency submitted a Bill proposing amendments to the EBL in order to address serious shortcomings in current bankruptcy proceedings highlighted by the National Audit Office in its audit report "*Management and Supervision of the Enterprise Bankruptcy Process*" (Audit Report) on 25 November 2014. The aim of the proposed amendments is to ensure quicker and more effective bankruptcy proceedings. One of the main areas addressed in this context is the directors' liability and that of other persons responsible for late filing or non-filing for bankruptcy. In addition, changes are proposed for realisation of assets and remuneration of bankruptcy administrators. The Parliament is

expected to vote on the Bill by the end of April 2015.

### "Lottery" for selection of Administrators

The new process for selecting administrators is set out in the Selection Rules for Bankruptcy Administrators.<sup>1</sup> Under these Rules, both administrators and insolvent companies are placed in categories. An insolvent company is to be categorised as small, medium, or large. The criteria to be applied are the value of the company's estate, the total value of the creditors' claims, and the absolute number of creditors and employees.

For example, in order for a company to fall into the 'large' category, the judge handling the petition to open bankruptcy proceedings must have determined that both the estate of the insolvent debtor and the total value of the creditors' claims

exceed €300,000, and that the number of creditors is above 80, the calculations being based on documents and data submitted with the petition and gathered in the opening procedure.

Administrators are placed in A1, A2, B and C categories.

Placement in categories depends on the respective administrator's:

- general experience (determined by an algorithm taking into consideration the number of previously administered companies of different sizes);
- special experience (determined by taking into consideration administration of specific proceedings such as proceedings with cross-border elements or administration of going concerns);
- effective penalties; and
- past refusals to accept an appointment.

Within a category, administrators are ranked according to their current workload.

As already mentioned, this "lottery" might seem strange, in particular to Western European insolvency practitioners. Yet critics should bear in mind that the new system is an attempt to address the rather negative reputation of the previous system of selection and appointment of bankruptcy administrators. The old system obliged the party filing for bankruptcy not only to propose an administrator but also to include in the filing documents showing the consent of the proposed administrator to accept the appointment.

Not surprisingly, the necessary pre-filing communication between the potential administrator and the filing party sometimes resulted in the appointed administrator being biased in favour of the filing party and its interests. It still remains to be seen, however, if the new computer-based selection system ensures the appointment not only of an objective and neutral administrator, but also of someone possessing the necessary skills and experience to administer the case.

### Changes proposed by the Presidency Bill, in particular regarding the directors' liability

Having examined in particular the period between 2011 and 2013, the National Audit Office in its Audit Report criticises the long duration of bankruptcy proceedings in Lithuania (average: 2-3 years) and the low satisfaction rate among creditors (average: 13%, but only 2% for unsecured creditors without priority rights).

Recommendations in the Audit Report include improvements for effective realisation of assets and changes in the way administrators are remunerated; particular emphasis, however, is placed on the need to improve the current regime with regard to the liability of directors of insolvent companies, since clearer and stricter rules for holding directors liable should incentivise earlier filings for bankruptcy and thus help increase the realisation rate for creditors. The Presidency Bill addresses the findings in the Audit Report.

As regards the directors' liability, the Bill proposes:

- to establish a clearly defined period of one month within which a director must file for bankruptcy once the company meets the criteria under the EBL for an insolvent company;
- to clarify who must file a claim for compensation of damages for late filing or non-filing by stating that it is the administrator's duty to claim for damages;
- to clarify who may initiate the process to have a director disqualified from holding management positions for three to five years after having failed to file for bankruptcy in due time or after having failed to meet certain obligations during the proceedings. The Bill proposes that the disqualification procedure may be initiated by the bankruptcy court on its own initiative or after having received a request from the

administrator or creditor(s) with more than 50% of the total value of the approved claims; and

- to entitle the creditors' meeting to order the administrator to file a claim for damages against a director and to address the court in order to initiate the disqualification of the director for holding management positions in the future.

Once enacted, the changes to the EBL will, to a certain extent, remove ambiguities in the current regime, which indeed offer ample room for directors to argue why they should not be held liable for not meeting their obligation to file for bankruptcy, while at the same time not clearly obliging the administrator to act against a former director. Yet, a clear rule in the EBL establishing the time when a director must file for bankruptcy is only one clarification, though an important one. Other clarifications are still necessary, be it by amending the law or by future court practice. For instance, open questions remain related to determining "insolvency", as well as to the calculation of damages caused by late filing or non-filing.

### EECC Conference

INSOL Europe's Eastern European Countries' Committee Conference will hold its annual conference on 15 May 2015 in Vilnius, Lithuania. Recent developments related to the appointment of insolvency office holders (including the Lithuanian "lottery" system) and to the liability of directors in the twilight zone are two of many interesting topics to be presented and discussed during the conference.

*For more information visit:*  
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#### Footnotes:

- 1 Selection Rules for Bankruptcy Administrators as approved by Government Order No 647 of 9 July 2014.



**THE NEW SYSTEM IS AN ATTEMPT TO ADDRESS THE RATHER NEGATIVE REPUTATION OF THE PREVIOUS SYSTEM OF SELECTION AND APPOINTMENT OF BANKRUPTCY ADMINISTRATORS**



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