ALLEN & OVERY

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Restructuring Across Borders

Latvia: corporate restructuring and insolvency procedures

Contents

Introduction

The Insolvency Law (the **Act**) which came into force on 1 November 2010, abolished both rehabilitation (*sanacija*) and settlement (*mierizligums*) proceedings and introduced a new insolvency procedure, corporate insolvency proceedings (*juridiskas personas maksatnespejas process*). The Act replaced the previous Insolvency Law of 2007 (as amended), however, the old legislation is still applicable to insolvency proceedings which were commenced between 1 January 2008 and 31 October 2010.

The three principal restructuring and insolvency regimes for companies in Latvia are:

- corporate insolvency proceedings (*juridiskas personas maksatnespejas process*)
- legal protection proceedings (*tiesiskas aizsardzibas process*)
- voluntary liquidation (*likvidacija*)

The Act was amended on 1 January 2015, making changes to the corporate insolvency proceedings (notably, the filing requirements) and the legal protection proceedings, but no further proceedings were introduced.

The Act introduced the following general legal principles which govern both corporate insolvency and legal protection proceedings:

(a) *Retention of creditor rights*: creditor rights acquired before the proceedings are retained during the proceedings and restrictions on creditor rights established during the proceedings cannot go beyond what is necessary to accomplish the objective of the proceedings.

(b) *Equality of creditors*: creditors will have an equal opportunity to take part in the proceedings and to receive payment of their claims under obligations that were established with the debtor before the commencement of proceedings.

(c) *Prohibition of damaging actions*: a creditor and/or a debtor may not conduct individual actions which would damage the interests of the body of creditors as a whole.

(d) *Performance of obligations*: during the proceedings such measures are to be applied that allow for the performance of the debtor's obligations to the maximum extent.

(e) *Efficiency of proceedings*: the proceedings are to be conducted so as to allow for the accomplishment of the proceedings' objective with the least resources.

(f) *Efficient disposals of property*: as the aim of the corporate insolvency proceedings is to facilitate the return of the company's assets to the market in accordance with commercial law, the sale of the debtor's property will be conducted so as to ensure that it is returned to the market as soon as possible.

(g) *Transparency*: all relevant information must be available to all entities involved in the proceedings in order to ensure that the proceedings are credible and that the interests of all parties are observed (there is an exception to this principle for information that might be damaging to the lawful interests of the debtor or the creditors).

(h) *Good faith*: the entities involved in the proceedings must exercise their rights and fulfil their duties in good faith and the debtor and/or creditors cannot use the proceedings for unfair gain.

Corporate insolvency proceedings (*juridiskas personas maksatnespejas process*)

These proceedings are commenced by the presentation of an application to the court by the company, its liquidator (if during a voluntary liquidation elements of insolvency occur), its creditors, an administrator appointed to any of its debtors, or the liquidator in the main proceedings. Secured creditors cannot submit an application for corporate insolvency proceedings (except to the extent that any part of their claim is unsecured) and unsecured creditors (including secured creditors in respect of any unsecured element of their claim) cannot submit an application if legal protection proceedings are initiated or being implemented unless the debtor company is in breach of its obligations in relation to its plan of measures.

In Latvia, there are several criteria which can lead to a debtor being insolvent, the most common being that the debtor is unable to pay its due and payable debts. If any of the criteria for insolvency are established by the court, then the court must open corporate insolvency proceedings and declare that the company is insolvent.

The effect of the opening of corporate insolvency proceedings is that:

(a) the company loses the right to dispose of its property, as well as any property of a third party held by it or in its possession – instead, such rights pass to an administrator

(b) the administration of the company's business also passes to the administrator, and

(c) the accrual of late payment charges and interest in respect of claims is stopped.

The opening of corporate insolvency proceedings also has the effect of staying civil proceedings against the company and of terminating the execution of any judgments for the collection of debts.

A creditor's application to open corporate insolvency proceedings will be reviewed by the court in an oral hearing. If it is the company itself that applies, the application will be reviewed by the court in written proceedings. Subject to certain caveats, the judgment of the court opening corporate insolvency proceedings is final.

The principal purpose of Latvian corporate insolvency proceedings is to satisfy, as fully as possible, the claims of creditors by obtaining the maximum revenue from the sale of the insolvent company's property. This is usually done in open auctions organised by the administrator. However, in the case of certain types of property, the legislation specifies particular forms of sale. The administrator may also sell the debtor's property to an individual purchaser without having offered it for sale at open auction.

Corporate insolvency proceedings are a terminal procedure which will ultimately result in the company being liquidated, dissolved and struck off the Commercial Register of the Register of Enterprise of Latvia unless legal protection proceedings are commenced.

Legal protection proceedings (*tiesiskas aizsardzibas process*)

The purpose of legal protection proceedings is to allow a debtor breathing space to restructure its debts. Legal protection proceedings are available to all corporate debtors regardless of whether they are insolvent or encountering financial difficulties; however, it is companies in financial difficulties which are likely to make use of legal protection proceedings. Legal protection proceedings are commenced by way of an application to the court by the debtor and the opening of legal protection proceedings results in a moratorium on creditor action.

Once legal protection proceedings are commenced, the company must draft a "plan of measures" (essentially the debtor's proposals as to how to resolve its economic difficulties). The plan may include any of the following:

(a) a postponement of the performance of payment obligations;

(b) the use of set-off;

(c) the cancellation or reduction of the principal debt, contractual penalties or interest;

(d) the granting of security or rights *in rem* over movable assets or real property;

(e) the sale of moveable assets or real property;

(f) a reorganisation of the company; and

(g) an increase in the company's share capital.

The plan must be agreed by the company's secured creditors and unsecured creditors in the following proportions:

(a) in respect of secured creditors, more than two-thirds of all the company's secured creditors by principal value must approve the plan; and

(b) in respect of unsecured creditors, more than half of all the company's unsecured creditors by principal value must approve the plan.

Following the creditors' approval of the plan of measures, the plan must be submitted to the court for approval. Once the court has approved the plan, it enters into force and binds all creditors, whether or not they voted in favour of the plan. An administrator will be appointed to oversee the company's operations during the implementation of the plan. The plan must be completed within two years from the date it became effective.

The Act also provides for out-of-court legal protection proceedings. Generally, these out-of-court proceedings are subject to the same rules as court-based legal protection proceedings. However, in out-of-court legal protection proceedings the company must simultaneously submit an application to the court demonstrating that it has complied with the following requirements:

(a) the company has drafted a plan of measures;

(b) creditors in the proportions described above have agreed to the plan of measures;

(c) the company has agreed with the proposed administrators and the creditors on the identity of the proposed administrator;

(d) the company has received an opinion from the proposed administrator on the likelihood of the plan of measures being effective; and

(e) the company has sent the plan of measures to those creditors who are not party to the plan.

In out-of-court legal protection proceedings, the work of putting together the plan of measures is done outside the court process. Once this (and the other steps above have

been taken) the court will approve the process and the plan will be implemented under the supervision of an administrator.

Voluntary liquidation (*likvidacija*)

The company may also terminate its activities in cases where it is solvent. A decision regarding the commencement of a liquidation procedure must be adopted by a shareholders' meeting. Such a decision is taken if not less than two-thirds of the votes represented at the meeting are in support of the decision, unless the articles of association specify that a larger majority is needed.

Company liquidation is carried out by the executive body through the company liquidator. However, the meeting of shareholders may elect another liquidator. Upon the election of the liquidator, the powers of the executive body cease, but its responsibility is preserved until the enterprise is liquidated.

Liquidators must collect debts, including amounts which are due to the company in relation to unpaid capital on shares, sell the property of the company, satisfy the claims of creditors and distribute the remaining property among the shareholders. If it is found during the course of the liquidation that the property of the company is not sufficient to satisfy all legitimate claims of creditors, the liquidator has a duty to submit an application for corporate insolvency proceedings.

The operations of a solvent company may be terminated by the court if the company has violated the requirements of legislation in its activities.

European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the Recast Regulation) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the Original Regulation) continues to apply to all proceedings opened before 26 June 2017. One of the key changes in the Recast Regulation is that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation. The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings - secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to terminal proceedings) in Annex B.

Of the above restructuring and insolvency regimes, corporate insolvency proceedings (*juridiskas personas maksatnespejas process*) and legal protection proceedings (*tiesiskas aizsardzibas process*) were available as main proceedings under the Original Regulation.

Corporate insolvency proceedings (*juridiskas personas maksatnespejas process*) were also available as a secondary proceeding under the Original Regulation.

Under the Recast Regulation, both corporate insolvency proceedings (*juridiskas personas maksatnespejas process*) and legal protection proceedings (*tiesiskas aizsardzibas process*) are listed in Annex A.

Further information

For further information on Latvian restructuring and insolvency procedures, we would refer you to the Sweet & Maxwell book "European Cross Border Insolvency" edited by Allen & Overy. To purchase a copy of this book, please visit www.sweetandmaxwell.co.uk

This fact sheet has been prepared with the assistance of Klavins Ellex.

Allen & Overy has launched an online service for clients focusing on debt restructurings and insolvency issues.

Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy to use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe and the US.

To request access for your organisation, please contact your usual Allen & Overy contact, or email rab@allenovery.com

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