

## Case No 2010-60-01\*

### Name of the Court:

Constitutional Court

### Parties:

20 MPs (*Valērijs Agešins et al.*) v *The Parliament*

### Type of action/procedure:

Abstract constitutional control (Article 85 Constitution and Articles 16(1), 17(1)(3) and 28.<sup>1</sup> Constitutional Court Law)

### Legal questions:

Whether the Contested Norms comply with the principle of proportionality, the principle of legitimate expectations, the principle of good administration and that of an independent state (Article 1 Constitution) and the right to property (Article 105 Constitution).

### Legally relevant factual situation:

On 19 February 2009, 29 October 2009 and 1 April 2010, amendments to the Credit Institutions Law came into force. A regulatory framework regarding transition of credit institution undertaking to ownership or use of another person (hereinafter – transition of a credit institution undertaking) was introduced. The aim of this regulatory framework is to include those norms into the Credit Institutions Law that would regulate transition of a failing credit institution undertaking according to the procedure compliant to its work specificity. The Contested Norm provides:

#### *“Article 59.<sup>2</sup>*

*(1) Transition to ownership or use of a another person (hereinafter – transition of a credit institution undertaking) of a credit institution undertaking or a part thereof, including affiliates, body of divisible property or body of standard contracts concluded with clients of the credit institution (hereinafter – credit institution undertaking) shall require permission of the Financial and Capital Market Commission. To receive the permission, the credit institution shall submit to the Financial and Capital Market Commission a proposal to transfer the credit institution, assessment of value of assets and liabilities pertaining to the credit institution undertaking under circumstances of a functioning market attached thereto and performed, 30 days prior to submission of the proposal, by a person that is not included into the list of auditors of property investments. Such transition of a credit institution undertaking that not been granted permission of the Financial and Capital Market Commission shall be regarded as null and void.*

*(11) The provision of Section 20 (1) of the Commercial Law regarding joint responsibility of person transferring or obtaining the undertaking shall not be applicable to transition of financial service agreements of a credit institution undertaking.*

*(2) For transition of a credit institution undertaking after receipt of permission of the Financial and Capital Market Commission, it is not necessary to obtain*

*permission of creditors of a credit institution involved in transfer of a credit institution undertaking and other persons, including permission regarding validity of liabilities of the credit institution undertaking or a part thereof between these persons and obtainer of the credit institution undertaking, as well as permission regarding existence of related liabilities at the moment of transfer of the credit institution undertaking unless the proposal of transfer of a credit institution undertaking establishes otherwise.*

*(21) In case of transfer of a credit institution undertaking, provision of information to obtainer of the credit institution undertaking on creditors, debtors of the credit institutions and other persons, whose agreements pertain to the transferable credit institution or a part thereof shall not be regarded as non-observance of requirements of law.*

*(3) Transfer of a credit institution undertaking in respect to property of the credit institution located outside the territory of the Republic of Latvia shall be valid disregarding any other national law applicable to such property or certain articles, rights or liabilities thereof.*

*(4) Appeal against an administrative act issued by the Financial and Capital Market Committee regarding permission for the transfer of a credit institution undertaking shall not suspend its execution.*

#### *Article 593*

*(1) If pursuant to Section 111 (1) indent 6 of this Law, the Financial and Capital Market Committee has appointed an attorney who has been granted the authority referred to in Section 117 (1) indent 3 of this law, the attorney shall decide on submission of the proposal regarding transfer of a credit institution undertaking to the Financial and Capital Market Commission. The provision of Section 20 (1) of the Commercial Law regarding joint responsibility of the transferor and the obtained of the undertaking shall not be applicable to the obtainer of a credit institution undertaking. In case of such transition, the Financial and Capital Market Commission shall permit executing transfer of a credit institution undertaking provided that the transaction is performed in the interest of security and stability of credit institutions sector or that of credit institution depositors, and Provisions of Section 170 of the Commercial Law regarding bringing an action in favour of the society is not applied to such transfer.*

*(2) Transfer of a credit institution undertaking based on a decision of the attorney appointed by the Financial and Capital Market Commission shall not be regarded as null and void.*

#### *Article 594*

*(1) A decision regarding transfer of a credit institution undertaking in the frameworks of the procedure of liquidation of the credit institution shall be adopted by the liquidator.*

*(2) A decision regarding transfer of a credit institution undertaking in the frameworks of the procedure of liquidation of the credit institution shall be adopted by the administrator, and the provision of Section 20 (1) of the Commercial Law regarding joint responsibility of the transferor and the obtained of the undertaking shall not be applicable to the obtainer of a credit institution undertaking.*

#### *Article 117*

*(4) The attorney shall have the right to the following to execute his or her duties:*

*1) to issue binding orders to all structural units and employees of the credit*

*institution;*

*2) not to observe restrictions established in articles of associations, bylaws and regulations of the credit institution (in policy, procedure descriptions and other functioning instruments);*

*3) to submit a proposal to the Financial and Capital Market Commission regarding transfer of a credit institution undertaking, to perform expropriation or transfer of property, tangible or intangible property, agreements and liabilities of the credit institution, provided that the purpose of the above mentioned actions is to ensure repayment of investments made into the credit institution;*

*4) on behalf of the credit institution administration, to draw and confirm financial accounts of the credit institution.*

*Article 173*

*(4) Transition of the credit institution undertaking performed based Section 593 or the second pa of Article 54(9) of this Law cannot be regarded as null and void.*

*Article 185*

*1) The basic purpose of the bankruptcy procedure is to gain maximum income from sale of assets and property of the credit institution by thus ensuring utter satisfaction of claims of creditors.*

*(11) The purpose of this section can be reached by the administrator by performing transfer of a credit institution undertaking pursuant to the procedure established in the present Law.”*

### **Arguments of the parties:**

**Applicants:** The norms regulating legal status of the credit institution undertaking transfer institution and characteristic features of application thereof fail to comply with norms of the Constitution. The Applicants indicated that the Contested Norms have been adopted in haste; therefore the consequences were not properly assessed. The sole aim of the norms was to give an opportunity to the credit institution to avoid fulfilment of a part of its liabilities and avoid the principle *pacta sunt servanda*. Haste and insufficient involvement of experts has prevented the legislator to properly assess alternative solutions and establish a more lenient transition to the new regulatory framework.

By introducing the institution of transfer of a credit institution undertaking, the legislator has taken over the terms “undertaking” and “transfer”; however, it has conferred the terms another content that differs from the one mentioned in the Commercial Law. Neither has the legislator applied the principle of joint responsibility to this transfer period. Introduction of such regulatory framework that can be applied only to the process of transfer of a credit institution undertaking contradicts Article 1 of the Constitution because all share owners, creditors and clients of credit institutions had reasonable ground to trust the fact that, in a democratic state, the general legal principles would be applied when introducing a new regulatory framework.

In the norms of Article 593(2) and Article 173(4) of the Credit Institutions Law, the irreversible character of the administrative decision has been enshrined. The above mentioned norms do not provide a possibility either to appeal or contest the decision adopted by the attorney. Such procedure fails to comply with Article 92 of the Constitution because persons have no possibility to defend their rights and legal interests by applying effective legal remedies. The Applicants hold that the Contested Norms do not provide the possibility for shareholders or creditors of the credit institution to participate in preparatory and decision-

making process of the transfer of the credit institution. The Contested Norms provide a possibility, by implementing transfer of a credit institution undertaking in a procedure of one or several stages, to reduce the actual value of assets and cause losses to persons. According to the Applicant, the Contested Norms fail to establish clear criteria for inclusion of assets and liabilities into a credit institution undertaking.

***Respondent (the Parliament):*** By means of transfer of a credit institution undertaking, it is possible, by transferring liabilities of one bank towards depositors to another bank, to timely prevent a payment crisis in respect of the above mentioned depositors in a short term, to preserve a positive balance of payments in the long term, as well as to facilitate development and stability of financial and capital markets. Consequently, the restriction included in the Contested Norms does have a legitimate aim – protection of the rights of other persons and assurance of welfare of the society.

The Parliament indicated that, when assessing the restriction of the property right of shareholders, it is necessary to take into account the fact that usually shareholders themselves and their attorneys (for instance, board or council) would adopt a decision regarding application of the Contested Norms. Consequently, in many cases no rights would be restricted because the decision is taken by the owners themselves. The Contested Norms permit restructuring of a credit institution without prohibiting shareholders to implement their rights following from shares owned by them. Reduction in value or failure to regain their property (for instance, shares or sold capital) follows from the fact that the credit institution has certain financial difficulties. Although the law does not confer creditors the right to appeal or interfere with receipt of permission to execute transfer of a credit institution undertaking, the Parliament still holds that it neither deprives persons of the right to address the court according to a claim procedure and ask assurance or recovery of losses in case their legal interests are threatened and liabilities are not performed. Consequently, the Contested Norms do not contradict Article 92 of the Constitution. The Parliament rejected the argument of the Applicant regarding non-compliance of the Contested Norms with the principle of legitimate expectations. Article 1 of the Constitution does not prohibit the legislator to introduce a new legal regulatory framework and the institution to apply it to new legal relations in order to ensure adoption of decisions substantial for welfare of the society.

**Answer by the Court to the legal questions and legal reasoning of the Court:**

Article 16 of the Constitutional Court Law provides that the Constitutional Court shall adjudicate matters on compliance of other regulatory enactments or parts thereof with the norms (acts) of a higher legal force. Assessment of mutual conflicts between norms of equal legal force does not fall within jurisdiction of the Court. Consequently, the argumentation of the Applicants regarding non-compliance of the Contested Norms with the Commercial Law or the Civil Law does not need to be assessed. In the frameworks of the present case, the Constitutional Court assessed the compliance of the Contested Norms with legal norms of a higher force only, namely, with norms of the Constitution.

The transitional regulatory framework of the Credit Institutions Law was introduced on 19 February 2009 and amended on 29 October 2010. During adoption and coming into force of the Contested Norms, no credit institution undertakings were in the transfer process. Likewise, none of the creditors exercised the right to claim, based on the second sentence of Section 20 (1) of the Commercial Law, in respect to a credit institution undertaking that would have already been overtaken. Consequently, the Contested Norms are not appropriate

for such transfer of credit institution undertaking that would have taken place or initiated based on Section 20 of the Commercial Law. The new regulatory framework permits deviating from joint responsibility regulated in the Commercial Law and other rights of creditors before a credit institution undertaking is transferred. Persons had legitimate trust into an anticipated right rather than an already acquired one. Such expectations have to be protected; however, the extent of protection is less than the one in case the right would have already been acquired, namely, in case the transfer of a credit institution undertaking would have already been executed.

A transitional period was established for introduction of the Contested Norms. However, at the time of their adoption, no transfer of a credit institution undertaking took place, neither the conditions for exercise of the right to claim of creditors had set in as a result of transfer of a credit institution undertaking. ***Consequently, the legislator did not have the necessity to establish a transitional period for persons to be able to get adapted to the new situation.***

***The Contested Norm constitutes no infringement of the principle of legitimate expectations and therefore complies with Article 1 of the Constitution.***

It has been erroneously stated in the application that the Contested Norms provide a prohibition to appeal against the administrative act adopted by the Commission in case of transfer of a credit institution undertaking is not executed in accordance with law. Norms included into the contested law regulate general issues of transfer of a credit institution undertaking, including the issue regarding appeal against an administrative act adopted by the Commission, namely, permission to transfer a credit institution undertaking by only establishing that appeal against the administrative act shall not suspend execution thereof. However, in such cases, the administrative act issued by the Commission shall be appealed against pursuant to the provisions of Article 59.<sup>2</sup>(4) of the Credit Institutions Law. The regulatory framework included into the Credit Institutions Law provides a possibility to appeal against the administrative act, by means of which the Commission would permit transfer of a credit institution undertaking. ***Consequently, the Contested Norms do not cause infringement of the principle of good administration.***

Possible reduction of property value of shareholders or creditors of subordinate liabilities follows from the fact that a credit institution undergoes financial difficulties, and the likelihood of loss of all invested resources is directly related with commercial risk. However, the State does not guarantee the right of a person involved in a risky business activity to be protected from commercial risk. This principle is reflected in Article 195 of the Credit Institutions Law, according to which claims of shareholders of a failing credit institution are satisfied the last. Consequently, the State is not committed to undertake responsibility for such relationship.

***The Contested Norms do not provide for denial of property right without compensation or deprivation of any guaranteed income from any category of persons subject to law referred to in the application.*** The Constitutional Court has already concluded that reduction of property of shareholders and creditors of subordinate liabilities follows from the fact that a credit institution undergoes financial difficulties. Consequently, ***it is not possible to establish a causal relationship between the Contested Norms and possible negative property consequences of an individual. Consequently, the Contested Norms do not restrict the property right and do not contradict Article 105 of the Constitution.***

The Contested Norms prohibit recognizing a transaction as null and void. Namely, they prohibit the right to a certain legal remedy, namely, restoration of legal status of a concerned person by litigation by means of recognizing a transaction as null and void. *Consequently, the Contested Norms restrict the right of persons to a fair court. The restriction does have a legitimate aim, i.e. finitude of transfer of a failing credit institution undertaking, which protects rights of other persons and welfare of the society. The measure selected by the State is appropriate for reaching the legitimate aim, which is protection of the rights of other persons and assurance of welfare of the society. The Constitutional Court agrees that finitude of transfer of a credit institution cannot be assured by applying an alternative solution, it being equally effective and permitting reaching of the legitimate aim at the same quality.*

The Court held:

1) proceedings in respect to compliance of Article 59.<sup>2</sup>(3) of the Credit Institutions Law with Article 1 of the Constitution of the Republic of Latvia regarding the principle of an independent democratic state shall be terminated;

2) proceedings in respect to compliance of Article 59.<sup>2</sup>, 59.<sup>3</sup>, 59.<sup>4</sup>, Article 117(4)(3), Article 173(4) and Article 185(1) Prim of the Credit Institutions Law with Article 91 of the Constitution of the Republic of Latvia shall be terminated;

3) Articles 59.<sup>2</sup>, 59.<sup>3</sup>, 59.<sup>4</sup>, Article 117(4) indent 3, Article 173(4) and Article 185(1) Prim of the Credit Institutions Law do comply with Article 1, Article 90, Article 92 and Article 105 of the Constitution of the Republic of Latvia.

#### **Legal effects of the judgment/decision:**

The operative part of the judgment becomes a law one announced.

#### **Shortly describe the main outcome of the judgment/decision and its broader political implications.**

In general this case dealt with the formalization of the procedure on how to take over banks in case of crisis. When the Government overtook the Parex Bank, no clear procedure existed on how to do that and therefore the legislator amended the laws accordingly for future situations.

\* *The information concerning the case and the reasoning of the Court from <http://www.satv.tiesa.gov.lv/?lang=2> (last visited 18 Nov 2013)*