



Satversmes tiesa

Press Release

Case No. 2020-49-01

27.05.2021.

Provisions of the law “On Control of Aid for Commercial Activity”, which restrict the right of the creditor of subordinated liabilities to regain the principle amount of loan, are compatible with the *Satversme*

On 27 May 2021, the Constitutional Court delivered the judgement in case No. 2020-49-01 “On Compliance of the First Part of Section 8 and the Second and the Third Part of Section 8¹ of the Law “On Control of Aid for Commercial Activity” with Article 1, Article 91, Article 92 and Article 105 of the *Satversme* of the Republic of Latvia”.

CONTESTED NORMS

Section 8 (1) of the law “On Control of Aid for Commercial Activity” (hereafter- the Law on Control):

“If a commercial company which is facing financial difficulties receives aid in accordance with the laws and regulations governing aid for commercial activities, from the moment of granting aid for commercial activities until the end of the provision of aid, observing the provisions laid down in the decision of the European Commission or a national laws and regulations on granting aid and irrespective of the effective legal obligations of a commercial company, the commercial company is prohibited from fulfilling subordinate obligations (including the prohibition to repay a loan, calculate, accumulate or pay out an interest or other remuneration for such loan) irrespective of the moment when the subordinate obligations were established.”

Section 8¹ (2) of the Law on Control:

“(2) Within the framework of the liquidation procedure initiated in accordance with Paragraph one of this Section, the subordinate liabilities shall be fulfilled only when the aid for commercial activity received has been fully repaid. Until the aid for commercial activity is repaid:

- 1) the inability to repay the aid for commercial activity and the non-fulfilment of the subordinate liabilities shall not constitute a basis for initiating insolvency proceedings;
- 2) the claim of the creditor of the subordinate liabilities shall not be secured, and also the creditor of the subordinate liabilities shall not be entitled to request depositing their claim amounts or the fulfilment of any other liabilities;
- 3) it shall be prohibited to pay liquidation quotas to members of the commercial company (shareholders, members, owners).”

Section 8¹ (3) of the Law on Control:

“The Enterprise Register shall exclude a commercial company from the public register even if, within the liquidation carried out in accordance with the conditions specified in this Section, the aid for commercial activity has not been repaid or the subordinate liabilities have not been fulfilled.”

NORMS OF HIGHER LEGAL FORCE

- Article 1 of the *Satversme* of the Republic of Latvia (hereafter – the *Satversme*):
“Latvia is an independent democratic republic.”
- Article 91 of the *Satversme*:
“All human beings in Latvia shall be equal before the law and the courts. Human rights shall be realised without discrimination of any kind.”
- Article 92 of the *Satversme*
“Everyone has the right to defend his or her rights and lawful interests in a fair court. Everyone shall be presumed innocent until his or her guilt has been established in accordance with law. Everyone, where his or her rights are violated without basis, has

a right to commensurate compensation. Everyone has a right to the assistance of counsel.”

- Article 105 of the Satversme : “Everyone has the right to own property. Property shall not be used contrary to the interests of the public. Property rights may be restricted only in accordance with law. Expropriation of property for public purposes shall be allowed only in exceptional cases on the basis of a specific law and in return for fair compensation.”

THE FACTS

The case was initiated on the basis of two applications submitted by Rems Kargins. He is a creditor of subordinated liabilities of the joint stock company “Reverta”, which has received aid for commercial activity. Wishing to regain from this joint stock company the principal amount of the loan he turned to a court of general jurisdiction, which dismissed his claim.

The applicant has turned to the Constitutional Court because he is of the opinion that the procedure, established by the contested norms, which denies his, a creditor’s of subordinated liabilities, right to receive the principal amount of the loan, restrict his right to property. The contested norms are said to violate also the principle of legitimate expectations because they had been adopted after the credit agreement had been concluded, without establishing a lenient transition to the new regulation or compensation.

The applicant holds that the contested norms also violate the principle of separation of powers and the right to a fair trial because they had been adopted at the time when the applicant already had submitted to the court the claim for the recovery of the principal amount of the loan and the legal proceedings in the civil case had not been completed yet.

The applicant also considers that the contested norms envisage differential treatment of him as a creditor of the subordinated liabilities of a commercial company, which had received aid for commercial activity, compared to the creditors of subordinated liabilities of a credit institution, which had received such aid, for whom the law has envisaged a lenient transition to the new regulation.

On 13 October 2015, the Constitutional Court delivered the judgement in case No. 2014-36-01, in which the compliance of Section 8 (1) of the Law on Control with Article 105 of the *Satversme* was examined.

THE COURT'S FINDINGS

On whether the claim has been adjudicated

The Constitutional Court found that the actual circumstances in the present case differed from the ones in case No. 2014-36-01 and new considerations regarding the scope of Article 105 of the *Satversme* had been expressed. Hence, the claim regarding the compliance of Section 8 (1) of the Law on Control with Article 105 of the *Satversme* cannot be recognised as being *res judicata*. [15.2.]

On turning to the Court of Justice of the European Union for a preliminary ruling

The Constitutional Court found that the regulation of the European Union on state aid was clear and did not cause reasonable doubts and there were no obstacles that would deny the Applicant the right to request review of the constitutionality of the contested regulation. The Constitutional Court is able to provide answers to the issues to be reviewed in the case without turning to the Court of Justice of the European Union. [16.2.]

On terminating legal proceedings in a part of the case

The Constitutional Court concluded that Para 3 of Section 8¹(2) of the Law on Control was not applicable to the Applicant and could not cause and infringement of his fundamental rights. Consequently, legal proceedings cannot be continued in this part of the claim and the legal proceedings in this part shall be terminated. [17.]

The Constitutional Court recognised that it had to establish whether the contested norms affected such rights of the Applicant, which fell within the scope of the first sentence of Article 92 of the *Satversme*. [18.]

The Constitutional Court found that materials in the case did not provide confirmation that the contested norms had prohibited any of the courts of three instances, in reviewing the civil case, to perform their constitutional duty – to administer fair justice. The fact that the legislator has adopted legal norms that pertain to subjects of law and their mutual relations, which is the matter of dispute before the court, does not affect the provision made in the first sentence of Article 92 of the *Satversme* that the particular dispute would be examined in a fair trial. Each norm is adopted on the basis of some circumstances to which the legislator has deemed it necessary to respond to. The legislator must respond to establishment and development of legal relations in the state. The Constitutional Court recognised that the contested norms did not violate the principle of separation of powers and did not affect the Applicant's right to a fair trial, included in the first part of Article 92 of the *Satversme*. Hence, legal proceedings cannot be continued in this part of the claim and the legal proceedings in this part shall be terminated. [18.2.]

On how the constitutionality of the contested norms should be examined

The Constitutional Court recognised that the contested norms restricted the fulfilment of subordinate liabilities and, thus, were closely interconnected, therefore it would examine the constitutionality of these norms as united regulation. At the same time, the Constitutional Court admitted that it would verify whether each of the contested norm had been adopted in due legislative procedure and whether the validity in time of each norm could have affected the Applicant's legitimate expectations. [19.1.]

The Constitutional Court recognised that, in the present case, it would, first and foremost, examine the compliance of the contested norms with Article 1 and Article 105 of the *Satversme* and their compliance with Article 91 – after that.

On the scope of Article 105 of the *Satversme*

The Constitutional Court recognised that the claim with respect to the fulfilment of the Term Deposit Agreement was “property” in the meaning of Article 105. [20.1.]

The Constitutional Court concluded that the contested norms should be examined in the scope of the first three sentences of Article 105 of the *Satversme* rather than that of the fourth sentence. [20.3.]

On whether the restriction on fundamental rights, included in the contested norms, had been established by law

The Constitutional Court recognised that the Applicant, regarding Section 8 (1) of the Law on Control, in providing reasoning for the existence of a violation of the principle of good legislation, had not provide any new arguments on their merits that had not been examined in case No. 2014-36-01. Moreover, it is not disputed in the case that Section 8 (1) of the Law on Control had not been promulgated and was not publicly accessible in accordance with statutory requirements and had not been worded with sufficient clarity. [23.]

The Constitutional Court had no doubts that Para 1 and Para 2 of Section 8¹ (2) of the Control Law. As well as its third part were norms that had been promulgated and were accessible in accordance with statutory requirements and had been worded with sufficient clarity. [24.1.] In adopting Para 1 and Para 2 of Section 8¹ (2), as well as its third part, the legislator had at its disposal sufficient information and it examined compliance of these norms both with the *Satversme* and the European Union law. [24.3.]

The Constitutional Court recognised that the restriction on the right to property, envisaged in Section 8 (1), Para 1 and Para 2 of Section 8¹ (2), as well as its third part had been established by a law adopted in due procedure. [23., 24.]

On whether the restriction included in the contested norms has a legitimate aim

The Constitutional Court concluded that the restriction established in the contested norms, which prevents receiving the repayment of the principal amount of subordinated liabilities, in accordance with the requirements of the European Union, serves the purpose of ensuring that creditors of subordinated liabilities do not receive unjustified benefits, State's resources are not squandered and the amount of money received as aid returns to the state budget as soon as possible. This restriction is intended to safeguard the important interests of taxpayers and society as a whole. Consequently, the legitimate aim of the restriction of fundamental rights included in the contested norms is to ensure society's welfare. [25.]

On whether the chosen measures are suitable for reaching the legitimate aim

The Constitutional Court found that, in deciding on the compatibility of the provided state aid with the internal market of the European Union, the European Commission took into account the Treaty on the Functioning of the European Union and its statement of 30 July 2013 on the application of aid rules in connection with the financial crisis (hereinafter – the Banking Communication). Paragraph 40.46 of the Banking Communication sets out, *inter alia*, the burden-sharing of shareholders and subordinated creditors as a condition for the authorization of aid. [27.]

The Constitutional Court concluded that after receiving the aid, the commercial company must continue to operate in such a way as to optimize the recovery of this aid and repay it to the state budget. Therefore, burden-sharing and restrictions are needed to prevent subordinated creditors from obtaining satisfaction of their claims. However, cases are possible where the liquidation of a particular company is initiated. In this case, too, it is important to promote the recovery of financial resources invested by the State. It is in

the public interest to ensure that creditors of subordinated liabilities do not receive satisfaction of their liabilities for the whole period until the aid has been repaid. The contested norms prohibit the fulfilment of subordinate obligations, including the calculation, accumulation or payment of interest or other remuneration, until the received aid is repaid in full. A prohibition like this is in line with Latvia's commitment to abide by the principle of burden-sharing, which it expressed to the European Commission when it decided on the compatibility of the State aid provided with the internal market of the European Union. [27.]

The Constitutional Court found that the measures used by the legislator were appropriate for reaching the aim of the restriction on fundamental rights. [27]

On whether there are measures that are less restrictive on a person's fundamental rights (more lenient measures)

The Constitutional Court concluded that when implementing the requirements arising from the legal acts of the European Union, several solutions and various regulations could be possible, but in any case they had to be such as to ensure the achievement of the goal of burden-sharing. All alternative measures identified in the European Commission Decision No. 2015/162 of 9 July 2014 on additional state aid provided to f JSC "Parex banka" (JSC "Reverta") and JSC "Citadele banka", would have been equally harsh for the creditors of subordinated liabilities, i.e., in any case the creditors of subordinated liabilities would not be able to have their claim satisfied before JSC "Reverta" had repaid the aid it received. [28.1.]

The Constitutional Court concluded that the alternative measures mentioned by the Applicant would not achieve the legitimate aim of the restriction of fundamental rights in the same quality. [28.2.1.]

The Constitutional Court established that, already in case No. 2014-36-0, it had concluded that none of the alternative measures assessed by the legislator would achieve the legitimate aim of the restriction established by Section 8 (1) of the Law on Control Law

in the same quality. The Constitutional Court acknowledged that in the present case it had no grounds to draw a different conclusion. Also in the present case it is necessary to ensure that the invested state funds are not used contrary to the public interest and are returned to the state budget as soon as possible. [28.2.2.]

In assessing the alternative measures to Para 1 and Para 2 of Section 8¹ (2), as well as its third part, the Constitutional Court established that the principle to ensure “that none of the creditors is worse than others” followed from the regulation of the European Union.

This principle requires that burden-sharing measures do not result in a deterioration of the situation of the creditors of the subordinated liabilities compared to the situation which would have arisen in the absence of the aid. However, this principle is not to be understood as precluding the introduction of burden-sharing itself, but as such that ensures introduction of proportional burden-sharing, i.e., that subordinated creditors should not assume a too heavy burden. [28.2.3.]

The Constitutional Court found that the legislator had assessed two alternative measures – liquidation of a commercial company and initiation of insolvency proceedings. The Constitutional Court also found that until 1 July 2014, when Section 8 (1) of the Law on Control entered into force, interest was calculated and paid on subordinated liabilities. However, their increase would stop with the declaration of insolvency proceedings, in accordance with Para 3 of Section 63 (1) of the Insolvency Law and Para 3 of Section 149 of the Credit Institutions Law. The Constitutional Court acknowledged that thus the creditors of the subordinated liabilities benefited from the granting of the aid in such a way that they would not have received if the aid had not been granted and the insolvency proceedings of JSC “Parex banka” had been initiated. In that case, the situation of these creditors would have been even worse, as the legal regulation on insolvency would prevent interest payments. [28.2.3.]

The Constitutional Court concluded that even if the insolvency proceedings of JSC “Parex banka” or later JSC “Reverta” were initiated, the Applicant’s right to receive satisfaction of his claim would be restricted. The regulation on insolvency provides for the grouping

of creditors, and it follows that the Applicant would be in one of the last rounds of creditors with his claim. Insolvency proceedings do not guarantee the creditor's right to receive full satisfaction of his claim, and the company may also be excluded from the public register without satisfying the claims of all creditors. [28.2.3.]

In conclusion, the Constitutional Court recognised that the Contested Norms restricted the Applicant's rights to property to an even lesser extent than they would have been restricted during the insolvency proceedings of JSC "Parex banka" or later, during the insolvency proceedings of JSC "Reverta", if the aid had not been granted. In view of the above, the Constitutional Court concluded that none of the above-mentioned alternative measures would achieve the legitimate aim in the same quality. They would jeopardize the operation of the company itself and, consequently, society as a whole, and would infringe the European Union rules on granting aid. [28.2.3.]

On whether the benefit obtained by the society from the restriction of the fundamental rights of an individual, established in the contested norms, outweighs the damage caused to the individual's rights and lawful interests

The Constitutional Court acknowledged that the special nature of subordinated liabilities would be taken into account in the assessment of the proportionality of the restriction of property rights. The nature of the subordinated liabilities gives rise to a risk in commercial activities, which the respective creditors must assess and assume when transferring their funds to the credit institution, i.e., the risk that the funds lent may be cancelled in the event of the credit institution's solvency difficulties. This risk applies not only to insolvency or liquidation proceedings, but to the entire period during which the credit institution experiences financial difficulties.

These difficulties can and have been addressed in the present case with the involvement of the State, providing aid to JSC "Parex banka" and, later, to JSC "Reverta". The creditor of a subordinated liability must take into account the fact that the provision of aid to a credit institution in financial difficulties will also affect his situation, i.e., he should take

into account that he will not receive satisfaction of his claim until the aid has been repaid. [29.1.]

The Constitutional Court acknowledged that the principle of legitimate expectations was closely linked to the basic values of the legal system. Its application is not and cannot be an end in itself. In any case, it is essential to ensure a fair final result. In accordance with the principle of justice, the contested norms have created conditions that are as close as they would have been in the case where aid had been absent. The restrictions set for the aid are aimed at the observance of the principle of justice enshrined in the *Satversme*. [29.2.]

In assessing the Applicant's legitimate expectations in the framework of Section 8 (1) of the Law on Control, the Constitutional Court concluded that the Applicant could not have developed lawful, valid and reasonable expectations regarding the unchangeability of legal regulation. The financial difficulties, potential insolvency and liquidation of JSC "Parex banka" in 2008 created an unprecedented situation in the State of Latvia, which required the State's involvement in salvaging this bank and providing aid. Consequently, changes in regulatory enactments were also required. In circumstances like that, the Applicant could not have reasonably expected that the legal norms regarding the fulfilment of the Term Deposit Agreement and control over aid would not be amended and that these amendments would not affect legal relations that had been established between JSC "Parex banka" (later JSC "Reverta") and the Applicant. The fact that for some time after provision of aid to JSC "Parex banka" began there was no such national legal regulation that would restrict the use of state aid contrary to its objectives, does not mean that the Applicant could reasonably have expected that these shortcomings would not be remedied and his situation would never change. [29.3.]

The Constitutional Court emphasized that the aid that was provided to a company in financial difficulties was a serious signal to its creditors, including the subordinated creditors, that the company was unable to meet its obligations. In those circumstances, the fact that no transitional period was laid down for the adoption of Section 8 (1) of the Law on Control is not of decisive importance. [29.3.]

Assessing the Applicant's legitimate expectations within the framework of Section 8 (1) of the Law on Control, the Constitutional Court concluded that these norms were valid *pro futuro* in relation to the Applicant. This means that at the time when the liquidation of JSC “Reverta” was started, the Applicant already knew what the consequences would be, and he could reckon with these consequences.

In assessing the Applicant’s legitimate expectations in the framework of Section 8 (1) of the Law on Control, the Constitutional Court concluded that these norms had *pro futuro* effect with respect to the Applicant. This means that at the time when the liquidation of JSC “Reverta” was started, the Applicant already knew what the consequences would be, and he could reckon with these consequences. [29.4.]

The Constitutional Court recognised that the State was not obliged to ensure that the claims of creditors of subordinated liabilities were satisfied through the aid mechanism. If the credit institution is unable to repay the aid, there are no grounds for satisfying the claims of subordinated creditors. [29.]

The Constitutional Court concluded that the public benefit from the fact that the state budget funds were used sparingly and recovered as soon as possible outweighed the losses suffered by some creditors of subordinated liabilities. The interest of individuals in recovering their money is disproportionate to the harm that could be caused to the public interest, as the non-implementation of the burden-sharing principle would prevent society from recovering the maximum amount of funds it had invested. [29.]

On compliance of the contested norms with Article 91 of the *Satversme*

The Constitutional Court, taking into account the reasoning provided in the constitutional complaint and other materials in the case, acknowledged that it would examine the compliance of the contested norms with the first sentence of Article 91 of the *Satversme*. [30.]

The Constitutional Court recognised that in the present case it had to be assessed whether the creditors of subordinated liabilities of JSC “Citadele banka” and creditors of subordinated liabilities of JSC “Reverta”, including the Applicant, were in according to certain criteria comparable circumstances. [32.]

The Constitutional Court concluded that the creditors of the subordinated liabilities of JSC “Citadele banka” and JSC “Reverta” became involved in these commercial companies for various purposes. In the first case, the aim was to rescue a bank that was experiencing financial difficulties, and in the second, to make a long-term profit. Thus, within the framework of the present case, there are significant differences between the creditors of subordinated liabilities of JSC “Reverta” and JSC “Citadele banka”, and they do not form comparable groups within the meaning of the first sentence of Article 91 of the *Satversme*. Consequently, the contested norms comply with the first sentence of Article 91 of the *Satversme*. [32.]

- The Constitutional Court held:

1. To terminate legal proceedings in the case in the part thereof regarding the compliance of Para 3 of Section 8¹ (2) of the law “On Control of Aid for Commercial Activity” with Article 1, Article 91, Article 92 and Article 105 of the *Satversme* of the Republic of Latvia.
2. To terminate legal proceedings in the case in the part thereof regarding the compliance of Section (8) 1, Para 1 and Para 2 of Section 8¹(2), as well as the third part of this section of the Law “On Control of Aid for Commercial Activity” with the principle of separation of powers and the first sentence of Article 92 of the *Satversme* of the Republic of Latvia .
3. To recognise Section (8) 1, Para 1 and Para 2 of Section 8¹(2), as well as the third part of this section of the Law “On Control of Aid for Commercial Activity” as being compatible with Article 1, the first sentence of Article 91, as well the first, the second and the third sentence of Article 105 of the *Satversme* of the Republic of Latvia .

The Constitutional Court's judgement is final and not subject to appeal, it shall enter into force on the day it is published.

The judgement will be published in the official journal "Latvijas Vēstnesis" within the term defined in Section 33 (1) of the Constitutional Court Law.

The text of the judgement is available on the Constitutional Court's homepage:
https://www.satv.tiesa.gov.lv/wp-content/uploads/2020/09/2020_49_01_Spriedums.pdf

The press release was prepared to inform society about the Constitutional Court's work. More detailed information about recent developments, cases initiated and heard by the Constitutional Court is available on the Constitutional Court's webpage www.satv.tiesa.gov.lv. Please follow also information published on the Court's *Twitter* account [@Satv_tiesa](https://twitter.com/Satv_tiesa) and *Youtube* [channel](#).

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