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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 & Norcoucs

Tier 2

Glimstedt & Partners
Liepa Skopina/Borenus
Sorainen

Tier 3

Eversheds Bitans
Kronbergs & Cukste

The big news in the legal market this year is the merger of the law firm Loze Grunte & Cers. Between four and six firms have emerged from the firm's ashes including the re-establishment of Grunte & Cers.

While a lot of sectors of the Latvian markets are slow, the collapse of Parex banka and the subsequent state takeover has proved a boon for law firms. A number of firms have won work from the fallout due to the sheer number of different stakeholders involved and the subsequent purchase of a stake in the troubled bank by the European Bank of Reconstruction and Development (EBRD). The need to draft legislation to allow the government to take control of the bank provided another window for firms to get work.

Financing work is in paralysis. International private funds are the main source of financing now, but it is a trickle of funding, not a flood. Most of the banking and finance work revolves around renegotiating loans. Traditionally banks in Latvia use in-

house teams for this work, but they are struggling to keep up. This has allowed law firms to "find a way into the kitchen" on the bankers' side, according to one partner.

M&A is dead. Little has happened since the collapse of Lehman Brothers, a situation that is unlikely to change. Any activity is generally of the merger kind, and the expected sale of distressed assets is still to come. That might change as the year moves on as banks can no longer afford to extend the duration of borrowers' facilities.

Klavins & Slaidins Lawin

Klavins & Slaidins Lawin's place in the top tier is undisputed by the market. The firm established itself soon after the Latvia's declaration of independence, with founding partners Filip Klavins and Raymond Slaidins bringing western legal nous to the fledgling state.

The firm has a strong financial and corporate reputation, but is noted for its strength in banking and finance. "Lawin is universally capable of large projects on the equity and debt issues, I would always go to them for a second opinion," says one peer.

The firm represented the European Bank of Reconstruction and Development (EBRD) in its dealings with Parex banka, in a transaction that included both M&A and financing aspects. Egon Pikelis led a team advising the EBRD on its purchase of an equity stake in Parex and extension of a €22 million subordinated loan to the bank.

On the financing side the firm gave Latvian law counsel to a syndicate of banks, including lead arranger Danske Bank, on a multi-jurisdiction financing and guarantee to Sanistal worth €391 million, which was completed in May 2009. In 2008 the firm acted as Latvian counsel to lead arranger DZ Bank on a €70 million syndicated loan to Aizkraukles banka.

M&A deals have been more sparse. Lawin represented News Corporation on the acquisition of the remaining minority stake in television stations TV5 and LNT it did not own. The transaction, closed in May 2008, saw News Corporation purchase the remaining shares from Belokon Holding to take full ownership of the stations.

Slaidins led a team advising KGF Production on the structuring and preparation of Almia for its sale to a company owned by Orkla. The team completed negotiations in October 2008.

Leading lawyers

Filip Klavins
Egons Pikelis
Raymond Slaidins

Raidla Lejins & Norcoucs

Raidla Lejins & Norcoucs maintains its top tier position due to its all-round strength in both banking and finance and M&A work. The firm is known to have good government connections, with one peer comparing the firm with Slaughter and May in the UK.

Name partner Girts Lejins is a visible presence on the market, with one competitor noting "he is strong on all privatisation work" and is "a proven entity". Dace Silava-Tomsone receives praise for her work and "because she is always easy to work with".

In June 2009 Raidla advised the Linstow group of companies on the restructuring and renegotiation of its finance arrangements with a syndicate of banks. The firm is involved with the fallout from Parex banka, with Silava-Tomsone and Andrejs Lielkalns advising the minority shareholders on their rights in the process of the bank's takeover by the Latvian government.

Lielkalns advised the Latvian Ministry of Economics and Ministry of Finance on entry into a funding agreement with the European Investment Fund in a transaction valued at €183 million.

The firm acted as Latvian counsel to private-equity firm Enterprise Investors on its €35 million investment in Pharmaswiss. Raidla also provided advice to another private-equity house in August 2008 on the sale of the Izzi group.

Leading lawyer

Girts Lejins
Andrejs Lielkalns
Dace Silava-Tomsone

Glimstedt & Partners

Glimstedt & Partners' reputation is in banking and finance matters, with a flair for capital markets work. Partner Eriks Blumbergs is regularly named as a leading lawyer in Latvia.

Glimstedt has picked up a significant amount of work from the Latvian state's efforts to save Parex banka. The firm acted for the Finance and Capital Markets Commission on the Parex banka capital injection and its subsequent rescue.

The Finance and Capital Markets Commission hired the firm in February 2009 to provide legal advice on the drafting of the Bank Takeover Law. The law was required by the IMF and Swedish Central bank to allow the Latvian government to take over non-performing banks.

In September 2008 the firm advised Enskilda Securities, a shareholder in Izzi, on the sale of Izzi to a German private-equity fund.

The firm worked on a transaction completed in March 2009 that saw retail network

Palink takeover Nelda. The transaction was completed through a restructuring and asset deal. Another deal saw Glimstedt work for French energy company Dalkia on its purchase of a heating unit in Cesis.

Leading lawyers

Eriks Blumbergs

Liepa Skopina/Borenus

Lauris Liepa is the big name at Liepa Skopina/Borenus. "He is practicing for almost 20 years, this is remarkable. He is still quite young, in his forties. For any banking and finance transaction I would recommend Lauris Liepa. His team is capable and fast," says one client.

Liepa Skopina/Borenus has a strong reputation for finance work and counts a number of important institutions as regular clients, including Deutsche Bank. Recent work for the German bank saw the firm advise on a €25 million loan to the Mortgage and Land Bank of Latvia in June 2008.

In a role reversal, the firm counselled the Mortgage and Land Bank of Latvia on its 85% stake in Parex banka after liquidity problems led to the Latvian government taking control of the latter bank.

Depfa Bank is another regular client, and the bank sought Liepa Skopina's advice on an intra-group assignment of loan agreements to a number of Latvian public entities. Ieva Azanda worked on the case, with a transaction value of €122 million.

Like other firms in Latvia the flow of M&A deals halted in the second half of 2008, but the firm won its fair share of mandates when the market was still active, representing Contaq Latvia Cable in the acquisition of Izzi and Austrian Gaming Industries in its acquisition of Admiralu klubs.

Leading lawyers

Lauris Liepa

Sorainen

Pan-Baltic firm Sorainen is viewed as a young and aggressive practice that is making inroads on competitors, particularly in the banking and finance market. "They are very visible, and they have technical ability," says one competitor. "They have the resources to move quickly."

Clients are happy with the firm too, with one saying: "I have worked with them on two or three deals. We were very successful and had a good co-operation with them." Girts Ruda is the firm's star name, with the market acknowledging his ability.

Sorainen has managed to secure its own slice of the Latvian government's takeover of

Parex banka. The firm is representing the Latvian Privatisation Agency, the state joint-stock company and new shareholder in the bank. The mandate included advice on recapitalisation, procuring financial advisors and conducting negotiations with the European Bank for Reconstruction and Development over its acquisition of a stake in the new Parex banka.

Raiffeisen Zentralbank Österreich mandated Sorainen for advice on a real-estate acquisition facility and the firm also advised HSH Nordbank on a syndicated loan worth €22 million to Tallink Hotels.

Eva Berlaus-Gulbe is also leading a team that is advising If P&C Insurance on the cross-border merger of its Baltic companies using the EU cross-border merger directive.

Leading lawyers

Girts Ruda

Other ranked firms

Kronbergs & Cukste's presence is more noticeable in the market according to competitors, particularly on small-to-mid-level deals. The firm is seen as stronger on the banks' side and still picks up work from its old Ernst & Young connection.

Clients like the western approach the firm brings to its work: "They were, I would say, high level, very precise. We were satisfied with them," says one banking client. The firm is active on the regulation side, with a number of mandates from Danske Bank and Ernst & Young. Kronbergs & Cukste is also helping CNH Financial Services, part of the Fiat Group, to draft finance agreements and finance structure plans.

The firm worked on the buyer's side for Wilson in its purchase of Bolderajas Kugu Remonta Rupnica and worked the seller's side for Pirmais Brokeris on its sale to MAI Insurance Brokers.

Eversheds Bitans debuts in the third tier on the back of strong recommendations from the market. The firm has been a fully fledged member of the Eversheds network since April 2008 and should reap benefits from that connection.

Eversheds Bitans is another firm to win work on the back of Parex banka's troubles, advising Parex, the Mortgage and Land Bank of Latvia and the Latvian Privatisation Agency on various aspects of the case. The firm also represented the City of Riga in a handful of deals, including the financing and collateral for municipal projects and a swap agreement with an international bank. The latter deal involved Eversheds' London office.

Ventspils Nafta instructed Eversheds Bitans on the disposal of non-core assets val-

ued at €120 million, and advised the Veolia Group on its purchase of a majority stake in a Latvian waste company.

Other notable firms

Grunte & Cers has reformed as a law firm after its demerger from Loze Grunte & Cers. The reformed firm contains name partners Gundars Cers and Ivars Grunte and is supported by six associates.

The firm has already managed to work on some notable deals. Grunte & Cers advised construction company ACB on its merger with 8CBR and worked on the restructuring of Ergo Life in the Baltics, resulting in the formation of two new companies.