



### **Atelier 3 - Une approche de l'exécution du 21<sup>e</sup> siècle**

Panel 1 - Nouvelles approches, nouveaux outils pour l'exécution

### **Workshop 3 – 21<sup>st</sup> Approach to Enforcement**

Panel 1 – New Approaches – New Tools to Enforcement

## **Bankruptcy Administration**

### **Enforcement Agents' Legal Service Extension and Introduction to the Market**

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#### **1. An Enforcement Agent's Right to Administer Bankruptcy of Natural and Legal Persons**

Bankruptcy administration is the latest legal service delegated to Lithuanian enforcement agents, the seventh among services rendered by enforcement agents. Lithuanian enforcement agents are entitled to render natural and legal persons' bankruptcy administration services since 1 July, 2014, upon the entry into force of amendments and supplements to the Article 21 of the Law on Bailiffs<sup>1</sup> and Article 11 of the Law on Enterprise Bankruptcy<sup>2</sup>.

Up to the mid of 2014, bankruptcy administration was solely within the scope of competence of bankruptcy administrators – natural or legal persons or agencies (branches) of legal persons, having the right to provide corporate bankruptcy administration services in accordance with the Law on Enterprise Bankruptcy of the Republic of Lithuania or the right to provide corporate restructuring administration services in accordance with the Law on Enterprise Restructuring Administration Services.

There were two main reasons for extension of the enforcement agents' legal services list: 1) the enlarged choice of qualified bankruptcy administrators and more favourable conditions for the persons to prepare for bankruptcy; 2) lower price of bankruptcy proceedings carried out by the enforcement agents compared with the average prices of other bankruptcy administrators.

#### **2. The Challenge: Introduction of the New Service to the Market**

It has been nearly a year since Lithuanian enforcement agents are entitled to provide bankruptcy administration services. True, they must pass an exam and acquire bankruptcy administration licenses, and only a few enforcement agents have them. The licensed enforcement agents are

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<sup>1</sup> [http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc\\_l?p\\_id=468929](http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=468929); Law on Bailiffs of the Republic of Lithuania No. IX-876.

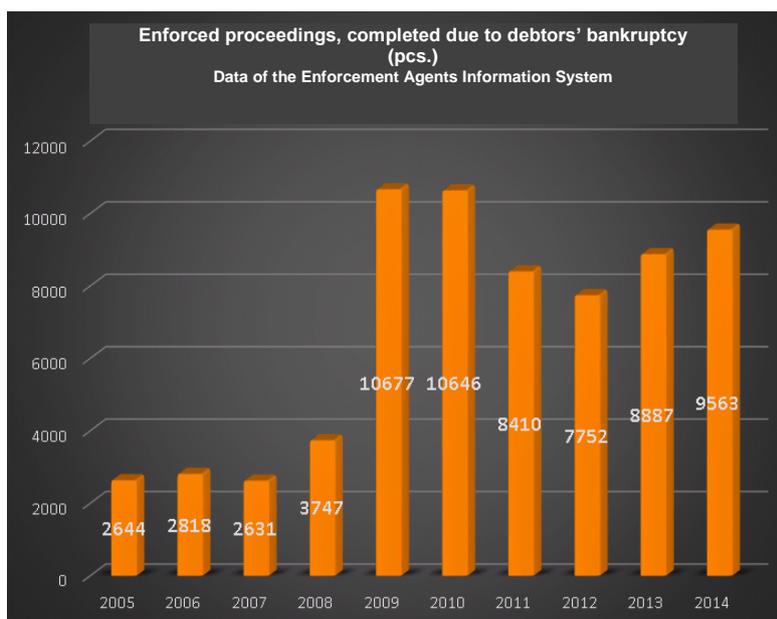
<sup>2</sup> [http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc\\_l?p\\_id=468929](http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=468929); Law on Enterprise Bankruptcy of the Republic of Lithuania No. IX-216.



entered into an official List of Persons Providing Enterprise Bankruptcy Administration (hereinafter - List) services<sup>3</sup>. However, none of them has had the occasion to practice the bankruptcy administration so far.

Why? One of the reasons is that Lithuanian legal persons in bankruptcy cannot choose or propose the adjudication of candidates for a bankruptcy administration from 1st January, 2015, as before. The administrator selection system has changed as well, so, administrators are now selected through software. It has been introduced to ensure the impartiality, transparency in the appointment of administrators and to assist courts. There is quite a low probability that a system will select an enforcement agent from the full List of bankruptcy administrators very soon. This List for the moment consists of 524 administrators – physical persons - and 228 companies providing bankruptcy administration. The selection procedure involves only the administrators who have submitted a declaration of consent to administer bankruptcy proceedings of certain companies or have signed a long-term (six-month) consent to administer bankruptcy proceedings of any legal persons assigned.

Despite the enforcement agents have confirmed their consents to begin on administration of certain legal persons' bankruptcy procedures, the system has not appointed any enforcement agent to be an administrator until now.



The table provides data for the period 2005-2012 on legal persons' bankruptcies only and data for the period 2013-2014 – on bankruptcies of legal and natural persons.<sup>4</sup>

Statistics on a debtor's bankruptcy state that enforcement agents accomplish a significant number of recovery proceedings – in 2014, they amounted to about 4 percent. The peak of bankruptcy proceedings that terminated the enforced recovery carried out by enforcement agents was recorded in 2009-2010. In such cases, it would appear logical to continue the bankruptcy administration in the enforcement agent's office, where the recovery was carried out before. Bankruptcy procedures

<sup>3</sup> Published on the website of the Department of Enterprise Bankruptcy Management under the Ministry of Economy.

<sup>4</sup> Data are taken from the Bailiffs' Information System.



would cost less since they would allow saving on using data collected by the enforcement agent on a debtor's loans payable, property appraisals, and other information.

According to the Department of Enterprise Bankruptcy Management under the Ministry of Economy of the Republic of Lithuania<sup>5</sup>, average actual bankruptcy administration costs amounted to 27,800 Lt (8,051 EUR) in 2014, among them administrator remuneration – 15,000 Lt (4,344 EUR).

However, an introduction of the automated selection of bankruptcy administration candidates has deprived enforcement agents of the opportunity to use their advantage against other bankruptcy administrators and to offer less expensive legal person bankruptcy administration services.

Pursuant to Article 11 of the Law on Bankruptcy of Natural Persons<sup>6</sup>, individuals, seeking a bankruptcy, and (or) their creditors have the right to propose the candidacy of a bankruptcy administrator to a court. And in case a natural person's bankruptcy proceedings are initiated in a simplified procedure, a natural person, apart from filing with the court a petition for the initiation of bankruptcy proceedings, must also propose the candidacy of a bankruptcy administrator. These are the cases where the enforcement agents' advantages might be resorted. However, a provision of bankruptcy administration services by enforcement agents is hindered by a relatively small demand in natural person bankruptcy administration and too low awareness of such services. Article 44 of the Law on Bailiffs<sup>7</sup> prohibits enforcement agents from advertising their activities.

For the reasons above, enforcement agent-bankruptcy administrator services have not yet been applied in practice the actual delivery thereof is yet to come. Nonetheless, enabling enforcement agents to administer the bankruptcy process is significant evidence that the scope of enforcement agents' professional competence is expanding, thus, turning them into multi-duty legal professionals. Perspective of these services and their position in the overall legal services market will largely depend on existing and future regulatory provisions defining bankruptcy procedures and conditions in the Republic of Lithuania.

### **3. Demand in Bankruptcy Administration to Lithuania**

Every year 1-1.5 thousand enterprises and hundreds of individuals go bankrupt in Lithuania. In 2014, 350 natural person bankruptcies were registered. Over two years (from 1 March, 2013, to 1 March, 2015), under the effect of the Law on Bankruptcy of Natural Persons of the Republic of Lithuania, bankruptcy proceedings were initiated, in total, against 517 individuals. In 2014, one natural person bankruptcy proceeding fell on 10,000 of the population. Statistically, one bankruptcy administrator (including individuals and companies) runs 2.4 bankruptcy proceedings a year.

A natural persons' bankruptcy procedure is fairly conservative in Lithuania and less attractive to residents in comparison with similar procedure in countries with a longer personal bankruptcy experience. Diverse legal regulation of natural persons' bankruptcy in the European Member States forces people with debt obligations to search for more favourable legal conditions and to seek that insolvency proceedings are brought abroad. Some Lithuanians who have decided to go bankrupt

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<sup>5</sup> Department of Enterprise Bankruptcy Management under the Ministry of Economy; <http://www.bankrotodep.lt>

<sup>6</sup> [http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc\\_l?p\\_id=445605](http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=445605) ; Law on Bankruptcy of Natural Persons of the Republic of Lithuania No XI-2000

<sup>7</sup> Cit. op. 1.



choose Latvia or England and write off their debts under laws of these countries, which offer a rather liberal bankruptcy regulation. A bankruptcy process can take up to 5 years in Lithuania, while, in Latvia or England, one can go bankrupt within a year.

There is no official statistics on Lithuanians bankrupt abroad, yet, the examples in a public space and court practice suggest that the bankrupt abroad is not a rare exception.

In order to address this issue, as well as in light of the EU Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency (2014/135/EU)<sup>8</sup>, aimed at encouraging European Member States to reform their national insolvency law, Ministry of Economy of the Republic of Lithuania has drafted the Law Amending the Law on Bankruptcy of Natural Persons which proposes to simplify bankruptcy procedures<sup>9</sup>. The maximum 5-year duration of bankruptcy procedures would be shortened to 3 years, a debtor would be able to keep the pledged property, to specify conditions for approval a solvency restoration plan, new financing tools would be proposed to a person engaged in individual activities.

#### **4. Relation between Enforced Recovery and Bankruptcy Procedures Carried out by Enforcement Agents**

A legal regulation defines bankruptcy law and enforcement process law as types of procedural law, the application which of involves many similar actions (property management, a forced sale of property in accordance with the principle of an adversarial proceedings established by law, etc.).

Enforcement is usually an individual process. A collector, having a writ of enforcement, appeals to an enforcement agent to carry out recovery activities. Creditors, in the absence of the enforcement document, do not participate in the process.

Bankruptcy proceedings defend interests of all creditors of an indebted person. It applies the so-called principle of global execution, involving all creditors, both those who have received a writ of enforcement and those who have not, while a recovery is enforced against all without exception, assets of a company in bankruptcy.

A general principle: natural or legal persons' bankruptcy and restructuring procedures terminate and accomplish an individual recovery carried out by enforcement agents in favour of a single creditor, in order to bring together all creditors' claims and all the debtor's assets in one place. Upon enforcement of the ruling on initiation of bankruptcy proceedings, an enforcement agent "hands over" tasks to a bankruptcy administrator. Yet, in certain cases, procedures carried out by the enforcement agent and the bankruptcy administrator against the same person may be parallel.

As per policy of the Supreme Court of Lithuania<sup>10</sup>, enforcement procedures, opened by an enforcement agent and terminated during the bankruptcy proceedings, are subject to resumption and completion, upon consent of the court that is investigating a person' bankruptcy case, after hearing the creditors' and the natural person's opinion.

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<sup>8</sup> [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2014.074.01.0065.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.074.01.0065.01.ENG)

<sup>9</sup> [http://www.lrs.lt/pls/proj/dokpaieska.showdoc\\_l?p\\_id=1023269&p\\_org=205&p\\_fix=n&p\\_gov=n](http://www.lrs.lt/pls/proj/dokpaieska.showdoc_l?p_id=1023269&p_org=205&p_fix=n&p_gov=n)

<sup>10</sup> Civil Case No.3K-3-189-690/2015



Pursuant to Part 4 of Article 33 of the Law on Enterprise Bankruptcy<sup>11</sup>, where the sale of the pledged assets has been announced by the bailiff prior to the date of initiation of bankruptcy proceedings, *the bailiff shall complete the sale of the assets in accordance with the procedure laid down in the Code of Civil Procedure of the Republic of Lithuania and, upon the sale of the assets at auction, transfer the proceeds to the account of the enterprise in bankruptcy.*

As practice shows, if assets are mortgaged and owned by several persons, the sale of the same asset can be completed by both an enforcement agent and a bankruptcy administrator at auction. This means that different regulated processes may take place in parallel.

Since 2013, auctions<sup>12</sup> are held by enforcement agents in e-space. Opportunity to participate in the auction remotely assures the highest number of participants, their competition, and the sale of assets at the highest price. Compared with auctions, held by enforcement agents, bankruptcy administrators' procedures are less advanced – they are still arranged as a meeting. Enforcement agents' experience has proven that auctions held in their offices involved a 1.5-2 times lower number of participants, thus, a chance to sell assets at a most favourable price in such auctions decreases as well.

An enforcement agent arranging an auction sets an initial asset-selling price in accordance with the Code of Civil Procedure, through real estate appraisers. Prerequisite – 80 and 60 percent of the market price at the first and second bidding. If sales of assets take place in bankruptcy proceedings, the meeting of creditors sets the selling price. If the assets are not sold at the first auction, the meeting of creditors may reduce the price of the assets for sale before the second auction.

The same asset may happen to be evaluated differently in the recovery and bankruptcy processes (the meeting of creditors is not bound by requirements of the Code of Civil Procedure of the Republic of Lithuania applicable to enforcement agents) and sold in a different procedure, i.e., the relation between the procedures can be inconsistent. Only the emerging case law may answer most questions arising.

## **5. Bankruptcy Administrators – Ones of Enforcement Agents' Clients**

Bankruptcy administrators quite often resort to enforcement agents when initiating enforcement measures, without which a duly performance of the functions is impossible. Enforcement agents are often asked to enforce a transfer of corporate assets/documents to persons concerned: a manager, management bodies and financial statement handling companies. Enforcement agents are also needed to act where a creditor is a bankruptcy initiator, and a manager (management bodies) either does not hand over assets/documents to a bankruptcy administrator or their whereabouts are unknown. In such cases, the enforcement agent's duty is to transfer the obligation to the debtor, at the same time, to impose a liability for the failure to meet this obligation.

In addition, bankruptcy administrators often use legal services provided by enforcement agents. This includes a delivery of service documents to parties concerned, submission of other documentation to debtors and creditors, as well as a statement of facts (in taking over assets and/or documentation, inspecting property, looking for property, stating a process of creditors' meetings).

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<sup>11</sup> Cit. op 2.

<sup>12</sup> It is set a special legal termin for auction "varzytynes" in Lithuanian Law.



## 6. Forced Recovery and International Bankruptcy Proceedings

In international insolvency cases, a debtor's assets and (or) debts are cross-border or a debtor follows jurisdiction of more than one state.

A number of foreign state-based bankruptcy proceedings is growing in Lithuania, and international bankruptcy procedures are not necessarily associated with large groups of companies or corporations. There are more and more cases of small businesses or individuals going bankrupt with assets and creditors situated in several countries. Since the policy of courts, enforcement agents, and bankruptcy administrators is still under development, it naturally builds up many uncertainties where a debtor and his/her assets are situated in more than one country.

Are consequences of bankruptcy initiation the same in all countries? If the institution of bankruptcy proceedings affects the other country, the law of which country does regulate such consequences? The Supreme Court of Lithuania formulated these questions in Ruling as of 14 November 2013<sup>13</sup> and answered them.

The fundamental conclusion of the Court is as follows: after initiating bankruptcy proceedings against a debtor in a Member State, no individual recovery procedures can be executed in any other Member State, including Lithuania. The panel of judges believes that an enforcement agent, in view of the provisions of Regulation 1346/2000 on insolvency proceedings regarding a prohibition to carry out any individual recovery actions after the initiation of bankruptcy proceedings against a debtor, must terminate the debtor's case. Meanwhile, all the creditors of the debtor in bankruptcy are entitled to file claims with a Member State' court (in particular – Croydon County Court of the UK), where the natural person's bankruptcy proceedings were brought.

Article 16 of the Regulation 1346/2000 on insolvency proceedings sets forth the versatility of insolvency procedures by setting the principle of automatic recognition of decisions in other Member States. According to Article 18 of the Regulation, a liquidator, appointed to the main insolvency proceedings, may exercise powers not only in the country where he was appointed, but also in other Member States. In accordance with Part 1 of Article 3 herein, *the courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings*, and Part 1 of Article 4 herein stipulates that, *the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened*.

Questions arising in enforcement agents' practice:

- What procedure should apply to sales of assets, situated in Lithuania, of a debtor who went bankrupt in a foreign country?
- Is it a function of a bankruptcy administrator appointed in the foreign country? If so - should the debtor's assets in Lithuania be disposed of according to law of the other country?
- How should issues of selling assets pledged in Lithuania be addressed, if they are open in the other Member State's court ruling?

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<sup>13</sup> Civil Case No.3K-3-580/2013.



- In what ways should a bankruptcy administrator in a foreign country locate the debtor's assets situated in Lithuania?
- If all the assets are pledged, and the debtor owns only ½ of it, should an enforcement agent dispose of that part of the assets? If so, would a mortgage creditor's interests be duly defended?
- And so on.

Due to various uncertainties associated with international personal bankruptcy, a number of enforcement proceedings enforced in offices of enforcement agents have been suspended, pending Court clarifications.

Significant findings regarding consequences caused by unfair actions of a natural person in bankrupt in the other EU country, are formulated in the Ruling of the Supreme Court of Lithuania as of 8 April 2015.<sup>14</sup> According to interpretation of the Supreme Court, judicial decisions of other EU countries, such as Latvia, on initiation and completion of personal insolvency proceedings, that are automatically recognized and enforced in Lithuania, do not eliminate debtors' liabilities to creditors in Lithuania, which were not recorded in a personal debt relief plan, approved by a court of the other Member State. That means, i.e., a debtor in bankruptcy undertakes to continue to fulfil liabilities to creditors not specified in the debt relief plan. In the particular case, the Supreme Court of Lithuania upheld the claim of the enforcement agent's order for the debtor's employer to make deductions from the debtor's wages.

## 7. Perspectives for Expansion of Enforcement Agents' Legal Services in Lithuania

Professional, experience accumulated by Lithuanian enforcement agents and a modern enforcement infrastructure developed on account of enforcement agents is a solid foundation for creation and development of new legal activities to be carried out by them. Hope the electronic unencumbered property sales to be the eighth legal service rendered by enforcement agents.

According to paragraph 4 of Part 1 of Article 21 of the Law on Bailiffs<sup>15</sup> of the Republic of Lithuania, sales is one of the private legal services the enforcement agents are entitled to carry out: they may *sell pledged movable property as collateral in sale*. However, unlike other enforcement agents' legal services, the scope of application of the sale service is very narrow: such sales can be used to sell a mortgaged property only, the sale are initiated solely by creditors. It is therefore proposed to make use of advantages of the existing e-auction system in improving procedures of selling unencumbered and pledged assets and in assuring persons involved in these auctions with broader guarantees of legality.

Pledged movable property sale procedures, compared with e-auction procedures, are morally outdated in Lithuania. Sales of pledged moveable assets in auction take place in meetings; participants meet in an enforcement agent's office or in any other premises in due time and bid by raising prices.

E-sales, arranged by enforcement agents, would become a logical step in the modernization of legal procedures following the e-auction procedure which was implemented at the beginning of 2013 and

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<sup>14</sup> Civil Case No. 3K-3-197-611/2015.

<sup>15</sup> Cit. op. 1.



has been efficiently operating since then. E-auction service assures openness, transparency, efficiency, and maximum availability of auctions. Within two years of the e-auction service (1 January 2013 – 31 December 2014), there have been 6,769 e-auctions announced. In total, 1,649 auctions held remotely have attracted 8,290 buyers and the assets therein were sold for 41,872,075 Euro.

Once enforcement agents start arranging e-sales, such e-auctions will have considerable advantages, both over the current meetings of pledged property sales and auctions on the internet held by various private companies. On the one hand, the sales electronization would relieve the pledged property market and expand a customer base thanks to the opportunity to compete for items for sale remotely from anywhere in the world. On the other hand, the presence of an enforcement agent, as a sales agent, in the auction arrangement would assure the reliability of the transaction and defence of interests of all the persons involved in the procedure, including the buyer protection against a risk of buying stolen goods or staying with no purchase after paying for it.

Making adjustments in the legal regulation would enable enforcement agents to carry out e-sales as an optional legal service, similar to other services rendered by enforcement agents.