

# Restructuring and insolvency in Latvia

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# Latvia

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Several normative acts govern insolvency proceedings in Latvia. The 1996 Law on Insolvency of Enterprises and Companies provides the general regulatory framework, while the 1995 Law on Credit Institutions and the 1998 Law on Insurance Companies and Their Supervision set out specific requirements for insolvency proceedings involving banks and other financial institutions and insurance companies, respectively. The procedural rules governing insolvency and bankruptcy matters are contained in the 1998 Civil Procedure Law. Additional laws and regulations provide for more detailed regulation of the appointment and supervision of administrators, and for the protection of employees' rights. There is no official English translation of the Latvian insolvency legislation, but some unofficial translations are available on the Internet ([www.ttc.lv](http://www.ttc.lv)) and in some databases available on subscription (eg, <http://pro.nais.dati.lv>).

Latvian legislation gives priority to continuing the business of a troubled company. The law specifies that creditors must first consider the possibility of an agreed settlement, failing which other options for the company's rehabilitation must be examined. Bankruptcy, and the recovery of value from the underlying business and assets of the company, is the very last resort.

The protection of creditors' interests has priority under the Insolvency Law. It favours the rights of creditors over debtors during the insolvency process, but defines very few rights of the debtor itself.

Although the legislation is structured so as to encourage settlement and rehabilitation of insolvent companies, in practice, bankruptcy proceedings are the most common solution. The difficulties facing distressed companies are often too advanced to allow a rescue by the time insolvency proceedings are initiated; however, this is not necessarily a reflection of excessive weakness in the insolvency legislation itself, but is more indicative of problems in the enforcement of the insolvency legislation and shortcomings in other legislation.

In practice, the problems are often caused by omissions in the applicable legislation and regulations. For example, if a company is declared insolvent, the administrator will have authority to borrow funds in the name of the company and to use the company's property as security only if a decision has been taken to rehabilitate the company. He cannot do so if a decision has not been made with regard to the company's rehabilitation. Very often, however, funds are required to preserve the company's business so that a decision on possible rehabilitation can be made in a properly structured way; and thus the purpose of the legislation is defeated.

The current law is relatively new and is constantly changing, thus preventing it from being fully implemented in practice. The implementation process is further complicated by the different transition periods that usually apply for the implementation of amendments.

There were substantial changes to the general insolvency legislation on July 1 2002, when the new State Agency of Insolvency Administration – the supervisory body for administrators and insolvency proceedings – was created by amendment of the Insolvency Law. In June 2004 amendments were made to the Law on Insurance Companies and Their Supervision, introducing supplementary regulations in respect of the reorganisation and liquidation of insurers and implementing the EU Insurers' Reorganisation and Winding-Up Directive (2001/17/EC).

The Insolvency Law was amended again at the end of 2003, and most recently by laws adopted on March 17 2005 (effective as of April 13 2005) and May 19 2005 (effective as of June 15 2005). It will ultimately be replaced by a new statute which has been prepared and is now under discussion before the relevant state institutions. Like the most recent amendments, the draft new Insolvency Law is intended to:

- strengthen the authority of the State Agency of Insolvency Administration and improve the supervision of administrators so as to enhance the legitimacy and effectiveness of insolvency proceedings; and
- accelerate insolvency proceedings in order to achieve satisfactory solutions within a reasonable timeframe.

The most recent amendments to the Insolvency Law empower the Cabinet to issue several Cabinet regulations on issues such as:

- the appointment of administrators based on the principle of random selection;
- issuance, termination and extension of the administrators' certificates; and

- reporting to the State Agency of Insolvency Administration.

Latvia became a member state of the European Union on May 1 2004 and is bound by the EU Insolvency Regulation. This provides that the EU member states (excluding Denmark) will automatically recognise insolvency proceedings in other member states, subject only to limited exceptions for public policy and moral hazard.

## **I The legal framework and the effectiveness of court processes/ legal remedies**

### **I.1 Describe the nature and the effectiveness of the following:**

#### **(a) Debt recovery remedies where the creditor has no security**

Creditors may seek satisfaction of their claims by lodging a claim in court or, under certain conditions, by transferring the dispute to arbitration for settlement. The resolution of disputes in court or before an arbitration tribunal is effected on the basis of an adversarial principle, whereby plaintiff and defendant are required to prove the factual and legal justification of their respective claims. As a court judgment can be appealed to the first and second-level appellate courts, the amount of time it takes to settle a debt through this process may vary from case to case.

If a debtor fails to comply with a court judgment, the plaintiff may seek compulsory enforcement of the judgment. This is performed by executors through:

- sale of the debtor's property;
- collection of the debtor's income or property in the possession of other persons; and/or
- seizure of assets owned by the debtor as specified in the judgment.

If the creditor's claim is undisputed, it is also possible to seek compulsory enforcement of the claim on a non-contested basis. Such enforcements are carried out only for certain types of claim as specified by law.

Under the Insolvency Law, an unsecured creditor may submit an insolvency petition to court if:

- the debtor has not settled a due debt within two weeks of receiving a letter of complaint giving notice of the creditor's intention to submit an insolvency petition;
- for a period of three months, it has not been possible to execute, fully or partially, a court judgment on recovery of the debt because the debtor's assets are insufficient to settle the debt; and/or
- the debtor has notified its creditors or given public notice of its insolvency.

If the petition is granted, the court will issue a declaration of insolvency, which may result in a settlement with the creditors, rehabilitation of the company or bankruptcy. The court may also terminate the insolvency proceedings if the debtor subsequently becomes solvent or if no creditors apply to the administrator within the specified timeframe for the submission of creditors' claims.

**(b) The enforcement of security**

The following types of security exist under Latvian law:

- possessory pledge – a pledge of movable property transferred to the creditor's possession;
- usufructuary pledge – a pledge of movable property or real estate which accrues value and which is transferred to the creditor's possession. The creditor is entitled to receive all accruals thereafter;
- mortgage – a pledge of real estate which is registered in a public register without the property being transferred to the creditor's possession;

- vessel mortgage – a pledge of a merchant ship, possession of which is not transferred to the creditor; and
- commercial pledge – a pledge of movable property which is registered in a public register of charges.

The enforcement of pledges and mortgages is performed in accordance with general practice pursuant to the provisions of the Civil Procedure Law or specific legislation on each separate type of pledge. Upon the commencement of insolvency proceedings, there are certain restrictions on the enforcement of pledges and mortgages (see section 1.3).

A creditor may sell pledged real estate by auction only. If the parties have agreed that the pledged real estate may be sold at a freely determined price, it will be sold at a voluntary auction through the court. The court will approve the auction terms. If the parties fail to agree on whether to sell the real estate at a freely determined price, an application for the compulsory enforcement of obligations on a non-contested basis may be filed with the court. The court's decision on this matter has the force of an executive document and is submitted to the executors to enforce the sale of the pledged real estate.

A vessel mortgage may be exercised either without court proceedings, if the debtor has granted such a right, or through court proceedings and a subsequent sale at auction.

Property secured through a possessory pledge may be sold by the creditor acting on the debtor's behalf, if the pledge allows for sale at a freely determined price. If there is no such agreement, property secured by a possessory pledge can be sold at auction through the courts. A notarised possessory pledge may be exercised through compulsory enforcement of an obligation on a non-contested basis.

Property secured by a commercial pledge may be sold at auction if at least one month's notice has been published in Latvia's official newspaper and at least one other newspaper; or without an auction

if the debtor has granted such a right and the pledge has been filed with the Register of Commercial Charges. The property can be sold without a court ruling if the creditor has notified the Registry Office of Commercial Pledges of its intent to exercise its right to sell the property at least 30 days before doing so, and has not received a court ruling prohibiting such action. If the property is not in the creditor's possession, it is necessary to enforce the security through a non-contested compulsory enforcement procedure.

### **(c) Corporate bankruptcy/ liquidation processes**

Subject to certain conditions, the right to initiate insolvency proceedings is enjoyed both by creditors and by the debtor, if the debtor cannot settle its obligations as they fall due.

Bankruptcy is one possible solution in the event of insolvency. The initiation of bankruptcy proceedings is decided on at a creditors' meeting, at which the creditors vote in proportion to the value of their respective unsecured claims. The creditors are deemed to have decided to initiate bankruptcy proceedings if:

- proposals have not been made for a settlement or rehabilitation plan;
- proposals for a settlement or rehabilitation plan have been rejected by the creditors' meeting; or
- a rehabilitation plan has been revoked and the creditors' meeting has not approved another rehabilitation or settlement plan.

On the occurrence of one of the above events, the court will initiate bankruptcy proceedings and will appoint an administrator, who will be nominated by the State Agency of Insolvency Administration.

The principal purpose of bankruptcy proceedings is to discharge the claims of creditors to the fullest possible extent by obtaining optimum income from the sale of the debtor's assets. The debtor's assets are sold through public auction, unless the law prescribes alternative methods of realising specific classes of

assets. The creditors' meeting may authorise the administrator to sell the assets by other means.

Creditors' claims are discharged in order of priority as specified by law (see section 7.2).

In a bankruptcy, a creditor is not permitted to offset amounts due to the debtor against amounts due by the debtor to the creditor.

### **(d) Formal corporate rescue processes**

Latvian law provides for two formal corporate rescue processes: settlement and rehabilitation.

'Settlement' is an agreement between the creditors and the debtor regarding the fulfilment of the debtor's obligations (ie, reduction and/or deferral of payment of the debtor's obligations without further measures).

'Rehabilitation' is an agreement to implement specified measures to prevent the possible bankruptcy of the debtor, to restore its solvency and to satisfy the claims of creditors, including (for example) the attraction of new capital.

In either rehabilitation or settlement, the company's activities will continue.

Both processes begin with consideration at a creditors' meeting of the possibility of applying for either settlement or rehabilitation. The debtor company (acting through its administrator) and/or any of its creditors are entitled, but not obliged, to propose a settlement. The law does not specify who is entitled to propose rehabilitation, but it may reasonably be assumed that the parties are the same as for a settlement.

After the creditors' meeting has accepted the possibility of settlement or rehabilitation, the draft settlement or rehabilitation plan must be prepared. The administrator is responsible for preparing the draft settlement, on the basis of the resolutions passed at the creditors' meeting. A rehabilitation plan can be prepared by the administrator, or by a creditor or group of creditors, or by third parties at the request of the administrator.

A further creditors' meeting is then convened to vote on acceptance of the draft settlement or rehabilitation plan. The voting is performed

under the procedure provided for by law. Once the settlement agreement has been accepted, it must be submitted to court for its approval. If the creditors' meeting votes against the approval of the rehabilitation plan, it must decide whether to prepare a new rehabilitation plan or avail of another insolvency solution (eg, bankruptcy or liquidation).

The law sets out only general provisions on the process for proposing and revising draft settlement or rehabilitation plans, and for voting on such plans. Current practice is that the creditors' meeting is entitled (by majority vote) to amend a draft settlement or rehabilitation plan before acceptance. In addition, the creditors' meeting can be suspended for up to one month (again, by majority vote) to allow the proposed settlement or rehabilitation plan to be amended and improved.

**Settlement:** A settlement plan may be proposed and accepted at all stages of the insolvency procedure, up to the commencement of auction of the debtor's assets. A settlement plan may comprise:

- a reduction in the amount of claims;
- a renunciation of contractual penalties or interest, including late charges, or of contractual penalties and interest, or their reduction; and/or
- a postponement of the term for fulfilment of obligations.

A settlement agreement cannot infringe the rights and interests of secured creditors without their consent, and will be invalid if and to the extent that it does so.

The provisions of an approved settlement agreement are mandatory and binding on all unsecured creditors, including those that voted against or abstained from voting on the proposed settlement. Unless the settlement states otherwise, it is presumed that an approved settlement includes all claims of creditors. Creditors are not permitted to raise additional claims after the settlement is approved in respect of transactions prior to the date of the settlement.

Following approval by the creditors' meeting and by the court, the settlement is binding and its terms are implemented by the management institutions of the debtor, under supervision of the administrator. The management has the power to manage the continuing operations of the debtor.

While a settlement agreement is in effect, the creditors' meeting cannot either approve a rehabilitation plan or commence bankruptcy proceedings. The settlement must first be revoked.

The court may revoke a settlement if:

- upon accepting the settlement, the provisions of law were violated;
- acceptance of the settlement was attained through fraud or duress, or as a result of error; and/or
- the debtor fails to fulfil its obligations under the settlement.

If a settlement agreement is considered to be inappropriate or unworkable, is proposed but not approved by the creditors, or is approved but subsequently revoked, the creditors' meeting is obliged to consider and decide whether to propose a rehabilitation plan or commence bankruptcy proceedings.

**Rehabilitation:** A rehabilitation plan may include "lawful measures directed towards renewal of solvency of the debtor" additional to those that would be permitted in a settlement agreement (see above). In practice, the measures that are included in a rehabilitation plan usually involve:

- the attraction of new capital or finance, including through borrowing and pledging the debtor's assets;
- the suspension of secured creditors' rights (while using the pledged property);
- the establishment of branches or representative offices of the debtor, and the transfer of the debtor's property and entrepreneurial activities (in full or in part) to these establishments or representative offices;

- the leasing of property; and/or
- any combination of the above.

The process for proposing and approving a rehabilitation plan is substantially identical to that for a settlement plan.

The implementation of a rehabilitation plan is managed by an administrator. The total time period for a rehabilitation plan may not exceed 10 years.

If a rehabilitation plan is approved, the secured creditors may not exercise their rights with respect to the property of the debtor on which their claims are secured until either the rehabilitation plan is revoked or its implementation is completed. However, following approval of a rehabilitation plan, secured creditors are entitled to request the court to allow compensation for infringement of their security rights. If compensation is not paid or additional security is not provided, the secured creditors may require termination of the rehabilitation plan.

The administrator, a creditor or a group of creditors may request the court to revoke a decision of the creditors' meeting regarding a rehabilitation plan if the decision was made as a result of fraud, duress or error.

The creditors' meeting may discontinue a rehabilitation plan if:

- the rehabilitation measures are not applied in accordance with the rehabilitation plan;
- during the period provided for in the rehabilitation plan, the debtor's solvency is not improved to the extent anticipated; or
- it is determined that the rehabilitation plan is unenforceable or not practicable.

If a rehabilitation plan is revoked, the creditors' meeting must decide whether to propose a new or revised rehabilitation plan, propose a settlement plan or commence bankruptcy proceedings.

The administrator is responsible for submitting to the Company Register for registration all decisions of the creditors' meeting approving, amending or extending a rehabilitation plan. Rehabilitation plans (and any amendments or extensions) are invalid and

unenforceable unless and until registered. Following registration, the administrator is required to submit to the court the evidence of registration.

#### **(e) Informal corporate rescue processes**

No informal corporate rescue processes are available under Latvian law.

It is always open to a debtor to seek to negotiate with its creditors, or some of them, a restructuring of obligations outside a formal insolvency proceeding.

#### **1.2 What are the formal processes to effect a liquidation of the company's assets?**

Settlement plans and rehabilitation plans do not necessarily involve the sale of the debtor's assets, although a disposal of some assets may form part of the plan.

To sell all of a debtor's assets, the creditors must initiate bankruptcy proceedings. The creditors decide whether to initiate bankruptcy proceedings through a vote at the creditors' meeting. Court approval is not required for the commencement of bankruptcy proceedings, although a court must rule on the termination of such proceedings. Decisions on the commencement of bankruptcy proceedings and the date of any auction of the debtor's property must be published in the official newspaper and registered with the Company Register (see also sections 1.1(a), (b) and (c)).

#### **1.3 What is the effect on debt collection and the enforcement of security of:**

##### **(a) An adjudication of corporate bankruptcy/liquidation?**

A court judgment announcing the debtor's insolvency is sufficient grounds to stay court proceedings against the debtor and to terminate enforcement proceedings for amounts adjudicated but not yet collected from the debtor.

The rights of secured creditors to enforce their security are also restricted upon the issue of an

insolvency judgment. There is an initial suspension of security rights until the creditors' meeting (usually at the first meeting) has decided how to resolve the debtor's insolvency. If bankruptcy proceedings are the chosen solution, secured creditors can exercise their security when the bankruptcy proceedings have commenced. However, secured creditors are required to liaise with the administrator with regard to:

- the terms of the auction and opening prices; and
- the terms of the written contract of sale of the secured property.

If no such coordination with the administrator takes place, any contract for sale of the secured property is null and void.

***(b) The commencement of a formal corporate rescue process?***

If either a settlement or a rehabilitation plan has been approved and remains in effect, secured creditors cannot seize or sell the debtor's property unless the plan provides for them to do so (eg, if the property is not necessary to the continuation of the debtor's business). However, when doing so they must liaise with the administrator as described in section 1.3(a).

***(c) The initiation of an informal corporate rescue process?***

Latvian law does not allow for any informal corporate rescue processes.

***1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised?***

Under Latvian law, the insolvency of a company incorporated in Latvia must be considered by a Latvian court of the administrative territory in which the insolvent company has its registered office. Similar provisions are included in the EU

Insolvency Regulation, which establishes principles for secondary proceedings. These secondary insolvency proceedings may be commenced in another EU member state only if a debtor has an establishment in that state, and are limited to the assets located in that state. 'Establishment' means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.

Insolvency proceedings commenced in a jurisdiction outside the European Union in respect of a corporation incorporated in Latvia will not be recognised in Latvia, because the insolvency of a Latvian company is subject to the jurisdiction of the Latvian courts.

If a foreign court (including a court in the United States) rules on the insolvency of a company not incorporated in Latvia, that ruling may be recognised by a Latvian court subject to the provisions of the Civil Procedure Law.

***1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential personal liability for continuing to trade?***

No restrictions apply to a debtor's business activities until:

- it is unable to settle its obligations within three weeks of their due date and no other agreement has been reached with the creditors; or
- its liabilities exceed its assets.

In such circumstances the debtor must submit an insolvency petition to the court. If an insolvency petition is not submitted, the individual at fault may be held liable in accordance with the Criminal Law. In addition, the Commercial Law provides for civil liability of board members for failure to submit an insolvency petition. In the past, there were few cases of creditors or administrators seeking to recover losses from directors, because the burden of proof fell on the plaintiff. However, from January 1 2005 board members have an

obligation to prove that they have acted properly, as honest and careful managers.

## **2 What are the advantages and disadvantages of triggering a formal procedure?**

From the creditors' viewpoint, the advantage of initiating insolvency proceedings is the guarantee that, once the formal procedure has commenced, the debtor's powers to manage its affairs are materially restricted.

Insolvency proceedings are conducted by an administrator, who is nominated by the State Agency of Insolvency Administration (which continues to supervise his performance) and approved by the court. Only an individual with an appropriate qualification who fulfils the requirements provided for by law and who has been certified by the State Agency of Insolvency Administration may act as an insolvency administrator.

The administrator's activities can also be controlled by the creditors' meeting. However, creditors have no influence in the process of selecting and appointing an administrator.

A major disadvantage of triggering a formal procedure is that once insolvency proceedings have commenced, they are not easily terminated. Termination of such proceedings requires the involvement and agreement of numerous parties, as well as the court.

Moreover, creditors risk the debtor being forced into bankruptcy and there being insufficient funds to discharge their claims. The impact of the commencement of insolvency proceedings may cause the debtor's business to deteriorate so that it becomes impossible to formulate a settlement plan or restructuring plan, or possible only on terms materially worse than might have been available.

Every creditor has the right to review claims submitted by other creditors, and to submit to the administrator reasoned objections to the claims of other creditors (except for claims in respect of which there is a court adjudication). At the first creditors' meeting, the creditors may review and

vote on the administrator's decisions to approve or reject creditors' claims.

A further risk of initiating a formal rescue procedure is the potential tax liabilities that may become payable. Tax liabilities are assessed on completion of a tax audit, which is mandatory when insolvency proceedings are initiated. Current experience is that such audits often identify significant tax liabilities.

Triggering a formal rescue procedure gives some protection to insolvent companies and the parties involved in the insolvency proceedings. Formal insolvency proceedings suspend civil court cases and terminate the execution of judgments for amounts adjudicated, but not yet collected. A secured creditor may sell assets held as security only after the creditors have decided in a general meeting that the debtor should be liquidated (ie, subject to bankruptcy proceedings) (see also section 1.1(d)).

## **3 What are the practical options for out-of-court restructuring?**

Latvian law contains no specific provisions on informal restructurings.

## **4 What is the effect on the management of a company of:**

### **(a) An adjudication of corporate bankruptcy/liquidation?**

When a debtor has been declared insolvent, all rights and powers of corporate management, as specified in the articles of association, laws or agreements, are transferred to the administrator, although some additional restrictions are imposed. The management of the debtor loses its powers to deal with the debtor's property and otherwise to manage the debtor's affairs.

**(b) The commencement of a formal corporate rescue process?**

Management's powers are suspended until a decision is reached on the commencement of insolvency proceedings. If a rehabilitation plan is approved, the administrator manages the debtor in accordance with the plan. If a settlement plan is approved, management rights are restored to the management subject to the supervision of an administrator; but if the settlement plan is revoked, the administrator will take over the powers of management. The powers of the debtor's management to manage the debtor's property are restored if insolvency proceedings are terminated.

**(c) The initiation of an informal corporate rescue process?**

Latvian law contains no specific provisions on informal corporate rescue processes. The management of the debtor retains all its usual powers. However, creditors may require changes in management personnel and/or practices, or additional supervision or monitoring, as part of any out-of-court restructuring or rescue that might be agreed.

**5 Parties in interest/key players****5.1 Who is responsible for the 'case management' control and administration of:****(a) A corporate bankruptcy/liquidation?**

The administrator, with some input from the creditors' meeting, is responsible for 'case management' control and administration in a bankruptcy. The creditors' meeting sets the date for the auction of the debtor's property, and the administrator will organise the auction and draft the terms of the auction sale. With the consent of the creditors' meeting, the administrator may use other forms of sale of the debtor's property.

The Insolvency Law governs the administrator's

activities, with certain exceptions. The Law on Credit Institutions regulates the administrator's activities in the insolvency of credit institutions. As noted, the administrator is appointed and dismissed by the court.

**(b) A formal restructuring?**

When the court has approved a settlement plan, the existing management is permitted to manage the debtor under the administrator's supervision.

If a rehabilitation plan has been approved, the court-appointed administrator is responsible for case management control and administration.

**5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?**

The administrator is responsible for drafting a settlement plan based on provisions approved by the creditors' meeting. The creditors' meeting and the court must then approve the plan.

The creditors' meeting will determine who is to draft a rehabilitation plan. The administrator, and/or creditors or a group of creditors, and/or third parties contracted by the administrator can draft the plan.

**5.3 Who are the key players? What are their roles and responsibilities?**

**Creditors:** During the creditors' meetings, the creditors elect the creditors' committee, agree on the type of insolvency procedure to be followed, request reports from the administrator and determine the administrator's remuneration. They may also take a vote of no confidence in the administrator, although the decision to replace the administrator is a matter for the court.

**Secured creditors:** Secured creditors do not have voting rights at the creditors' meeting, except in relation to the unsecured part of their claims or if a rehabilitation plan is being voted on and the

plan proposed would restrict the rights of the secured creditors.

**Administrator:** An administrator is appointed by the court immediately upon the commencement of insolvency proceedings, and is responsible for the proceedings. Insolvent companies may be administered only by an individual:

- with higher education in the field of law, economics, management or finance;
- with at least three years' practical experience on the management or supervisory bodies of enterprises or companies; and
- who satisfies all requirements to obtain the qualification of administrator and has been certified as such by the State Agency of Insolvency Administration.

**Other advisers:** With the consent of the creditors' meeting, the administrator may employ specialists (eg, accountants, lawyers and economists) if this is necessary to ensure the efficiency of the insolvency proceedings.

**State Agency of Insolvency Administration:** In 2002, the Latvian government established the State Agency of Insolvency Administration with the aim of improving the efficiency of insolvency administration proceedings. This agency is responsible for the certification of administrators (individuals only), administrators' training, supervision of the employee claims funds of insolvent companies and so on.

## 6 What financial information is available to creditors?

The statutory accounts of Latvian companies are usually prepared in accordance with Latvian laws or regulations, which are more general than international accounting standards (IAS) but contain few contradictions.

The first four Latvian financial standards have been adopted. These are based on IAS, but

at present their application is not compulsory. The generally accepted practice is to apply IAS in less regulated areas of accounting (eg, mergers and acquisitions, deferred tax accounting and finance leases). Banks and companies with shares listed on the Riga Stock Exchange must comply fully with IAS. There are also specific IAS-based regulations designed for financial institutions such as insurance companies, pension funds and investment funds.

Accounts of all companies meeting at least two of the following criteria must be audited by a certified auditor:

- turnover exceeding LVL200,000;
- total assets of LVL100,000 or more; and
- average number of employees exceeding 25.

Companies can end their financial year on any date for statutory reporting purposes, but most keep to the calendar year.

Statutory accounts must be filed with the Company Register no later than four months after the end of the accounting year (usually by May 1). The accounts are publicly accessible – a hard copy of either the full accounts or a condensed version (consisting of the balance sheet, income statement and cash-flow statement) may be obtained upon payment of small fee; or this information can be accessed through an online database, also on payment of a fee. The online database also contains some financial data and benchmark analyses.

## 7 Common questions

### 7.1 Funding and the priority given to new money

**(a) If an insolvent corporation requires urgent working capital funding, what difficulties are likely to be encountered in the provision of such funding?**

Prior to an insolvency filing, it is possible for a debtor to borrow additional funds and to pledge

assets or provide other security for such funding. However, there are two major difficulties:

- The directors are obliged to file for the debtor's insolvency as soon as the debtor becomes insolvent; and
- Transactions immediately prior to insolvency may be invalidated, as described in section 7.3.

There is therefore a risk to a provider of new funds immediately prior to an insolvency that any security given may be invalidated.

Following an insolvency judgment, the administrator does not have any right to borrow funds or pledge the debtor's assets, unless and until a rehabilitation plan has been approved (and then only in accordance with the terms of the plan).

***(b) Are lenders providing new money, or debtor-in-possession financing, given any statutory priority?***

The law specifies no priority for creditors that lend money to or make other investments in a company after the commencement of insolvency proceedings.

**7.2 Ranking of creditors**

***In what order are creditors paid in a corporate bankruptcy/liquidation?***

Administrative expenses of the insolvency proceedings (including the remuneration of the administrator) are paid as a first priority from the funds realised from the debtor's assets.

Creditors' claims are grouped in the following categories, and will be paid in the following order:

- specified employee claims; mandatory contributions to the state social security fund and payments of personal income tax related to employee claims; mandatory contributions to the state social security fund to ensure receipt of unemployment benefits; and claims for costs incurred during the insolvency administration

(other than administration expenses, which are paid first), after all other claims in this category have been paid in full;

- payments to farms, individual producers, cooperatives and incorporated companies for agricultural products supplied to processing undertakings;
- payments of social security debts for one year prior to the commencement of insolvency proceedings;
- state claims for the repayment of state-guaranteed credits;
- claims for the repayment of taxes and other duties, including other social security debts but excluding deferred payments;
- claims of all other creditors, including bank debts and trade creditors, and the claims of creditors that acquired the status of creditor after the commencement of insolvency proceedings and to which the general terms for submission of claims by creditors do not apply; deferred tax payments; and outstanding salary debts remaining after payments to priority creditors and after other payments relating to lawful employment relationships;
- claims for the payment of interest; and
- claims submitted after the prescribed period for submission of claims.

Claims in the first five groups above are commonly referred to as 'priority' claims.

Payments can be made to a group of creditors only after the claims of the preceding group have been paid in full. If the assets are not sufficient to satisfy all claims within one group of creditors, claims in that group will be paid *pro rata* to the claims of the creditors in that group.

Property subject to a charge is excluded from the pool of assets available to settle the claims of other creditors. The claims of secured creditors are settled from the proceeds of sale of the assets subject to the security. Any shortfall in the sums received as against a secured creditor's claim will be treated as an unsecured claim.

### 7.3 Avoidance of antecedent transactions

**Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?**

At the administrator's request, the court may declare invalid any transaction between the debtor and a third party if:

- it was executed after the date on which the insolvency petition was submitted and the debtor thus knowingly caused losses to its creditors;
- it was executed in the five years prior to the insolvency proceedings, the debtor knowingly caused losses to creditors and the counterparty was aware that such losses would result; or
- it was executed in the five years prior to the insolvency proceedings, a criminal court has determined that the debtor was rendered insolvent through a criminal act and the counterparty was aware of such offence.

If the third party is an 'interested party' (eg, a member of management or auditor or a spouse or relative of such person, or an employee), it is presumed that the third party would have known that losses could result.

It is presumed that the debtor knowingly harmed the creditors' interests if any transactions were entered into after the commencement of insolvency proceedings or in the month prior to the commencement of proceedings.

Subject to certain exceptions, a gift or similar transaction may also be declared invalid.

An administrator may request that a personal support agreement be declared invalid if it was entered into after the date on which the debt obligations arose. A 'personal support agreement' is an agreement through which property is transferred to someone in exchange for the maintenance of a third party during his or her lifetime. For the duration of this period, real estate is pledged in order to secure his or her interest. In

Latvia, such personal support agreements can be entered into by both individuals and companies.

The court may order that amounts paid by the debtor to settle debts in the six months prior to the commencement of insolvency proceedings – or after their commencement, with the exception of amounts paid by the administrator in the course of the insolvency proceedings – be repaid if:

- a payment was made before the debt fell due (the law is stated in very strict and simple terms, but in practice the administrator and the court will look to the specific circumstances and assess whether there is evidence that the transaction was improper or outside the ordinary course of business);
- a payment resulted in the debtor's actual insolvency; or
- a payment was made to settle a debt due to interested persons, if the debtor cannot prove that at the time of payment it was not actually insolvent or that payment did not cause its actual insolvency.

If a company is insolvent, a pledge agreement may be invalidated if:

- the pledge right was established prior to the creation of the obligation to be secured, during the course of the insolvency or in the six months prior to the insolvency (this provision does not apply to mortgages);
- it was established during the insolvency proceedings, or up to one year prior to the proceedings, and the party involved is an interested party; or
- the pledge is enforced during the course of the insolvency proceedings, or six months prior to the proceedings, without an open auction, where this is required by law or by agreement.

A secured creditor whose pledge agreement is invalidated is reduced to the status of an unsecured creditor.

#### **7.4 'Cram-downs'**

**What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or informal rescue plan?**

The provisions of a settlement that has been approved by the creditors' meeting and the court are binding on all creditors, including those which voted against the settlement or which did not participate in the vote.

The creditors' meeting may vote on a rehabilitation plan. Voting takes place in the following creditor groups:

- secured creditors, in respect of the secured part of their claims;
- priority creditors (see section 7.2); and
- other creditors.

Creditors will vote in their separate groups. If at least two of the three groups vote in favour of the plan (by a majority by value of claims actually voting) and at least one such group would not recover the full amount of its claims in a bankruptcy of the debtor, the plan is regarded as being approved by the creditors' meeting and may be submitted to the court.

#### **7.5 Creditor protection**

**What actions can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?**

The administrator conducts the insolvency proceedings through rehabilitation, settlement or bankruptcy. The creditors control the administrator's activities by way of decisions passed at creditors' meetings, which are binding on the administrator, or by appealing to the court against decisions or actions of the administrator. The creditors' meeting can demand reports of the administrator's activities and may either approve

those reports or take a vote of no confidence in the administrator.

If the creditors' meeting passes a vote of no confidence in the administrator and it is found that the administrator has exercised his or her powers in bad faith, the administrator can be removed from office by the court.

Creditors are entitled to review all claims submitted, and to vote either to admit or to reject claims admitted by the administrator; but they cannot reject secured claims or claims on which a court decision has been issued. A creditor can appeal to the court against the admission of any creditor's claim or rejection of its own claim by the creditors' meeting.

A creditor, a group of creditors or the creditors' meeting may request the court to revoke a settlement if:

- any of the applicable provisions of the Insolvency Law were violated in its creation;
- the settlement was achieved through misrepresentation, deceit or duress; or
- the debtor fails to fulfil its obligations under the settlement provisions.

A creditor or group of creditors may request the court to revoke a decision of the creditors' meeting to approve a rehabilitation plan if the decision was achieved through misrepresentation, deceit or duress. The creditors' meeting may also reject a rehabilitation plan, in which case it must then decide whether to approve a settlement or commence bankruptcy proceedings. The creditors' meeting is additionally entitled to discontinue a rehabilitation plan if:

- the rehabilitation measures are not taking place in accordance with the plan;
- the debtor's financial situation has not improved to the extent anticipated within the timeframe provided for in the rehabilitation plan; or
- the rehabilitation plan cannot be executed.

A secured creditor may request that a rehabilitation plan be revoked if the creditor's

rights are restricted during the rehabilitation and it is not paid the compensation for such restriction specified in the plan or awarded by the court.

In the event of bankruptcy, the creditors' meeting is entitled:

- to prohibit the administrator from using any forms of disposal other than sale of the debtor's property through auction; and
- to decide on the assignment of the debtor's claims.

The State Agency of Insolvency Administration will examine complaints in respect of decisions or

actions taken by administrators, and is entitled to issue a decision on its opinion. If the parties do not agree with a decision or action of the State Agency of Insolvency Administration, it can be appealed before the court.

An administrator will be liable for losses incurred as a result of his or her wrongful and/or negligent actions, and must have insurance against such liability.

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Klavins & Slaidins was established in 1992 and now has 16 lawyers in all, making it one of the largest law firms in Latvia.

The firm's international practice is enhanced by its membership of Lex Mundi, the network of leading law firms in jurisdictions all over the world. Klavins & Slaidins is also a member of LAWIN, a group of leading Baltic law firms including Lepik & Luhaaar in Estonia and Lideika, Petrauskas, Valiunas ir partneriai in Lithuania.

The firm's general area of practice is business/commercial law. It provides legal consultation and advice to international clients coming to Latvia from all over the world, as well as experienced guidance for local Latvian clients.

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