FOREIGN INVESTORS COUNCIL IN LATVIA

Position Paper No 2

30 May 2014

Position Paper on the Security and Protection of Investment

1. Executive Summary

During the past years, the need to attract foreign investments and to improve the investment environment has been defined, in various policy planning documents, strategic development plans and government declarations, as one of the goals that Latvia has to achieve. The progress in accomplishing these goals, however, has not proved to be as clear as it could have been. Thus, in such positions as comprehensibility and predictability of the implemented policy, according to the Global Competitiveness Reports of the World Economic Forum both for 2012-2013 and for 2013-2014, Latvia still falls behind its neighbour states Lithuania and Estonia. Additionally, in the Doing Business 2014 research, published by the World Bank at the end of the last year, the overall indexes of Latvia also fall slightly behind its neighbouring states Lithuania and Estonia (Latvia ranks as the 24th, while Estonia — as the 22nd, whereas Lithuania — as the 17th).

Foreign Investors' Council in Latvia (hereinafter — "FICIL") underlines that one of the most important factors in adopting a decision to make an investment in a particular state is the existence of an effective and reliable law enforcement system guaranteeing secure business environment. Non-transparent business environment and general lack of stability makes it difficult, if not almost impossible, to attract investments. Bearing this in mind, further work should be continued not only towards promotion of security of business transactions and of flow of capital, as well as towards improvement of the normative regulation of the holding regime and the enhancement of the efficiency of the court system, but also regarding promotion of the stability of legislation and facilitation of wider involvement of all stakeholders, industry professionals as well as the public in the law-making process. Not infrequently, rushed and insufficiently discussed amendments to the legislation may cause an undesirable perception of Latvia as an unsafe jurisdiction for making investments. Whereas qualitative and predictable law-making processes, as well as bills duly discussed among professionals and experts reduce the necessity to frequently amendment legislation and create confidence in consistent further development of the justice policy.

When planning future investments, any investor will always evaluate and approve the quality of the legislation and its stability, the tax policy and its predictability, as well as the efficiency of the available law enforcement mechanisms and civil remedies. Consequently, observance of the

investors' interests as well as protection of the already acquired interests are among the factors that should be taken into account by the government when adopting or amending the legislation in order to avoid the possibility to become involved in continuous and expensive legal proceedings.

In respect of the above, in its annual Position Paper the FICIL Working Group has focused on the available possibilities for promotion of the security and protection of investments and in doing so has addressed the following matters.

1. Matters regarding commercial law:

1.1. security of transactions and their legally binding effect in the context of significant changes in legislation;

1.2. strengthening of the procedures regarding the Registry of Shares;

1.3. lack of legislation affording protection to creditors throughout the procedure of compulsory alienation of immovable property for state or public needs;

1.4. amendments to the Law on Enterprises Income Tax in relation to the abolished opportunity to carry forward loss in groups of companies and its negative effect on the holding regime;

1.5. use of electronic signature on a cross-border level;

1.6. improvement of the legislation on corporate governance of companies and of the mechanisms for protection of shareholders' rights:

1.6.1. the need to afford mandatory character to the rules of the Commercial Law regarding companies;

1.6.2. the need to include in the Commercial Law rules that define the standing, consequences and enforceability of shareholder agreements and other related aspects;

1.6.3. the need for the Law on Enterprises Register to grant the state notary of the Register of Enterprises the competence to verify the substantive correctness of the information submitted for registration in the Commercial Register.

2. Matters regarding the judicial system:

2.1. specialised departments for commercial cases in the regional courts and in the Supreme Court and rules on commercial procedure;

2.2. attorney process in the civil procedure in the courts of first and second instance in relation to the amendments to the rules on conditions for admittance to the bar;

2.3. legal effect of arbitration clauses in case of assignment of the principal claims and exceptions to the requirements on certification of arbitrators.

2. Recommendations

The FICIL Investment Security and Protection Working Group has come to conclusions and recommendations regarding the required changes in and suggestions concerning both legislation as well as its enforcement in order to better ensure the security and protection of investments and in order to improve the business environment in Latvia in general.

These conclusions and recommendations concern:

1. improving the procedure for adoption of legislation (complete harmonisation of legislation, sufficient period to discuss the law, assessment of the conformity of the selected measures, planning of the justice policy, provision of reasonable transition period for transition to the new legislation, carrying out due assessment prior to prescription of immediate or retroactive effect to the legislation regulating legal relations subject to private law);

2. establishing opportunities for improvement of the procedure regarding the Registry of Shares (by providing, for instance, a possibility to delegate the function of the registration procedure regarding the registry of shareholders and stockholders to a third party (institution));

3. ensuring protection of creditors throughout the procedure of alienation of immovable property required for public needs by providing for such protection in the Law on Compulsory Alienation of Immovable Property for State of Public Needs;

4. amendments to the Law on Enterprises Income Tax by reintroducing the opportunity to carry forward loss in groups of companies;

5. support for participation in cross-border cooperation projects dedicated to the improvement of the use of electronic signature to facilitate cross-border cooperation among businesses;

6. amendments to the Commercial Law establishing that provisions on joint stock companies (and, possibly, limited liability companies as well) are mandatory norms, in case of fundamental breach of which the respective resolutions and other actions of the corporate governance bodies shall automatically be recognised as null and void;

7. amendments to the Commercial Law establishing the validity, consequences and enforceability of provisions of shareholder agreements and other related aspects, clearly defining that shareholder agreements cannot amend the respective rules, but may only supplement and clarify them;

8. amendments to the Law on Enterprises Register defining competence of the state notary of the Register of Enterprises to verify the substantive correctness of the information submitted for registration in the Commercial Register;

9. establishment of specialised departments for commercial cases — Commercial Court Panel with the regional courts as the courts of first instance in commercial cases and Commercial Department of the Supreme Court as the court of cassation in commercial cases —, providing for respective provisions in the law On Judicial Power, as well as in the Civil Procedure Law or in a separate Commercial Procedure Law;

10. attorney process within civil procedure in the courts of first and second instances in relation to the amendments to rules for admittance to the bar, by decreasing the requirements for entry of new lawyers to the bar provided for in the Advocacy Law;

11. the bill on Arbitration Law should provide that in cases when a legal claim arising from a contract that requires disputes to be resolved in arbitration is assigned, the agreed dispute resolution in arbitration is binding also to the assignee;

12. the bill on Arbitration Law should also provide exceptions to the general rules requiring official certification of arbitrators.

3. Rationale for Recommendations

3.1. Matters regarding commercial law

3.1.1. Security and the binding legal effect of transactions in the context of significant changes in legislation

It follows from the notion of a democratic republic, derived from Article 1 of the Constitution of the Republic of Latvia, that the state has an obligation to observe in its actions the basic elements of the principle of rule of law, one of its elements being the principle of legal certainty. The principle of legal certainty requires that the state, when amending legislation, must observe reasonable balance between the expectations of a person and the interests for which the legislation is being amended.[1]

Whereas in the jurisprudence of the Constitutional Court concerning establishing an appropriate regime for protective transition to the new legislation, it has been emphasised that the said regime can manifest itself either as setting of a reasonable transition period[2] or as a provision of compensation.[3] That, however, does not prevent the state to guarantee the protective transition to the new legislation by other mechanisms as well.[4] This having been said, FICIL would nevertheless like to particularly emphasise that protective and proportional transition to the new legislation is especially significant in cases when the new legislation affects virtually all participants of relations governed by private law.

Considering the concerns expressed by the FICIL members regarding certain recent law-making processes, particularly in relation to the already adopted amendments to the Law on Time of Coming into Effect and Application Procedure of the Law of Obligations Part of the Restored 1937 Civil Law of the Republic of Latvia and to the bill, supported at the 2nd reading in the parliament, on Amendments to the Insolvency Law (where at the 2nd reading were adopted significant changes that may affect current investment environment), FICIL would like to

[1] See the judgment of the Constitutional Court of 6 December 2010 in the case No.2010-25-01, paragraph 4.
[2] Only in individual cases derogation from the rights granted to a person may be allowed with no transitional period, by balancing the scope of the restriction on the legitimate expectations and the necessity and urgency of the change of the normative regulation.
[3] See the judgment of the Constitutional Court of 25 March 2003 in the case No.2002-12-01, conclusion section, paragraph 2.
[4] See, e.g., the judgment of the Constitutional Court of 26 November 2009 in the case No.2009-08-01, paragraph 25.

repeatedly draw attention to the effect law-making processes and stability of legislation have on attraction and protection of investments. The investment environment must be stable and predictable.

It should be noted that the cornerstone of the relations governed by private law is the possibility to rely on the fact that already concluded transactions, which comply with the legislation that was in force at the time of their conclusion, are not going to be considered null and void only because the respective legislation has later been amended. The contracting parties, by deciding to enter into an agreement, base their decision on those legal and factual considerations that are available to them at the moment when they are making the agreement.

The private law is governed by a principle that a new legal norm is applicable only to forthcoming circumstances, that is, a legal norm has effect only as to the future, and rules on immediate and retroactive effect of legal norms are considered merely as an exception to this basic principle.[5] Therefore, FICIL would like to emphasise that in cases when the legislator considers it absolutely necessary to make an exception to the said general basic principle, particular attention should be devoted to setting a proportional and reasonable transition period.

The fact that significant amendments to the existing legislation are adopted within a very short timeframe and, moreover, that they are applied also to already initiated (continued) legal relations and, furthermore, that the transition period is set as a relatively short one, in the opinion of FICIL, suggests an adverse tendency with regard to the predictability of legislation, which is of particular importance to foreign companies making or planning to make investments in Latvia by carefully assessing the potential security of the investment environment.

FICIL would like to indicate that non-transparent business environment and general lack of stability makes it difficult, if not almost impossible, to attract investments. Whereas qualitative and predictable law-making processes, as well as bills duly discussed among professionals and experts do, on the contrary, reduce the necessity to frequently amendment legislation and create confidence in consistent further development of the justice policy.[6]

Emphasising the critical importance such amendments have on the legal relations governed by private law and on the possibilities for investors to safeguard compliance of their actions with the requirements set by laws, FICIL invites to provide for longer transition periods in cases of significant legislative amendments, during which the adopted changes could be approbated and explanations regarding the substance and application of the respective amendments should be provided, thereby giving businesses an opportunity not only to express their opinion, but also to appropriately prepare for the forthcoming changes. In this context, we want to emphasize the role of the Ministry of Justice as the leading state administrative institution in the sector of justice in order to prevent the adoption of unreasoned amendments, particularly in cases where the new regulation would affect already existing relations.

Summarising the above, FICIL recommends to observe the following basic principles during the

[5] Kalniņš E. Tiesību normas spēkā esamība un intertemporālā piemērojamība. Likums un Tiesības, July, 2000.
[6] See in detail Kusiņš G. Normatīvo aktu jaunrade. In: Mūsdienu tiesību teorijas atziņas: rakstu krājums. Ed. by E.Meļķisis [auth.: E.Levits, E.Meļķisis, J.Briede et al.], Riga: Tiesu namu aģentūra, 1999.

law-making processes:

1. complete harmonisation of legislation (drafting at the respective ministry at the level of experts, announcing at the State Secretary Meeting, review by Committees of the Cabinet of Ministers and adoption by the parliament in three readings); in case of initiative of the legislator, it should be ensured that the procedure for assessment of the effect and quality of the new legislation is equally efficient and that non-governmental sector is involved as well;

2. period for discussing the proposed legislation may not be rushed and should be appropriate taking into consideration the potential effect of the proposed legislation on the legal relations governed by private law and on the security of investments;

3. assessment, during the drafting of the legislation, of the suitability of the selected measures for achieving the defined goals, including an assessment of the possible risks and damages;

4. adequate planning of the justice policy, ensuring its stability and reducing the necessity for frequent amendments of the existing legislation;

5. setting of a reasonable transition period regarding the new legislation, thereby allowing the public to understand its substance and to take the required measures to ensure compliance with it, particularly in cases when the new legislation provides for significant changes to the existing legal order and to the legal relations governed by private law;

6. careful assessment whether it is necessary to establish immediate or retroactive effect of the new legislation, and indication of appropriate reasons and justification in case of an affirmative decision.

3.1.2. Possibilities to improve the operation of the Registry of Shares

According to the effective regulation of the Commercial Law, the registry of shareholders and stockholders is maintained by the board of the company. A person acquires the status of a shareholder or a stockholder at the moment of being entered into the registry of shareholders or stockholders. In case of a limited liability company, the board files the registry of shareholders with the Enterprises Register for attachment to the company file, in order for the registry to be publicly available. Whereas in case of a joint stock company, the registry of stockholders is not filed with the Enterprises Register for attachment to the company registration file — it is available only at the company itself and is not made publicly available to other persons.

With regard to the described procedures and in relation to the acquisition and protection of the rights of shareholders and stockholders, there exist several problems. One of the possible solutions for such situations would be to transfer the administration function of the registry of shareholders or stockholders to a third party (institution), and in such case the new owner of the shares or stocks of the company could personally apply to the holder of the registry of shareholders or stockholders for the holder to make a respective entry in the registry. Such procedure would ensure a control mechanism when owners of the shares change and thus would improve the protection of the shareholders' rights. Such option was indicated already in 2011, when there was a discussion on the maintenance of the registry of shareholders and stockholders, by emphasising that the law should provide for a procedure whereby the owners of shares (via the

management board of the company as an intermediary) are entitled to maintain the registry of shareholders by means of a state-ensured registry and by suggesting, at the same time, the need to define the legal consequences of such an entry, including that existence of such an entry is a precondition for use of the rights arising from the shares and that the entry protects third parties acting in good faith.[7]

It should be noted that the Central Depository of Latvia is already offering maintenance of the registry of stockholders to companies that have applied for such service by choice.

At the same time FICIL should mention that such obligation of public registration is, in substance, a restriction on the private autonomy of the subjects of private law and therefore stresses that such possibility should be prescribed as only optional, that is, the shareholders or stockholders of a company should have an opportunity to choose whether to involve a third party in the maintenance of the registry or not.

3.1.3. Lack of legislation for protection of creditors in the procedure of compulsory alienation of immovable property for state or public needs

Article 16, paragraph 1, of the Law on Alienation of Immovable Property for State or Public Needs provides that "when registering in the Land Register rights to an immovable property that has been alienated based upon the law on alienation of the respective immovable property, the respective immovable property shall be transferred to the ownership of the state or the local government free of any encumbrances which had been put on the immovable property as a result of obligations (including all debts registered in relation to this property, rights of pledges, registrations of securities for claims, registrations of insolvency, prohibitions by the officials in charge of the procedure, encumbrances accepted as a condition when acquiring the property, as well as lease, rent, maintenance and inheritance agreements) and for which the institution has not directly notified that it accepts the respective encumbrances".

It follows from the annotation of the said law that persons to whom any rights arise from the encumbrances registered on the immovable property to be alienated for public needs remain only with a personal claim against the owner of the respective immovable property.[8] Law on Alienation of Immovable Property for State or Public Needs currently provides no involvement of creditors of the owner of the immovable property, nor protection of their interests during the procedure of alienation of the immovable property.

With regard to ensuring fairness in the compulsory alienation procedure, it has been noted as a basic principle in legal literature that, as a result of the alienation, the owner may not be set to a better or worse position, since otherwise no fair balance, which is at the heart of a fair compensation, would be achieved.[9] Additionally, Article 21 of the Law on Alienation of Immovable Property for State or Public Needs provides that the former owners of the immovable properties should receive such compensation that would ensure that their financial standing

[7] Dalībnieku un akcionāru reģistra vešana: problēmas un risinājumi. Jurista Vārds. 22 November 2011, No.47 (694).
[8] Annotation available at: *http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/614B6229E4CC5107C225767F00364BDE?OpenDocument*.
[9] Informative report "Par nekustamā īpašuma atsavināšanu valsts vai sabiedriskajām vajadzībām procesa efektivizēšanu", available at: *polsis.mk.gov.lv/LoadAtt/file65124.doc*.

regarding the ownership of the property is equivalent to their former financial standing.

A situation could not be regarded as fair if the state or local government was assigned an obligation to cover all debts of the owner of the immovable property which have been secured by that immovable property, but which are not yet covered and if the mortgage registered as to the immovable property was deleted only afterwards, for in such case the owner would experience unjustified enrichment on the account of the state or the local government — the owner would no longer have obligations to repay the debts, even though such obligations existed prior to the alienation. There would be no grounds to consider such solution as an equal situation.

At the same time, however, in the opinion of FICIL, it would not be acceptable that, during the alienation procedure of immovable property, the law does not provide any protection to creditors' interests at all. Therefore, FICIL invites to make amendments to the Law on Alienation of Immovable Property for State or Public Needs that would ensure involvement of mortgage creditors in the respective procedures and that would also define the means of such involvement.

3.1.4. Amendments to the Law on Enterprises Income Tax regarding the abolished possibility to carry forward loss in groups of companies and its negative impact on the holding regime

On 1 January 2014 relatively extensive amendments to the Law on Enterprises Income Tax came into effect. One of the most significant changes, which has an impact on the use of holding regime in Latvia, is the deletion of Article 14^1 of the said law, which essentially means that as of 1 January 2014 the possibility to carry forward loss in groups of companies has been cancelled.

In the annotation of the respective bill,[10] as the reason for these changes was indicated the fact that during the meeting of 27 August 2013 of the Cabinet of Ministers it was decided to extend, till 2020, the tax relief for new manufacturing technical units and for investments made in the investment projects to be supported in excess of EUR 10M, as well as to implement a new relief for promotion of research and development as of 1 July 2014. In order for these changes not to cause, both in short-term as well as in long-term, negative fiscal effect on the state budget, when reviewing the efficiency of the existing corporate income tax reliefs it was decided to abolish, as of 1 January 2014, the relief for carrying forward loss in groups of companies.

FICIL would like to note that the objectives of the state in relation to attraction of investors and holding companies ought to be clear and specific. It was only in 2013 when in the Law on Enterprises Income Tax several norms were provided with a purpose to create a more favourable tax regime for holding companies. However currently, merely a year after those amendments were adopted, the new amendments significantly restrict attracting holding companies, considering that abolishing the possibility to carry forward loss within groups of companies is going to prevent Latvia from competing with other countries for attraction of holding companies.

The Position Paper developed by Taxation Working Group of FICIL incorporates a list of

[10] Available at: *http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/F0C0D56A647CD32CC2257BF700487F6F?OpenDocument*.

additional comments and proposals for the development of holding companies regime legislative instruments in Latvia. Please therefore consider these proposals jointly.

In the opinion of FICIL, these matters should be viewed together with the matter referred to in section 3.1.1 of this paper on the stability and predictability of the legislation. The stability of the tax policy implemented by the state has significant role in attraction of investments and in development of commercial activities. Considering this, FICIL would like to emphasise the significance of implementation of a consistent tax policy and, at the same time, to strongly invite reassessment of the possibility of carrying forward loss within groups of companies.

3.1.5. Use of electronic signature on a cross-border level

Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures[11] (hereinafter – "E-signature Directive") establishes the electronic signature and prescribes the legal basis for certification services. The E-signature Directive provides that the European Union member states may not restrict provision of certification services by other member states (use of electronic signature) if it complies with the conditions set out in the Directive.[12]

However, in practice, difficulties often arise, particularly with conclusion of cross-border commercial transactions, if businesses are willing to use opportunities offered by the electronic signature.

According to the informative report On the Cross-Border Inter-Usability of the Electronic Signature and the Electronic Identification, which was reviewed during the meeting of 22 October 2013 of the Cabinet of Ministers,[13] in the commercial sector solutions are being developed by the help of which it is possible for a single document to be signed by several persons, where each of these persons uses a secure electronic signature issued in that person's respective state. One of such solutions is planning, in the near future during this year, to support in its product also the electronic signature included in the Latvian electronic identification card. It means, for instance, that a single agreement could be signed by an Estonian using electronic signature issued in Estonia, on the one hand, and by a Latvian using electronic signature issued in Latvia, on the other hand. With such solution, cross-border cooperation – conclusion of contracts and agreements between businesses as well as between state officials – would have a potential for particular facilitation and promotion.

At the same time, in the informative report it has been stated that currently in the European Union there does not exist comprehensive cross-border and inter-disciplinary legislation for secure, reliable and easy-to-use electronic signature mechanisms, which include electronic identification and authentication, and currently Latvia is not involved in any cross-border cooperation project that would ensure it. For Latvia to able to successfully use the electronic identification in other European Union states as well as to be able to use the electronic identification of other European

[11] Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures.
[12] Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures, Article 4.
[13] Available at: *http://mk.gov.lv/doc/2005/VARAMZINO_240913.2977.DOCX*.

Union member states in provision of various services, it would be advisable for Latvia to become involved in the e-SENS project, which has just been commenced and which is expected to have the second expansion stage.

FICIL would like to express its support for initiatives of this type and to call for more active involvement in solving such matters, noting that it would significantly facilitate cross-border cooperation between businesses.

3.1.6. Improvement of regulation of corporate governance of companies and mechanisms for protection of shareholders' rights[14]

3.1.6.1. Rules of the Commercial Law regarding companies should have the effect of mandatory norms

According to the jurisprudence established by the Senate of Latvia, the Supreme Court of the First Republic of Latvia, Civil Cassation Department (CCD) (Sen. CCD judg. 1925/75; 1931/717; 1935/122; 1937/502; 1938/432;), „*generally all rules on share companies*[15] *and joint stock companies (contrary to the rules on personal companies) have a nature of strictly binding norms (jus cogens) which do not permit amending them by a shareholders' agreement, but never a nature of dispositive norms, since these rules affect not only the interests of the shareholders, but also the interests of third parties, and these rules possess an element of public law, therefore they cannot be amended by a shareholders' agreement. Legally binding norms, pursuant to the general principle, are to be interpreted in the narrowest possible meaning.*"[16] Considering the said thesis, the Senate of Latvia almost automatically found all resolutions of shareholder meetings, as well as the board resolutions, that were in conflict with the said rules to be null and void. It ensured high level of corporate governance integrity of Latvian joint stock companies.

Whereas in 2010, when interpreting the rules of Article 286 of the Commercial Law on recognition of the resolutions of shareholder meetings as null and void, the Senate of the Supreme Court of the Republic of Latvia arrived to a completely contrary conclusion, namely, that Article 286, paragraph 1, of the Commercial Law reflects the signs of a dispositive legal norm, and therefore the court has discretion whether to apply the legal consequences provided for in the

[14] Initiatives 3.1.6.1.-3.1.6.3. were prepared with the support from the Latvian Law Institute.
[15] Analogue to the modern limited liability company.
[16] See, e.g., the judgment of the Senate Civil Cassation Department of 31 January 1925 in the case of Eduards Gašelis against "Linu un džutes manufaktūras akciju sabiedrība", published: Latvijas Senāta spriedumu (1918-1940), Vol. 9 – Senāta Civilā kasācijas departamenta spriedumi (1925), kārtējo sēžu spriedumi, Riga: Latvijas Republikas Augstākā tiesa un Senatora Augusta Lēbera fonds, 1997, pp.3348-3354; the judgment of the Senate Civil Cassation Department of 25 January 1935 in the case of Markels Frīdmanis and Nikolajs Starcens against A/S "Rīgas konservu fabrika S.K.F.", published: Latvijas Senāta spriedumu (1918-1940), Vol. 13 – Senāta Civilā kasācijas departamenta spriedumi (1934-1936), kārtējo sēžu spriedumi, Riga: Latvijas Republikas Augstākā tiesa un Senatora Augusta Lēbera fonds, 1998, p.5117; the judgment of the Senate Civil Cassation Department of 27 May 1937 in the case No.502 P/S "Stodoļskas tūku fabrikas Vasilija Barišņikova dēli" against "Maskavas Rūpniecības banku, bij. J. W. Junker un Co, Rigas nodaļu", published: Latvijas Senāta spriedumu (1918-1940), Vol. 14 – Senāta Civilā kasācijas departamenta spriedumi (1937-1940), kārtējo sēžu un kopsēžu spriedumi, Riga: Latvijas Republikas Augstākā tiesa un Senatora Augusta Lēbera fonds, 1998, pp.5408.-5409.

respective norm or not, however, the court has to explain why the respective legal norm is or is not applicable to the established factual circumstances of the case (Senate CD SKC-37/2010).[17]

Such interpretation of Article 286 of the Commercial Law (which is *mutatis mutandis* applicable also to Article 217 of the Commercial Law that deals with limited liability companies) in practice may lead to absolute ignorance of the minority shareholders' rights, for instance, not inviting the minority shareholders to shareholder meetings, not providing information etc., which, in turn, means that investment in minority shareholding in Latvian joint stock companies is unsecure and unattractive, except if a shareholders' agreement is concluded, which offers minority shareholders additional protection (however, the legal force and consequences of such agreements have not been sufficiently assessed in the jurisprudence of Latvian courts).

The consequence of the said deficiencies is a decrease in the number and scale of such investments in minority shareholdings, which means that it is more difficult and more expensive for Latvian joint stock companies to attract capital in the form of investments in minority shareholding, thus slowing down the economic growth.

Therefore, in the opinion of FICIL, it is necessary to make appropriate amendments to the Commercial Law which would provide that rules on joint stock companies (and, possibly, also on limited liability companies) are mandatory norms, in case of significant breach of which the respective resolutions of the corporate governance bodies of the company and other actions would automatically become null and void.

3.1.6.2. Commercial Law should contain rules defining the validity, consequences, enforceability and other aspects regarding shareholder agreements

Shareholder agreements between the shareholders of Latvian limited liability companies and joint stock companies is a legal instrument that is frequently used in practice and which increases the level of corporate governance integrity and commercial predictability, however, neither legislation, nor jurisprudence of Latvian courts have clearly defined the validity, consequences and enforceability of shareholder agreements, for instance, whether their contractual provisions can bind the company itself or its board, whether they can bind third parties etc. The rules contained in Article 281 of the Commercial Law establish restrictions to only known shareholders obligations.

Therefore, in the opinion of FICIL, it would be necessary to make appropriate amendments to the Commercial Law that would define the validity, consequences and enforceability of shareholder agreements, as well as other related aspects. Considering the said thesis concerning the mandatory effect regarding the rules on companies, it must be clearly prescribed that shareholder agreements may not amend the respective rules, but can only supplement or further specify them.

3.1.6.3. Law on Enterprises Register should provide for authority of the state notary of the Register of Enterprises to verify the substantive correctness of the data submitted for registration in the Commercial Register

[17] See the judgment of the Senate Civil Cassation Department of 10 February 2010 in the case No.SKC-37/2010, available at: *http://at.gov.lv/files/uploads/files/archive/department1/2010/37-vi.doc*.

The Law on Enterprises Register should provide for authority of the state notary of the Register of Enterprises to verify the substantive correctness of the data submitted for registration in the Commercial Register (verification of the factual circumstances), including the rights to request from the applicant and other persons explanations and evidence. Similar rights were once provided for judges of the Trade Register by the rules of Article 30 of the Cabinet of Ministers Rules on the Trade Register of 29 May 1934 (Law Vol. 145/1934).[18]

Such competence would allow the state notary, in critical situations, to verify, with regard to the provided information, its correctness and genuineness and its compliance with the requirements prescribed by law, as well as would prevent unjustified entries in the Commercial Register until the adoption of a judgment on merits by the court in accordance with the rules of Section 30^4 of the Civil Procedure Law.

If the state notary would have any legitimate doubts on the substantive correctness of the provided data, the state notary could suspend making of an entry in the Commercial Register until the judgment of the court, referred to above, comes into effect, subject to such court proceedings being initiated within a specific number of days from the date of the decision of the state notary.

Such regulation would be of crucial importance in order to ensure that it is not possible to enter in the Commercial Register false data within a short period of time, since otherwise, considering the public reliability of the entries in the Commercial Register; it would be possible to irrevocably affect the situation and matters of companies.

Therefore, in the opinion of FICIL, it is necessary to make amendments to the Law on Enterprises Register that would provide for rights of the state notary of the Register of Enterprises to verify the substantive correctness of the information submitted for registration in the Commercial Register. These amendments should be harmonised with the rules of Article 30^4 of the Civil Procedure Law. Should this recommendation was accepted, it would be necessary to also evaluate, in order to prevent any doubts on possibly corrupt or incorrect application of legal norms, whether a concrete procedure should be provided on how the state notary would carry out the granted rights to request additional information and documents, by suspending the making of the entry in the Commercial Register.

3.2. Matters regarding the judicial system[19]

3.2.1. Specialised departments for commercial cases in regional courts and in the Supreme Court, and rules for commercial procedure

In the opinion of FICIL, a possibility should be considered to establish specialised court departments for commercial cases — Commercial Cases Court Panels with the regional courts as the courts of first instance in commercial cases and Commercial Cases Department of the Supreme Court as the cassation instance in commercial cases. Consequently, it would be necessary to make respective amendments in the law On Judicial Power,[20] as well as in the Civil

[18] See Juris Grinbergs, "Jaunie Latvijas tirdzniecības likumi", published: "Jurists", No.6, 1935.01.01. Col.13.
[19] Initiatives 3.2.1.-3.2.2. were prepared with the support from the Latvian Law Institute.
[20] The main version of the law On Judicial Power, Articles 42, 43 and 47, provided that the Senate of the Supreme Court shall include the Commercial Cases Department, the Court Panel of the Supreme Court shall include the Commercial Cases Court Panel, but in the regional court there is also Commercial Cases Board. Article 8 of the said law provided that

Procedure Law (possibly in the form of an annex) or in a separate Commercial Procedure Law, by including special procedural norms regulating the operation of such departments for commercial cases that would provide an efficient and speedy procedure for hearing the commercial cases in two instances, since speed, and reasonableness and predictability in application of legal norms is of crucial importance in the business environment.

Creation of specialised departments for commercial cases with the regional courts and with the Supreme Court, rather than establishment of a separate Commercial Court, would be a less expensive option and would not come into conflict with the currently existing principles of the Latvian judicial system, which, already from the very beginning, provided for specialised departments with courts for resolution of commercial disputes. Establishment of specialised commercial departments, moreover, complies also with the parallelism of the substantive civil and commercial law, chosen by the Latvian legislator.

Historically, the initiative to establish a separate Commercial Court or specialised departments for commercial cases with the existing courts is comparatively old. Already at the time of the Russian Empire, in some of the largest Russian cities (not in the territory of Latvia however), there were special commercial courts. In the beginning of 20th century, the Ministry of Justice of Russia recommended establishment of special departments for trade (commercial) disputes with the regional courts. This recommendation was, in principle, supported also by the Riga Stock Committee, subject to the condition that the judges would be only professional lawyers, having had an opportunity to acquaint themselves with local stock exchange and trade customs, rather than elected merchants, as well as subject to another condition that the trade departments with the regional courts be subordinate to similar departments with court panels (appellate instance) and the Senate (cassation instance) and that the general procedure of the court proceedings be supplemented with rules on speedier procedure for hearing and deciding commercial cases.[21]

Similarly, in 1929 the Ministry of Justice of Latvia had prepared a new bill on establishment of commercial courts in Latvia.[22] As it has already been noted, the law On Judicial Power initially provided for special commercial dispute departments with Latvian courts as well. Furthermore, nowadays too, from time to time, one can encounter pleas for establishment of special commercial courts.[23] Also FICIL has repeatedly expressed its support for establishment of commercial courts or specialised departments with the courts of general jurisdiction to promote the speed and quality in deciding disputes between businesses.

Competence of the departments for commercial cases should cover all commercial disputes, i.e.:

1. corporate law disputes (including rules contained in parts A-C of the Commercial Law,

---

the commercial cases are adjudicated by the court by hearing and deciding in the court hearings cases on disputes that arise by concluding, performing, amending or terminating commercial agreements, as well as cases regarding other disputes between legal entities if the parties to the particular dispute have not turned to arbitration.

[21] See, e.g., V. Helds, "Komerctiesas agrākā Krievijā", published: "Ekonomists", No.6., 15.03.1930, p.252 et seq., available from the digital portal of the National Library of Latvia: *www.periodika.lv*.

[22] Ibid.

[23] See, e.g., "Latvijā rosina izveidot Komerctiesu", published: TVNET.lv, 15.04.2005, available at: *http://www.tvnet.lv/zinas/latvija/206243-latvija_rosina_izveidot_komerctiesu*; M. Zālīte, "Latvijā būtu jāievieš komerctiesas", published: Delfi.lv, 13.04.2010., available at: *http://www.delfi.lv/news/comment/comment/maija-zalite-latvija-butu-jaievies-komerctiesas.d?id=31231893*; M. Ķirsons, "Vēlas komerctiesas", published: DB.lv, 17.04.2013, available at: *http://www.db.lv/laikraksta-arhivs/zinas/velas-komerctiesas-391992*.

Group of Companies Law, including matters related to merchants, shareholder disputes etc., disputes of Article 30^4 of the Civil Procedure Law, currently in the competence of the Jelgava Court, disputes regarding the validity of the decisions of the Enterprises Register in relation to entries in the Commercial Register to prevent parallel proceedings in the courts of general jurisdiction and in the administrative courts);

2. competition law disputes[24] (both review of the decisions of the Competition Council (CC) and competition law related disputes between private persons);
3. insolvency matters;
4. commercial transactions disputes (including rules of part D of the Commercial Law);
5. commercial insurance disputes;
6. trademarks and other industrial property;
7. other commercial disputes (to be defined in detail).

It would be advisable to form the commercial departments of the courts from specialised judges and judicial clerks having experience and a specialised master's degree in economics and commercial law, competition law, etc. Commercial cases should be decided in two instances — Court Panel of the respective regional court as the court of first instance and Commercial Department of the Supreme Court (Senate) as the cassation instance. Commercial procedure would mean speedier process for adjudication of the commercial cases, ensuring better quality and efficiency due to the specialisation of the judges, as well as improvement of predictability by ensuring development of uniform jurisprudence. The commercial procedure ought to include modern and effective instruments appropriate for business environment, provide for securitisation of claims as well as for adequate mechanisms for compensation of costs for legal assistance, etc.

Speedier and qualitative procedures for adjudication of commercial cases would justify introduction of higher fees for filing claims and for performing other actions in courts, from which it would be then possible to fund the operation of such departments. Similarly, qualitative, speedy and efficient legal protection of businesses by the said departments would ensure attraction of local and foreign investments in the Latvian economy, consequently resulting in economic growth and higher income from taxes, which could therefore be partly used for funding the operation of such departments.

3.2.2. Attorney process in civil procedure in the courts of first and second instance in

[24] The previous jurisprudence of Administrative courts in disputes between private persons and the CC suggests that private persons can achieve annulment of the decisions of the CC in exceptional cases only (in more than 95% of cases, the CC wins) (see, e.g., CC homepage: *http://www.kp.gov.lv/lv/konkurences-padomes-lemumi*). The abovementioned statistics, however, cannot be considered as undisputable evidence that the decisions of the CC are always well reasoned, but it may indicated to a controversy whether the Administrative courts perform sufficiently comprehensive analysis of the justification of the decisions of the CC, perhaps, because of lack of specific knowledge in competition law and economics that is required to carry out an adequate review of the decisions of the CC on their merits. Recently, this has been emphasised by Latvian competition practitioners in the World's leading competition magazine **"***Global Competition Review***"** (See, e.g., CC homepage: *http://www.kp.gov.lv/lv/aktualitates/250-konkurences-zurnals-global-competition-review-konkurences-padome-ir-aktiva-un-zinosa-iestade*).

connection with the amendments to the requirements for admittance to the bar

Introducing attorney process in the civil procedure in the courts of first and second instance would undoubtedly facilitate and speed up the operation of courts, thereby also improving the general efficiency of protection, by the Latvian courts, of the rights of individuals and businesses, resulting in positive impact on the business environment and the volume of foreign investments. However, conferring such monopoly status to the Latvian bar will also increase the litigation costs in the Latvian courts and will considerably complicate access to judicial protection in relation to certain legal fields, such as the European Union law, the law of banking and finance, M&A transactions, competition law, international trade, and others, where the number of competent members of the Latvian bar is too small to justify the attorney process. It is justifiable however to apply an exception to attorney process in respect to representatives of in-house legal departments of companies, institutions and organisations, who are employed on the basis of employment agreements, i.e. the respective specialists shall be allowed to represent the company, institution or organisation in courts.

In the beginning of 2014, the total number of sworn attorneys and their assistants in Latvia was 1253, which includes also 110 attorneys whose operation has been suspended or who are dismissed from the performance of their duties. In addition, for professional operation in the Latvian bar there have been registered also 11 attorneys from other European Union states and two Swiss Confederation attorneys, with the title of their profession as it is used in their country of origin, as well as one attorney from a European Union state whose professional qualification has been recognised as adequate for permanent operation in Latvia.[25]

Although the Latvian bar itself and the Supreme Court actively supports introduction of the attorney process in the civil procedure also in the courts of first and second instance, however, it is not being taken into account that the requirements for acceptance of new lawyers to the bar have been made very strict lately, as a result of which, for instance, there has been considerable reduction in the number of attorney assistants.

Amendments to the Advocacy Law of 28 October 2010 provide for a range of rules (for instance, that the sworn attorney candidate must have worked in the profession of the judge no less than 3 years), the necessity of which is controversial but the result of which is a significant decrease in the number of new sworn attorneys and attorney assistants. The number of attorney assistants has decreased sharply, and the access of new lawyers to the bar has become considerably difficult in practice. The attorney training programme, implemented by the bar, should also be significantly improved, in particular in the fields where the number of attorneys, competent specialists, is low against the already small total number of attorneys in Latvia.

Therefore FICIL considers that if the attorney process in civil procedure was implemented also in the courts of first and second instance, it would simultaneously be required to significantly facilitate lawyers', including the new lawyers', entry into the bar. This could be achieved, first, by repealing the amendments to the Advocacy Law of 28 October 2010, which are aimed to decrease the number of new attorneys and their assistants (including amendments to Articles 14,

[25] See the Report of the Council of the Latvian Bar to the General Meeting of Attorneys of 2014, available at the Council of the Latvian Bar.

41^3, 84, 85, 94, 95, 96, 101 of the Advocacy Law). Second, to ensure an increase in the number of attorneys and competence in the fields referred to above, where the number of experts is limited, a possibility should be considered to reduce also the requirements for access of new lawyers to the bar that had existed in the Advocacy Law already before the adoption of the amendments of 28 October 2010.

3.2.3. Need for improvements to the bill on Arbitration Law concerning the legal effect of an assignment of a claim on the arbitration clause and regarding the contemplated rules on certification of arbitrators

As of the time of the present position paper, the parliament is reviewing the bill on Arbitration Law. Currently, the bill has already been adopted in its first reading and consequently is under examination in the Justice Policy Sub-Commission of the Legal Commission of the parliament for the second reading. In the opinion of FICIL, however, there are several possibilities for the present version of the bill to be improved.

3.2.3.1. Bill on Arbitration Law should provide that in cases when a legal claim arising from a contract that requires disputes to be resolved in arbitration is assigned, the agreed dispute resolution in arbitration is binding also to the assignee

Among the several innovations the bill introduces, in Article 13, paragraph 4, there is a proposal providing that in cases when a claim, for instance, arising from a contract, is assigned, then only the claim itself, but not the arbitration clause — and thus not the obligation to settle disputes by means of arbitration as well — is transferred to the assignee. Additionally, Article 49, paragraph 2, further clarifies that in such cases, when a claim is assigned, the arbitral tribunal is under an obligation to terminate the ongoing arbitration proceedings, unless the parties have again agreed to settle disputes by means of arbitration.

FICIL would like to note that the conformity of the proposed rules and of the current court jurisprudence[26] with the present legislation, including one of the cornerstones of the legal concept of assignment, which provides that the situation of the debtor may not, as a result of the assignment, become worse, is to be regarded as strictly controversial.[27] Since the prohibition of the situation of the debtor to become worse applies also to various privileges, including privileges arising from law, for instance, privileges regarding enforcement,[28] then, if, contrary to the intention of the parties, the dispute is not resolved in arbitration, the interest of the debtor become injured and his situation, as a result, becomes worse, compared to the initial one. Besides, in accordance with the practice of many other jurisdictions with longstanding traditions regarding regulation of arbitration, such as the USA,[29] England,[30] France,[31] Germany,[32] Switzerland and

[26] The view that the arbitration clause agreed in the contract does not transfer to the assignee is based on approximately ten years old jurisprudence of the Senate of the Supreme Court, for instance, the decisions of the Civil Department of the Senate of the Supreme Court of 12 May 2004 in case No.SPC-28 and of 27 July 2005 in case No.SPC-43.

[27] Article 1807 of the Civil Law provides that „*the condition of the debtor may not become worse with the assignment, therefore the assignor, if he personally has any privileges against the debtor, may not use them*".

[28] See Torgāns K. (zin. red.). *Latvijas Republikas Civillikuma komentāri. Ceturtā daļa. Saistību tiesības*. Rīga: Mans Īpašums, 2000, 307.lpp.

[29] See, e.g., Born G. B. *International Arbitration: Law and Practice.* Alphen aan den Rijn: Kluwer Law International, 2012, p.98; Blackaby N., Partasides C., Redfern A., Hunter M. *Redfern and Hunter on International Arbitration.* Oxford: Oxford University Press, 2009, pp.103-104, para. 2.48; Lew J. D. M, Mistelis L. M., Kröll S. *Comparative International*

Sweden,[34] the legally binding nature of the arbitration clause transfers to the assignee as an inherent and inalienable objectively mandatory element for realisation of the respective claim.

In the opinion of FICIL, the present version of the bill on Arbitration Law in relation to the effect of an assignment of a claim on arbitration ought to be improved, taking into consideration also the fact that the current regulation might have a negative impact on the stability and predictability on the legal relations governed by private law. The regulation proposed at the moment has the effect of stripping the arbitration clauses of their legally binding nature, since they allow for an easy way how to evade the dispute to be resolved in arbitration by possibly fictitiously assigning the claim to a third party, which means that in such case the disputes could only be referred to state courts, but not arbitration. The possibility of such situations could accordingly significantly decrease the predictability of Latvian legal and business environment, bearing in mind that uncertainty would exist regarding resolution of disputes involving foreign investors. FICIL wishes to emphasise foreign investors are interested in efficient, predictable and flexible resolution of disputes, which qualitative regulation of arbitration can ensure. Whereas adoption of the bill in the current version would mean creation of an easy possibility to circumvent the legally binding nature of arbitration, preventing to resolve legal disputes by the means the investors have agreed for in the respective contracts, which, as a consequence, could be regarded as a negative sign to foreign investors regarding the stability of contractual transactions and security of investments in Latvia. Therefore, FICIL invites to harmonise the Latvian legislation concerning arbitration with the generally accepted principles established in the legislation and court jurisprudence of other European Union states and to expressly provide for in the new bill on Arbitration Law that in case the parties have agreed for dispute resolution by way of arbitration and a claim is assigned to a third party, the obligation to resolve disputes in arbitration is binding also to the respective third party (the assignee).

3.2.3.2. Bill on Arbitration Law should also provide exceptions to the general rules requiring official certification of arbitrators

The bill also establishes a requirement that for persons to be able to act as arbitrators, they must first attend specialised courses, take a qualification exam and receive an official certificate. The respective matters are to be regulated in detail by rules adopted by the Cabinet of Ministers.

Commercial Arbitration. The Hague: Kluwer Law International, 2003, p.148, para.7-53.

[30] Pursuant to the regulation in force in England, in accordance with Arbitration Act 1996, in case claims arising from a contract containing an arbitration clause are transferred to an assignee, the arbitration clause becomes legally binding to the assignee (see, e.g., the judgment of the Commercial Court of the High Court of Justice of 1 August 2007, folio 1108).

[31] Jurisprudence of the French courts has established a principle that, in case of an assignment, an international arbitration clause automatically transfers to the assignee as rights belonging to the assigned claim (see. the judgment of *Cour d'appel de Paris* of 19 December of 2008, *Revue de l'Arbitrage*, 2009, p.377).

[32] Such rules are provided by Article 401 of the German Civil Code (Bürgerliches Gesetzbuch), in accordance with which the assigned claims that are connected with certain appurtenant rights, as a result of the assignment, automatically transfer to the assignee. The Federal Court of Justice of Germany applies the these rules by way of analogy also to arbitration clauses (see, e.g., the judgments of the Federal Court of Justice of Germany of 3 May 2000 in case No. XII ZR 42/98 and of 2 October 1997 in case No. III ZR 2/96).

[33] See, e.g., Born G. B. *International Arbitration: Law and Practice.* Alphen aan den Rijn: Kluwer Law International, 2012, p.98; Blackaby N., Partasides C., Redfern A., Hunter M. *Redfern and Hunter on International Arbitration.* Oxford: Oxford University Press, 2009, pp.103-104, para.2.48.

[34] In its jurisprudence, the Swedish Supreme Court has recognised that an arbitration clause is binding also to the assignee (see the judgment of 15 October 1997 in NJA, 1997, s.866).

In the opinion of FICIL, as it has already been noted in the Position Paper on Proposals for Facilitating Efficiency of the Court System, the requirement for mandatory training of the potential arbitrators should have exceptions. Considering that there is a certain range of specialist whose knowledge of law and experience in managing efficient arbitration proceedings are already sufficient, for instance, persons with a doctor's degree in law, former judges, attorneys, prosecutors, or arbitrators, etc., then with regard to such persons the proportionality of and conformity with generally accepted international practice of the requirement for compulsory training course, taking of the qualification exam and certification is to be regarded critically.

At the same time it also has to be emphasised that, in line with the principle of party autonomy, it should be provided that the parties, at least in case of businesses, may agree to depart from the mandatory requirements set for an arbitrator by the law, as well as that such possibility can be provided for in the rules of arbitration of arbitral institutions, considering that the parties may, for instance, wish to appoint as an arbitrator an internationally renowned expert who does not meet the formal requirements currently prescribed in the bill. Such exception should be established particularly bearing in mind that the possibility to appoint a specific specialist well recognised in a particular field as an arbitrator for resolution of a specific dispute is, compared to dispute resolution in state courts, one of the most significant advantages of arbitration as well as a fundamental prerequisite for preserving the flexibility of arbitration as an alternative dispute resolution method.