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Enforceability of close-out netting provisions under insolvency rules

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On January 1 2008, a new Insolvency Law came into effect in Latvia. Among other things, it regulates the invalidation and recovery of a debtor's transactions. However, the Insolvency Law is not the only legal act regulating insolvency proceedings in Latvia. Credit institution insolvency proceedings are governed by the Credit Institution Law (CIL). Insolvency proceedings of insurance companies are governed by the Insolvency Law subject to special provisions and regulation under the Insurance Companies and their Supervision Law (ICSL). Of course, EU law, notably EC Insolvency Regulation 1346/2000, applies as well. Latvia, as an EU member state, is also bound by the EC directives regulating insolvency issues.

Definition of close-out netting under Latvian law

The laws of Latvia do not contain one uniform definition of close-out netting. According to the CIL and the ICSL, close-out netting is a legal obligation established between a debtor and a creditor before commencement of the debtor's liquidation or the debtor's insolvency following an agreement in writing according to which all claims and obligations under the agreements between the parties are expressed in one claim and one obligation so that only one claim is being brought and only one obligation is to be fulfilled.

A close-out netting arrangement within the meaning of these laws is a legal arrangement between two parties which has been established before either party has been declared insolvent. Provisions defining the

meaning of close-out netting are also in the Financial Collaterals Law and Civil Law.

General rules on invalidation and recovery of debtor's transactions

Under the Insolvency Law, the insolvency administrator is under the obligation to assess the transactions entered into by the debtor and bring an action in the court to avoid or reverse the transactions which, irrespective of their type were either: (i) concluded after the date of the debtor's insolvency and the debtor has thereby suffered a loss, irrespective of whether or not the person, with whom or for the benefit of whom the transaction is concluded, was aware of the loss to the creditors; or (ii) were entered into within five years before the date of the debtor's insolvency and the debtor has thereby suffered a loss, provided that the person, with whom or for the benefit of whom the transaction is concluded, was aware of or had to be aware of such loss. There is a rebuttable presumption of knowledge of loss if the transaction has been entered into with or for the benefit of an interested party in relation to the debtor.

The payments of debt obligations may be reversed if they have been made within six months from the date of the debtor's insolvency or after that date and if either: (i) the payment has been made before its maturity in circumstances where other payment obligations have been defaulted, provided full restitution is possible; or (ii) the payment is made to an interested party in respect of the debtor in circumstances where other payment obligations have been defaulted.

Avoidance of transactions entered into by credit institutions is governed by the CIL. With some exceptions, the grounds on which a transaction entered into by a credit institution may be reversed or avoided in credit institution insolvency proceedings are similar to the grounds for reversal and avoidance under the Insolvency Law. Thus, the payment obligations performed by the credit institution

before initiation of its insolvency proceedings cannot be reversed in its insolvency proceedings.

Specific exemptions and exclusions

Under the laws of Latvia and the Insolvency Regulation, certain types of transactions are exempt from the general avoidance and reversal regulation under the insolvency laws and are subject to specific regulation. These include, among other things, close-out netting, set-off under the Insolvency Regulation and financial collateral arrangements.

Furthermore, in matters governed by the Insolvency Regulation, the effect of the provisions of the Insolvency Law concerning the rules relating to voidness, voidability or unenforceability of legal acts detrimental to all the creditors may be excluded by virtue of Article 13 of the Insolvency Regulation, according to which these rules are not applicable where a person who has benefited from an act detrimental to all the creditors provides proof that the said act is subject to the law of an EU member state other than Latvia and the law of that EU member state does not allow any means of challenging that act in the relevant case.

Similar right may be invoked in the credit institution proceedings in Latvia pursuant to EC Directive 2001/24 as implemented in the CIL, and in insurance undertaking insolvency proceedings in Latvia pursuant to EC Directive 2001/17 as implemented in the ICSL.

Risk of unenforceability of close-out netting arrangements

Financial institutions should take into account that the exemptions and exclusions mentioned above are not always sufficient to ensure enforcement of close-out netting arrangements in cases where the counterparty is subject to insolvency proceedings or a temporary relief procedure.

First, under the laws of Latvia, determination of an insolvency date in respect of an insolvent party always is made retroactively. This leads to a situation in which contractual arrangements, which have been entered before the date on which the insolvency decision is passed by the court but after the insolvency decision specified in the insolvency decision, are not treated as close-out netting arrangements for the purposes of the CIL and ICSL even if they meet all other requirements. Second, these exemptions and exclusions might be inapplicable in cases where the counterparty is a person other than a bank, credit institution or insurance company. Third, under the laws of Latvia, interested parties have fairly broad rights to challenge the performance of netting provisions.

Consequently, financial institutions are advised to carefully examine provisions of their close-out netting arrangements to make sure they are enforceable in the case of the insolvency of their counterparties.

Financial and corporate

Recommended firms	
Tier 1	Klavins & Slaidins Lawin Raidla Lejins & Norcouc
Tier 2	Glimstedt & Partners Liepa Skopina/Borenis Loze Grunte & Cers Sorainen
Tier 3	Kronbergs & Cukste Skudra & Udris Treilons & Petrovics

Latvia has been the EU's star performer in recent times, but economic growth looks set to take a dive, falling from 10.3% in 2007 to potentially 2.4% in 2008. Fears could now focus on recession - in contrast with last year's concerns about overheating. Law firms are as busy as ever, but as one partner comments: "There is a little more of a contentious atmosphere and an irritable air."

It is the real-estate market that is hit hardest by the slowdown, particularly in the residential sector. The number of real-estate transactions has gone back to the pre-surge levels of 2001. The government's anti-inflationary measures introduced in May 2007, which included rules on issuing mortgages, have bitten the property sector hard.

A tightening of real-estate financing reflects the conservative stance that the foreign-dominated banking sector is applying to financing deals. Some view this more difficult banking environment as a process of normalisation, compared to the recent times of cheap and easy financing.

The economic slowdown has created a buyers' market in M&A. Although private-equity houses may be tempted by a bargain, leveraged deals are failing to move forward. But Blackstone's purchase of a 51% stake in Lattelecom, as part of the telecoms provider's privatisation, is an indication that international private-equity investors can still find the occasional deal.

Although IPOs are not traditionally a favoured source of financing in Latvia, Nasdaq's February 2008 merger with the OMX group (which operates all three Baltic stock exchanges) has improved the infrastructure for companies looking to list. Once global market conditions improve, Latvian companies may be able to take advantage of this new setup to list on the Riga Stock Exchange.

As in Estonia and Lithuania, project finance - particularly PPPs - is subject to intense discussion. Not only are local law firms investing resources in the practice area, but big UK firms are also said to be snooping around. Although there may be enthusiasm from many quarters, a lack of political will has so far stifled progress. Due to insufficient funds in the state budget and EU financing, the Latvian Ministry of Transport is planning six road reconstruction projects along PPP lines, with a total cost in the region of €1.2 billion.

Klavins & Slaidins Lawin

Klavins & Slaidins is a member of the pan-Baltic Lawin group along with Lepik & Luhaäär in Estonia and Lideika Petrauskas Valiunas ir partneriai in Lithuania. The alliance is a top-tier outfit across all three states and took home *International Financial Law Review's* 2008 award for the best Baltic firm.

Klavins & Slaidins has a well established reputation as a leader among its competitors. "They have a long standing relationship in the market. They are in the majority of the notable transactions," says one peer. Clients are also pleased with the standard of the firm. "They respond very well to questions," says one. "I was very pleased with the service level."

Capital markets activity is thin on the ground even for the Latvian firms with expertise in the area. Klavins & Slaidins has, however, been involved in some advisory work, notably providing Citigroup with a detailed

analysis of the Latvian Stock Exchange and securities market, and also providing advice to the International Capital Market Association. One client of the firm comments: "They are perhaps the best for international financial law."

The firm is assisting Dawnay Day Carpathian, the eastern European real-estate investor, on its negotiations and drafting of three loan facilities to fund its construction of a shopping centre. In one standout lending transaction, the firm advised the arrangers - Mizuho Corporate Bank, HSBC, Raiffeisen Zentralbank and Mitsui Banking Corporation - on their €275 million syndicated loan to Parex bank. The deal was closed in February 2008 and featured partner Egons Pikelis.

It is the firm's M&A work that is really driving its success, with Filips Klavins seen by clients as the key to the firm's success. "Filips Klavins was excellent. He is first class as an individual. Having worked in America, he knows the American and British way of doing things. I would thoroughly recommend him," one client says.

Peers are also very complimentary: "He is extremely experienced and capable of delivering the highest quality in a short time frame," says one competitor.

Klavins remains active on the firm's top transactions. In a deal closing in July 2007, he advised car retailer Inchcape on its acquisition of Baltic Motors Group for €100 million.

Liga Hartmane and Filips Klavins led a team which represented private-equity group Blackstone and the management of telecoms company Lattelecom in their MBO of Lattelecom. The total value of the transaction is Lats290 million (€417 million), with Blackstone taking a 51% stake, and the management taking the remaining 49%. The privatisation is a rare example of a prominent international private-equity investment in the region, and the saga surrounding the transactions has received significant press attention in the past 12 months.

Leading lawyers

Filip Klavins
Egons Pikelis

Raidla Lejins & Norcouc

From May 2008 Lejins Torgans & Partneri consolidated its alliance with its Estonian and Lithuanian partners by changing to the single name of Raidla Lejins & Norcouc across the whole Baltic region. Peers and clients place the firm firmly in the top tier, both in terms of its banking and finance and M&A work. "They give a high level of service. I do not have a bad word to say in two years of service," says one client.

Corporate partner Dace Silava-Tomsone is commonly praised by competitors and clients, as is the experienced Andrejs Lielkalns. Named partner Girts Lejins is also well respected, with one peer noting he is “a solid lawyer. [There is] no question of that”. Clients are pleased with his reliability: “He is very precise. His promises are always kept in line.”

In banking and finance work the firm’s client list comprises notable financial and commercial clients including Deutsche Bank, SEB and DnB Nord. Despite the problematic market for real-estate financing, Raidla Lejins & Norcoux advised an international banking syndicate composed of MKB Bank, SEB and Unicredit Bank on the €83 million financing of the construction of the Riga Plaza shopping mall in December 2007.

Working with the firm’s alliance partners in Tallinn and Vilnius, Girts Lejins and senior associate Martins Aljens advised SEB on a €200 million facility to the Homburg Group for its acquisition of SEB Baltic’s real-estate portfolio in January 2008.

The firm was also involved in PPP projects at a municipal level, advising Affiliated Computer Services France in the establishment of the joint venture with Riga City municipality enterprise Rigas Satiksme to introduce an e-ticketing system for the Riga public transport system. The project, closed in February 2008, was one of the first significant public infrastructure PPP projects in Riga.

In one of the firm’s most notable M&A transactions, it advised PKN Orlen and the Kuwait Energy Company in their acquisition of a Latvian company which holds Baltic Sea oil-and-gas exploration rights in April 2008.

Raidla Lejins & Norcoux again showed the capabilities of its network through its role advising Borse Dubai in its unsuccessful public takeover bid for OMX, a Swedish stock exchange operator. As OMX owns the Riga, Vilnius and Tallinn stock exchanges, all three of the firm’s Baltic offices were involved in the deal.

Leading lawyers

Gerts Lejins
Andrejs Lielkalns
Dace Silava-Tomsone

Glimstedt & Partners

Glimstedt & Partners is the Latvia office of the Glimstedt association, which has offices in Estonia and Lithuania, as well as in Sweden. Glimstedt has established itself as a local capital markets specialist in recent times, although in line with other Latvian firms, the transactions have dried up as the international markets falter.

The firm was especially active in summer 2007, when its activities included advising the Estonian company Silvano Fashion Group on the Latvian law elements of its listing on the Warsaw Stock Exchange.

Partner Eriks Blumbergs is respected as an expert in financial matters. “It is hard to find a high-level consultant in Latvia like him,” says one client.

Blumbergs counts the Treasury of Latvia amongst his clients. He recently advised the Treasury on Isda negotiations with the likes of Barclays, Lehman Brothers and Citigroup. In addition to this, he advised the Treasury on its development of standard securities trading agreements, again with international banks and institutions such as Citigroup and Depfa Bank.

In one notable financing transaction, the firm advised Baltic private-equity company Alta Capital on its €34 million refinancing of a real-estate project in June 2007, provided by a banking syndicate including Nordea and Hansabank. The firm also advised a Danish brewery group in its €17.5 million acquisition of Latvian brewery Livu Alus.

According to one partner: “Their M&A practice certainly benefits from very good banking and finance expertise. They can deliver their clients a consistent service across both practice areas.”

Leading lawyers

Eriks Blumbergs

Liepa Skopina/Borenus

Partner Lauris Liepa is a key figure at Liepa Skopina/Borenus. “He is so good in so many areas. It is very pleasant to work with him on the other side,” says one peer. Another says: “Lauris Liepa is still very strong, very visible and very active.”

Ieva Azanda was singled out by the market as a rising star who regularly supports Lauris Liepa on deals. “She was very helpful. Exactly what you want from a lawyer,” says one client.

The firm was strengthened in April 2008 with the addition of Edgars Lodzins from Hansabank’s in-house team. Lodzins’ recruitment follows associate Martins Zalans’ departure in October 2007 to become vice-president of Latvijas Krajbanka.

The firm has a number of leading banking clients on its books, including Morgan Stanley, Goldman Sachs and Deutsche Bank. Liepa Skopina/Borenus has also done some notable work for Depfa Bank, advising on the tendering for two loans, of €55.6 million and €66 million respectively, to two Latvian hospitals in November 2007.

Client feedback has illustrated that the firm’s finance capabilities are well appreciated.

“I have nothing but good things to say about them. They were particularly good at loan agreements and incorporating international law,” says one.

The firm has earned praise for its capital markets expertise and has been active in regulatory work, such as acting for Qatar Holding to notify the Financial and Capital Market Commission of Qatar’s acquisition of shareholdings in the OMX Group.

In M&A, Indrikis Liepa led a team which advised the owners of the Latvian alcohol distributor Lion & Ko on its sale to Estonian alcohol beverage producer Liviko in October 2007.

The firm also teamed up with other Borenus Group members in Estonia and Lithuania to advise private-equity investment fund BaltCap on its acquisition of the Interinfo group of companies across the Baltics in February 2008.

Leading lawyers

Lauris Liepa

Loze Grunte & Cers

Loze Grunte & Cers is a large firm, but according to the market focuses mainly on domestic work. The firm’s connections on the local market help it maintain its position within the top two tiers, as an established member of what one partner joked was “Latvia’s magic circle”.

Despite this reputation the firm is sometimes active in deals with a more international dimension, and this usually comes as a result of its alliance with Estonian partners Tark & Co and Lithuanian partners Sutkiene Pilkuskas & Partners.

The firm has been providing both Nomura International and the Bank of Montreal with a Latvian legal opinion on the Isda master agreements. The firm has also provided Hansabank with a Latvian legal opinion on covered-bond regulations in Latvia.

Loze Grunte & Cers has been advising Danske Bank on Latvian regulatory matters following its acquisition of Sampo Bank and its Finnish and Baltic operations. The role follows Loze Grunte & Cers’ work advising on the Sampo Bank acquisition, which was closed in May 2007. Janis Loze has been advising the client along with partner Karlis Reihmanis, who is singled out for praise by clients. Says one: “He has the touch, so to speak.”

The firm has had roles on some notable financing transactions in the past 12 months. These include providing Latvian law advice on aspects of a loan agreement and Latvian securities on a \$300 million financing for the reconstruction of an industrial company. In

addition, the firm advised ABG Sundal Collier on its €13 million secured loan agreement for the financing for a Latvian shopping centre.

Leading lawyers

Janis Loze

Sorainen

One partner comments that Sorainen's Riga office is "young and energetic", which is the way many competitors view the only single pan-Baltic firm. One client says he decided to use the firm "because local operators recommended them from hard-nosed practical experience." The client adds: "Sorainen are top class and a professional group."

Girts Ruda heads Sorainen's Latvian banking and finance team and is well respected by market commentators. The firm has advised some notable clients on capital markets work including the Riga Stock Exchange, now part of the Nasdaq OMX Group, and ING. The firm advised Société Générale and Bank Austria Creditanstalt in relation to the 1992 Isda master agreements.

Existing Latvian banks have been reorganising in the past year and new banks have been establishing branches. This has provided regulatory work for Sorainen, which has provided advice to UniCredito Group on the reorganisation of its Baltic structure. Sorainen also assisted Swedish bank Handelsbanken in the establishment of a branch in Latvia and on the drafting of its banking agreements.

Among its representation of lenders, the firm has acted as local counsel for Standard Bank and Commerzbank, which were the lead arrangers on a €28.5 million syndicated loan to Norvik Bank.

The market for project finance is still at an early stage in Latvia, but it is an area where Sorainen is active. As part of the trend for municipal-level Baltic PPPs, Sorainen has advised the Riga City Development Department on the €1 billion Northern Crossing PPP project.

Sorainen's Riga M&A team is headed by Pekka Puolakka, and in the past year has been strengthened by the additions of two senior associates, Renate Purvinska and Lauma Berzina, who both joined from Deloitte's Latvian office. Clients see Puolakka as a real asset to the office. "I think he's bloody good. I would recommend him for anyone. He thinks outside the box," says one client.

In June 2007 the team advised Allied Irish Bank on its €40 million acquisition of the mortgage finance business of AmCredit in the Baltics from the Baltic-American Enterprise Fund - the largest mortgage finance acquisition in the Baltics in 2007.

The firm advised private-equity funds managed by Capital International in their €28 million acquisition of a majority shareholding in Lode, a listed Latvian manufacturer of building materials. The firm has also been assisting the client with the minority shareholder squeeze-out, which is an unusual assignment in the Latvian legal environment.

Leading lawyers

Pekka Puolakka

Girts Ruda

Other notable firms

Treilons & Petrovics enters the rankings for the first time this year following solid peer feedback. The firm, which boasts ex-Klavins Slaidins & Loze lawyer Ugis Treilons, was launched in 2003 and has been slowly building its capacity over the past five years.

Kronbergs & Cukste was selected by the Latvian Bankers' Association to advise it on the draft law of trusts, the first phase of which was completed in December 2007. The firm has been advising Icelandic clients, including Icebank, on its acquisition of a banking licence in Latvia.