



THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

JUDGMENT

on behalf of the Republic of Latvia

Riga, 27 May 2021

in Case No 2020-49-01

The Constitutional Court composed of the Chairperson of the court hearing Sanita Osipova, Justices Aldis Laviņš, Gunārs Kusiņš, Daiga Rezevska, Jānis Neimanis, Artūrs Kučs and Anita Rodiņa,

following constitutional challenges filed by Rems Kargins,

pursuant to Article 85 of the Constitution of the Republic of Latvia and Section 16(1), Section 17(1)(11), Sections 19² and 28¹ of the Constitutional Court Law

at the court hearing held on 27 April 2021 examined the following case in a written procedure

‘On the compliance of Sections 8(1) and 8¹(2) and (3) of the Law on Control of Aid for Commercial Activity with Articles 1, 91, 92 and 105 of the Constitution of the Republic of Latvia’.

Statement of Facts

1. On 19 June 2014, the *Saeima* adopted the Law on Control of Aid for Commercial Activity (hereinafter also – the Control Law) in an urgency procedure, which came into force on 1 July 2014.

Section 8(1) of the Control Law: 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 the aid, observing the provisions laid down in the decision of the European Commission or 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.

The above provision has not been amended and its initial wording is in force.

The Law ‘Amendments to the Law on Control of Aid for Commercial Activity’ of 2 February 2017 which came into force on 2 March 2017 supplemented the Control Law with Section 8¹ which reads as follows:

‘(1) If a commercial company which is in financial difficulty and receives aid in accordance with the laws and regulations governing aid for commercial activity, not later than six months prior to the term of liquidation of the commercial company specified in the decision of the European Commission or in the national laws and regulations regarding the granting of aid, concludes that the aid for commercial activity has not been fully repaid and will not be repaid until the end of the term of the provision of the aid, the commercial company shall terminate the activity and shall initiate the liquidation procedure of the commercial company, taking into account the conditions provided for in Paragraphs Two and Three of this Section.

(2) Within the framework of the liquidation procedure initiated in accordance with Paragraph 1 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).

(3) 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.

(4) If a part of the aid for commercial activity is not recovered, following the liquidation of the commercial company, this part shall be cancelled in the amount specified in the Law on the State Budget for the current year.'

The above Section has not been amended and its initial wording is in force.

2. The Applicant – Rems Kargins (hereinafter – the Applicant) – holds that Section 8(1) and Sections 8¹(2) and (3) of the Control Law (hereinafter – the contested provision) is not in line with Articles 1, 91, 92 and 105 of the Constitution (*Satversme*) of the Republic of Latvia (hereinafter – the Constitution).

2.1. It follows from the applications that on 12 May 2008 the Applicant's mother and *AS Parex banka* signed an agreement on accepting and servicing a time deposit (hereinafter – the Time Deposit Agreement) with the principal deposit amount of EUR 15 million for the period of seven years with a fixed interest rate of 12 per cent p.a. On 13 May 2008, a supplement agreement was signed stipulating that the time deposit would be used as subordinated capital of the credit institution and forbidding early termination of the agreement and withdrawal of the time deposit before the date specified in the agreement except in the case of liquidation of the credit institution. On 19 June 2008, the Applicant, pursuant to a donation agreement, acquired the rights to the deposit placed pursuant to the Time Deposit Agreement and the rights arising from it.

As of the end of September 2008, *AS Parex banka* was the second largest credit institution in Latvia by the amount of assets, with its assets making 13.8 per cent of the total assets in the credit institution sector in Latvia. October 2008 saw

the start of deposit withdrawals from *AS Parex banka*, resulting in its capital adequacy falling below the required minimum, which continued to diminish rapidly. In November 2008, the Financial and Capital Market Commission, the Ministry of Finance and the Bank of Latvia found that *AS Parex banka* was facing an immediate risk of insolvency unless it received aid for commercial activities (hereinafter – the aid). On 4 November 2008, the State Chancellery received an application of the majority of *AS Parex banka* shareholders requesting aid for *AS Parex banka*. It was approved in principle by a Cabinet meeting.

On 10 November and 2–3 December 2008, voting shares of *AS Parex banka* were transferred to the Latvian State. Aid was granted to save the credit institution. On 15 September 2010, the European Commission adopted the decision declaring the aid provided compliant with the EU internal market. The European Commission Decision No 2015/162 of 9 July 2014 (hereinafter – Decision No 2015/162) declared that additional aid provided to *AS Parex banka* (*AS Reverta*) and *AS Citadele* was also compliant with the EU internal market.

2.2. In the opinion of the Applicant, the contested provision does not comply with the principle of legitimate expectations enshrined in Article 1 of the Constitution.

The Applicant had no grounds to expect, either at the moment of receipt of the donated rights to the deposit placed in accordance with the Time Deposit Agreement, or during the entire time period before the contested provision was adopted, that their right for repayment of the principal amount stipulated in the agreement might be affected by the aid provided to *AS Parex banka*. Legislation that was in force at the time was sufficiently well defined and stable to instil trust. It did not create additional commercial risks that creditors of credit institutions would need to take into account.

Hence, regulations in force as at 19 June 2008 and the conduct of the State following the commencement of provision of aid to *AS Parex banka* gave the Applicant legitimate, reasonable and justified expectations that their right to receive the principal amount stipulated in the above agreement would not be affected.

Allegedly, the inability to recover the amount loaned to *AS Parex banka* causes and will continue to cause significant damage to the Applicant. It is said that EUR 15 million is a significant amount of money for anyone, which can have an effect on their future life. It certainly affected the Applicant's choices in the period between 19 June 2008 and the time when the contested provision was adopted.

Section 8(1) of the Control Law applies to legal relations that had commenced six years before the provision came into force and that were to end less than a year after the coming into force of the provision. The legislature did not make provisions for a lenient transitional period, nor did it provide for any sort of compensation to the Applicant. Furthermore, the Applicant would not even be heard so as to find out if there were any possibilities of compensating the damage caused to them. It is alleged that the legislature did not prove an obvious and fundamental necessity to justify interference with the Applicant's legitimate expectations. And even if it were proved that restricting the legitimate expectations was aimed at protecting the public welfare, Section 8(1) of the Control Law is not in line with the proportionality principle.

Furthermore, it is alleged that Sections 8¹(2) and (3) of the Control Law are applied retroactively. These provisions came into force on 2 March 2017 and are applicable to an agreement with a due date of 12 May 2015. The legislature did not give reasons to justify retroactive application of Sections 8¹(2) and (3) of the Control Law. The infringement of the principle of legitimate expectations established by these provisions cannot be justified with the objective of protecting the public interests. If the Constitutional Court found that Sections 8¹(2) and (3) of the Control Law had no retroactive effect, there would be no doubt that they have an immediate effect and there is no transitional period or respective compensation.

2.3. The Applicant states that the contested provision is not compliant with Article 91 of the Constitution.

It is claimed that all persons holding subordinated liabilities in enterprises receiving aid are in equal and, according to specific criteria, comparable circumstances, regardless of whether the enterprise is a credit institution. Also a credit institution receiving aid, allegedly, is obliged to observe the burden-sharing

principle to the same extent and in the same manner as other enterprises receiving aid. In respect of the same loan the Applicant faces both a situation where aid was provided to *AS Parex banka* as a credit institution, and a situation where this aid was provided to an enterprise.

Both Section 8(1) of the Control Law and Section 59⁶(1) of the Credit Institution Law prohibit fulfilling subordinated liabilities from the moment of granting the aid to the end of the provision of the aid. However, pursuant to Section 8(1) of the Control Law, the above restriction is applicable ‘irrespective of the moment when the subordinated liabilities were established’. Application of Section 59⁶(1) of the Credit Institution Law is restricted by Paragraph 36 of the Transitional Provisions of this law, according to which the prohibition does not apply to credit institutions that were granted aid pursuant to aid-related legislation prior to the coming into force of the legal provision in question.

If Sections 8¹(2) and (3) of the Control Law are also applicable to credit institutions, the legal consequences of these provisions affect credit institutions differently than other enterprises, and this difference is significant. Pursuant to Section 59⁶(1) of the Credit Institution Law and Paragraph 36 of the Transitional Provisions, obligations to subordinated creditors of credit institutions may have already been fulfilled by the time of commencement of the liquidation procedure, and restrictions imposed by Sections 8¹(2) and (3) of the Control Law would not affect them.

The differential treatment established by the contested provisions is unrelated to the theoretical differences between credit institutions and other enterprises. The differential treatment is solely a result of the actual situation that developed in connection with the provision of aid to *AS Parex banka*.

According to the Applicant, if their subordinated liabilities had been transferred to *AS Citadele banka* rather than *AS Reverta*, they would continue to be protected by Paragraph 36 of the Credit Institution Law and would have already been repaid the principle amount of the loan. When adopting the contested regulation, the legislature intentionally made it applicable only to enterprises other than credit institutions, so that the contested provision may only be applicable to *AS Reverta*.

2.4. In the opinion of the Applicant, the contested provision does not comply with the principle of separation of powers enshrined in Article 1 of the Constitution and Article 92 of the Constitution.

The Applicant's civil claim with regard to terminating the Time Deposit Agreement and recovery of the principle amount of the deposit from *AS Reverta* was declined only because the contested provision had been adopted. It is claimed that materials pertaining to the drafting of Section 8(1) of the Control Law indicate that the legislature had intended to achieve exactly this outcome with the contested provision. By adopting Sections 8¹(2) and (3) of the Control Law, the legislature also intentionally interfered with legal relations the court's assessment of which was given in Civil Case No C04433312. Allegedly, there is no doubt that the legislature's intention, when adopting Sections 8¹(2) and (3) of the Control Law was to prevent repayment to the Applicant of the amount disputed in the above civil case.

Therefore, it is clear that, by adopting the contested provision, the State, essentially, achieved a resolution in the civil case under the court's examination in its favour. Such conduct by the State contradicts the very essence of the principles of separation of powers and a fair trial because it deprives the Applicant of any possibility to protect their rights in the civil case.

The general objective of the contested provision, i.e. to ensure observation of the burden-sharing principle, cannot justify interference with adjudicating the civil case caused by the provision. It is alleged that there is no evident or fundamental public necessity that would justify the legislature's interference with the court proceedings.

2.5. In the opinion of the Applicant, the contested provision is not compliant with Article 105 of the Constitution.

The claim for repayment of the principal amount of the loan by *AS Reverta* constitutes property in the meaning of Article 105 of the Constitution. The contested provision involves expropriation of property and is therefore to be considered in accordance with provisions of the fourth sentence of Article 105 of the Constitution.

On the grounds of Section 8(1) of the Control Law, the Applicant, in essence, has been denied any right to dispose of their property for more than five years already. The actual expropriation of property, which has already occurred pursuant to Section 8 of the Control Law, will inevitably be finalised when *AS Reverta* is excluded from the public registers in accordance with Section 8¹(3) of the Control Law, without fulfilling its obligations to the Applicant.

The Applicant's right to recover their funds or interest is not just temporarily restricted; their right to property that they could use is no longer preserved at all. As a result of the contested provision, the Applicant completely and irreversibly lost their property – a claim for recovery of EUR 15 million deposited in *AS Parex banka*.

The loss of the Applicant's property was not caused by an insolvency procedure or any other reason associated with a business risk. It was lost as a result of a law adopted by the State. Such conduct by the State cannot be deemed a business risk that an entrepreneur has to take into account and it cannot be deemed a result of market factors.

The Applicant's property was not expropriated in a procedure laid down in the fourth sentence of Article 105 of the Constitution.

It is the Applicant's opinion that, unless it can be established that the contested provision falls within the scope of the fourth sentence of Article 105 of the Constitution, it does not comply with the first three sentences of Article 105 of the Constitution.

Allegedly, the principle of good legislation was not observed when adopting the contested provision. When adopting Section 8(1) of the Control Law, the legislature, allegedly, did not conduct any explanatory studies, social impact assessment, risk forecasts or evaluations. Section 8(1) of the Control Law was adopted with such an urgency that it was impossible for the legislature to conduct any in-depth analysis even in theory. There was no objective necessity for the contested provision.

Furthermore, materials pertaining to the drafting of Sections 8¹(2) and (3) do not indicate that compliance of these provisions with the case law of the Court of Justice of the European Union was assessed, and the respective study and risk

assessment with regard to the damage that these provisions would cause the Applicant were not conducted either.

Likewise, the legislature did not consider all measures necessary for implementing and enforcing the contested provision. There were justified grounds to expect that, by the time it started providing the aid, Latvia would have assessed if the provision made it possible to implement measures required for the granting of such aid and what amendments to the provision it would require.

The contested provision is intended as a means of ensuring that the burden-sharing principle is observed, and it follows that its legitimate objective consists in protecting the public welfare. The Applicant emphasises that the legitimate objective of the contested provision does not consist in observing Latvia's obligations arising from its membership in the EU, because the EU law did not require Latvia to adopt the contested provision. Neither the Treaty on the Functioning of the European Union (hereinafter – the TFEU), nor any other EU legal provision directly requires that the principle of the distribution of powers be observed.

The contested provision is not an appropriate means of introducing the principle of the distribution of powers. The burden-sharing measures must ensure that the 'no creditor worse off principle' is observed; namely, it needs to be ensured that creditors of liabilities subordinated as a result of these measures do not suffer greater loss than they would have suffered if no aid had been provided. This principle requires assessing the situation of the creditor as it would have been if the State had not interfered, rather than making the situation of the creditor entirely dependent on results of the State's interference, both successful and unsuccessful ones.

It is the opinion of the Applicant that the contested provision does not ensure observance of the above principle because the provision does not limit the amount of subordinated liabilities that may not be fulfilled to the amount of liabilities that would not have been fulfilled if the aid had not been provided. Likewise, the contested provision does not set forth any limiting criteria and does not even require assessing the creditor's situation in the case if no aid is provided to the enterprise. In order to implement the burden-sharing measures correctly, the

State had to make a precise estimate of the loss the Applicant would have suffered if no aid had been provided to *AS Parex banka* and *AS Parex banka* had been placed in insolvency procedure. If the aid had not been provided, the Applicant would have received at least partial repayment of the deposit in a ‘normal’ insolvency procedure.

The legislature did not make a proper assessment of whether the legitimate objective of the contested provision could be achieved by more lenient means. A unilateral default on subordinated liabilities, initiating the enterprise’s insolvency procedure or its liquidation are not alternative solutions to observe the burden-sharing principle but merely considerations as to what would have happened had the the contested provision not been adopted.

In the opinion of the Applicant, the legitimate objective of the contested provision could have been achieved more efficiently if Latvia had assessed its legislation and amended it as necessary prior to providing aid to *AS Parex banka*. Adopting the contested provision, which was neither timely nor consistent on the part of the State, caused adverse consequences for the Applicant.

The legitimate objective of the contested provision could have been achieved by including in it the ‘no creditor worse off principle’, i.e. by stipulating that the amount that is not paid to subordinated creditors pursuant to the contested provision may not exceed the amount that the subordinated creditors would not have been able to recover if the aid had not been provided.

Likewise, the legitimate objective of the contested provision could have been achieved by making provisions for writing down the subordinated liabilities on the basis of an agreement or in return for a fair compensation in accordance with the law. It would have allowed implementing the burden-sharing measures by way of negotiation, assessing the individual situation of a subordinated creditor and to make an estimate of the value of their subordinated liabilities as they would have been if the aid had not been provided.

The contested provision allegedly caused a significant and irreversible infringement of the Applicant’s right to property, affecting the rest of their life. At the same time, the enterprise’s benefit from applying this provision is purely

financial and is relatively small compared to the national budget funds used to provide aid to *AS Parex banka*.

The consequences of the contested provision cannot be attributed to business risks that the Applicant could and had to anticipate. The infringement of the Applicant's right has been directly and solely caused by the State's actions, i.e. by adopting the contested provision. If any previously unanticipated amendments to legislation could be deemed as the onset of a business risk, the rights enshrined in Article 105 of the Constitution would become declaratory and meaningless.

The application of the contested provision resulted in a situation where only some depositors of *AS Parex banka* participated in the burden-sharing, whereas the depositors whose deposits had been transferred to *AS Citadele banka* did not participate in the burden-sharing at all. Therefore, the contested provision caused individual and gross infringement of the rights of the Applicant as an individual.

The Applicant was definitively and irreversibly denied the rights enshrined in Article 105. A situation where the deposit may be repaid is no longer legally possible. In this case, there are no public interests whose significance could justify such infringement.

Upon review of materials in the case, the Applicant adds that the contested provision is to be assessed in the context of the actual circumstances which its adoption was intended to address and in which it was adopted. The Applicant also repeatedly emphasised a number of their arguments already expressed in their applications. In addition, a request was made to refer to the Court of Justice of the European Union for a preliminary ruling.

3. In the opinion of the body issuing the contested legislation – the *Saeima* – the contested provision is in line with Articles 1, 91, 92 and 105 of the Constitution.

3.1. The contested provision was adopted in order to fulfil Latvia's commitments approved by Decision No 2015/162. When adopting the decision, the European Commission assessed the compatibility of the aid provided with the EU internal market on the basis, inter alia, of its Communication of 30 July 2013 on the application, from 1 August 2013, of State aid rules to support measures in

favour of banks in the context of the financial crisis (hereinafter – the Banking Communication). The European Commission is the body which takes the final decision with regard to the compatibility of aid with the EU internal market, it has extensive discretion on the issue, and it is obliged to observe the rules of the above Communication; therefore, it would not have been reasonable if in exercising its commitments Latvia did not follow the Banking Communication.

The burden-sharing principle derives from the Banking Communication. The burden-sharing principle in the aid-related EU law had existed also before the adoption of Decision No 2015/162 and it was reflected in documents adopted by the European Commission and in the legal doctrine. Inter alia, according to this principle, subordinated creditors lose all their funds invested in the rescued enterprise. The burden-sharing principle is based on the view that the provision of aid to enterprises facing difficulties is to be regarded as the last resort when all other measures have been exhausted.

3.2. In the opinion of the *Saeima*, the Applicant's reliance on repayment of the principal amount of the subordinated loan is neither legitimate, nor justified and reasonable.

At the time when the subordinated loan was made and the Applicant obtained the right to claim repayment of the loan, there existed no legal provisions that would guarantee that the Applicant would be repaid the principal amount of the subordinated loan in case *AS Parex banka* terminated its operations.

The Applicant did not mention any circumstance that would have enabled them to justifiably and reasonably expect that *AS Parex banka* would have really been able to repay them the subordinated loan of EUR 15 million in seven years' time.

3.3. In the opinion of the *Saeima*, the contested provision does not establish differential treatment of groups of persons who are in equal or, according to specific criteria, comparable circumstances.

Section 8(1) of the Control Law makes provision for the same restriction as Section 59⁶(1) of the Credit Institution Law. These provisions do not establish differential treatment of groups of persons who are in equal or, according to specific criteria, comparable circumstances. Furthermore, Paragraph 36 of the

Transitional Provisions of the Credit Institution Law allegedly applies only to *AS Parex banka*. All subordinated creditors of *AS Parex banka* were treated equally because *AS Parex banka* could fulfil subordinated liabilities until the effective date of Section 8(1) of the Control Law. After the coming into force of the provision the fulfilment of the liabilities was no longer possible.

For the same reasons, Sections 8¹(2) and (3) do not establish differential treatment of groups of persons who are in equal or, according to specific criteria, comparable circumstances.

3.4. The *Saeima* states that the contested provision is in line with the first sentence of Article 92 of the Constitution.

It is stated that the objective of the contested provision was not resolving the dispute in Civil Case No C04433312 in favour of *AS Reverta*. According to Decision No 2015/162, one of the conditions for declaring the provided aid compatible with the EU internal market was adopting legislation to ensure that, in accordance with the burden-sharing principle, no subordinated liabilities be fulfilled until the aid was repaid in full. The above condition comprised also an obligation to adopt the contested provision in such a way that it applied also to the Applicant's subordinated liabilities, i.e. so that these subordinated liabilities might not be fulfilled until the aid was repaid in full.

The adoption of any legal provision is based on circumstances that have necessitated the adoption of this provision, and these circumstances may also be individual. This was the case when adopting the contested provision where requirements of Decision No 2015/162 with regard to the State aid to *AS Parex banka* and *AS Citadele banka* were taken into account.

The Applicant's claim against *AS Reverta* for repayment of the principal amount of the subordinated loan was declined pursuant to Section 8(1) of the Control Law. Neither the Civil Cases Department of the Supreme Court nor Riga District Court made reference to Sections 8¹(2) and (3) of the Control Law.

The legislature cannot ensure that, before a provision is adopted, no one will have brought action before the court in connection with the legal relations that are to be governed by the specific provision. However, before adopting the law the

legislature can and must consider the time of the coming into force of the legal provisions. The legislature has significant discretion on this issue.

The Constitution does not prohibit the legislature to adopt provisions with immediate effect and retroactive force even in cases where the legal relations that are to be governed by the respective provision are subject to legal proceedings. The Constitution requires that all interests involved in the specific case be fairly balanced. This was done when adopting Section 8(1) of the Control Law.

The legal relations affected by Section 8(1) had already been established by the time of coming into force of this provision. This provision was not adopted as an end in itself, but rather to comply with the EU aid-related law and to ensure that the aid provided is compatible with the EU internal market.

The interests in preventing the fulfilment of subordinated liabilities such as the Applicant had before the coming into force of Section 8(1) of the Control Law until the State aid was repaid in full prevailed over the interests of persons such as the Applicant in fulfilment of the subordinated liabilities irrespective of the full repayment of the State aid.

3.5. The *Saeima* does not agree with the Applicant that the contested provision was used to expropriate their property. The contested provision does not fall within the scope of the fourth sentence of Article 105 of the Constitution.

There is no causal link between the contested provision and the fact that the Applicant has not been repaid and, in all likelihood, will not be repaid the principal amount of the subordinated loan. In respect of subordinated creditors, the contested provision only ensures that they do not gain further unjustified benefit from the aid provided and that the State aid is repaid first. The financial difficulties faced by *AS Parex banka* is the reason why the Applicant has not been and, most likely, will not be repaid the amount in question.

The right of claim makes it possible to request fulfilment of these liabilities, but does not guarantee their fulfilment. There are various risks that may affect the fulfilment, and financial difficulties of the person responsible for the fulfilment of the liabilities is one of such risks. Furthermore, the risk of financial difficulties specifically applies to unsecured liabilities. Financial difficulties are to be deemed

a business risk which needs to be taken into account by any unsecured creditor, and especially a subordinated creditor.

There are no grounds to claim that subordinated creditors were not aware of, or did not have to be aware of, the fact that they assumed the risk. At the time of signing the Time Deposit Agreement, Paragraph 4 of Section 193 of the Credit Institution Law was in force from which it followed that, in the case of insolvency of a credit institution, claims of subordinated creditors were only to be fulfilled after claims of all other creditors but before claims of shareholders, if funds of the credit institution are sufficient.

If Latvia had not provided aid to *AS Parex banka*, subordinated creditors would have suffered loss. It would have resulted in a situation triggering insolvency of the credit institution. In this situation, Paragraph 4 of Section 193 of the Credit Institution Law would have applied and the subordinated liabilities in all likelihood would not have been fulfilled. The reason for the non-fulfilment of the liabilities would have been financial difficulties faced by *AS Parex banka*. However, *AS Parex banka* received aid.

The Applicant's right to property was infringed by Section 8(1) of the Control Law in order to ensure that the aid was repaid first. Sections 8¹(2) and (3) do not infringe the Applicant's right to property because these provisions do not give rise to any specific procedure applicable to credit institutions facing financial difficulties; specifically, these provisions do not require that rules laid down in the Insolvency Law are applicable to such credit institutions. Furthermore, Section 8¹(2)(3) does not infringe the Applicant's right to property because it is applicable to members of the enterprise.

Before adopting the contested provision, its compliance with Article 105 of the Constitution had been assessed by the Ministry of Finance and the Ministry of Justice. The mere fact that the Applicant disagrees with this assessment does not mean that no assessment was made.

The Constitution does not imply a legal standard requiring that studies, social impact assessment and risk assessment measures are conducted and other analytical tools are used. They may improve the quality of legislation, but they cannot be deemed mandatory for any provision adopted by the *Saeima* to be

deemed a duly adopted law. The restriction of fundamental rights introduced by the contested provision was determined by a duly adopted law.

The infringement of the Applicant's right to property is aimed at ensuring the public welfare. Given that the contested provision was adopted in order to comply with the EU law, its objective is also to protect the democratic regime.

The contested provision ensures that the rules of EU aid-related law are complied with and the enterprise which has received aid repays it as far as possible. The recovered funds are transferred to the national budget and used for the benefit of the public. Hence, the contested provision is applied in order to achieve legitimate objectives.

A deposit that gives rise to subordinated liabilities differs significantly from a deposit that does not give rise to such liabilities. In essence, subordinated liabilities are considered a loan by the owner of the funds to the credit institution with specific conditions laid down by the law. The protection level of subordinated creditors of credit institutions is considerably lower than the protection level of other clients, i.e. depositors. By making a loan to a credit institution, a subordinated creditor voluntarily assumes a higher risk that they may not receive the principal amount of the subordinated loan in the case of liquidation or insolvency of the credit institution.

The legislature assessed if there were more lenient means to achieve the legitimate objectives. Two alternative means were assessed when adopting Section 8(1) of the Control Law: a unilateral default on subordinated liabilities and initiation of an insolvency procedure. But none of them would have enabled achieving the legitimate objectives with the same quality. They would not have ensured that the aid was repaid in the same amount that Section 8(1) of the Control Law did; neither would they have ensured that provisions of the EU law were complied with and would have violated Decision No 2015/162. They would have put in danger operations of the enterprise and society as a whole, and would also have placed the Applicant and other subjects of subordinated liabilities in an even more unfavourable situation.

Two alternative means were assessed when adopting Sections 8¹(2) and (3) of the Control Law: the initiation of a liquidation procedure of the enterprise

pursuant to the Commercial Law and the initiation of an insolvency procedure. These means were not found to be more lenient either, because they would have contradicted Decision No 2015/162 and the burden-sharing principle, and would not have ensured repayment of the aid in the same amount as Sections 8¹ (2) and (3) of the Control Law.

The means suggested by the Applicant cannot be deemed more lenient means of achieving the legitimate objectives. They would either have placed the Applicant in an even less favourable situation or would not have ensured repayment of the aid in the same amount as the contested provision, and would also cause violation of Decision No 2015/162.

The State does not guarantee protection against business risks. The Applicant would have suffered loss even if the contested provision had not been adopted. However, interest was paid up until the coming into force of Section 8(1) of the Control Law. In this way, subordinated creditors gained benefit from the provided aid.

In the opinion of the *Saeima*, the fact that the aid was declared compatible with the EU internal market was in the interests of society as a whole. Likewise, the appropriate use of the national budget funds and recovering these funds as quickly as possible is in the interests of society as a whole. The benefit gained by society exceeds the damage to the Applicant's right to property.

3.6. Having reviewed materials in the case, the *Saeima* adds that, in essence, the Applicant wishes to gain a more favourable position than they would have had if no aid had been granted to *AS Parex banka* and the credit institution had been declared insolvent. Namely, they wish to achieve full or partial repayment of the subordinated loan from the amount of aid granted to *AS Parex banka*, even though the loan would not have been repaid even partially if the aid had not been granted.

4. In the opinion of the joined party – the Ministry of Finance – the contested provision is in line with Article 105 of the Constitution. The legitimacy of the respective restrictions was assessed in the process of drafting and adopting the provision. The contested provision does not affect other rights or freedoms enshrined in the Constitution.

The objective of Section 8(1) of the Control Law is to prohibit the fulfilment of subordinated liabilities from the moment aid is granted until its provision ends, while complying with the EU law, in order to ensure that the enterprise that has been granted aid repays the aid first. The objective of Sections 8¹(2) and (3) of the Control Law is, while complying with the EU law, to ensure that even if operations of the enterprise that has been granted aid is to be terminated and a liquidation procedure is to be initiated, the aid provided is repaid first to the extent possible. In this way it is ensured that State funds invested in the form of aid are repaid to the national budget as soon as possible. This objective is in line with society's interests.

The obligation to ensure adequate burden-sharing by shareholders and subordinated creditors for the purposes of granting the aid derived from numerous sources of EU law even before Decision No 2015/162 was adopted: it was established in the primary EU legislation, i.e. the TFEU, in secondary legal instruments of the EU Council and the European Commission, including the Banking Communication, and in the general principles of the EU law and case law of the Court of Justice of the European Union.

The principles enshrined in the Communications of the European Commission are implemented and become binding on the Member States via decisions of the European Commission adopted in respect of the specific Member State. In this specific case, recital 70 of Decision No 2015/162 contained the requirement and Latvia made numerous commitments aimed at implementing the burden-sharing principle (*see recitals 73, 165 and 166 of Decision No 2015/162*). These specific commitments were largely the reason why the European Commission declared the aid granted by Latvia compatible with the internal EU market.

The contested provision was adopted in order to fulfil these commitments, and its compatibility with EU law, including the EU internal market, was already assessed and approved by Decision No 2015/162.

The burden-sharing principle is one of the principles used to decide on compatibility of aid with the EU internal market, and the Member State's discretion in the application of this principle is restricted. According to this principle, aid to

enterprises that face difficulties can only be granted if their members and subordinated creditors first cover in full the enterprise's loss existing before granting the aid from their own resources. It also means that subordinated creditors lose all their funds invested in the rescued enterprise. The burden-sharing principle is based on the view that aid is to be regarded as the last resort when all other measures have been exhausted.

If Latvia had not granted aid to *AS Parex banka*, it would have resulted in a legal situation that required liquidation of the credit institution. Pursuant to Section 139³(4) of the Credit Institution Law, the fulfilment of claims of subordinated creditors would not have been possible because these creditors take the lowest place in the creditors' hierarchy which is only above the shareholders' claims. In comparison with the legal situation requiring liquidation, granting aid to *AS Parex banka* allowed interest to be paid to the subordinated creditors.

The Ministry of Finance notes that subordinated loans issued by *SIA Publisko aktīvu pārvaldītājs Possessor (Public assets manager Possessor)* (hereinafter – *Possessor*) and the European Bank for Reconstruction and Development (hereinafter – EBRD) were transferred to *AS Citadele banka*. However, these loans were issued after the majority of shares of the credit institution had already been transferred to *Possessor*. All other subordinated liabilities were kept at *AS Reverta*. In this way, all subordinated liabilities subject to the burden-sharing principle derived from recital 165 of Decision No 2015/162 and which were related to former majority shareholders of *AS Parex banka* and holders of subordinated liabilities were concentrated in *AS Reverta*.

Insolvency cannot provide an adequate alternative so that the principle of fair burden-sharing may be observed. Taking into account the fact that the aid is, in essence, taxpayers' money, it is necessary to ensure that it has priority over claims of other creditors. It requires preventing situations where creditors of subordinated liabilities gain unjustified benefit from granting the aid.

The legitimate objective of the restriction of fundamental rights established by the contested provision is ensuring the public welfare. The restrictions applicable to the aid seek to ensure not only that Latvia as an EU Member State fulfils its commitments, but also that the principle of equality enshrined in the

Constitution is observed. Aid provided to an enterprise protects the entire society from the negative consequences that could result from unsuccessful management of the enterprise and its subsequent insolvency. By granting the aid, the State gains a controlling influence over the enterprise's funds, wherefore the State has to ensure that the enterprise is managed in a way that protects society's interests best. Restricting the enterprise's possibility to fulfil subordinated liabilities ensures that the aid is used in the interests of the enterprise, namely, for restructuring the enterprise and restoring its normal operations. In this way it also ensures that the State funds invested in the enterprise are, as much as possible, used in the interests of the enterprise and recovery of the invested State funds is facilitated. Legal provisions ensure protection of the interests of society and taxpayers.

The *Saeima* considered alternative means that could have ensured recovery of the funds invested in the enterprise to the maximum extent. However, none of them would have achieved the legitimate objective with equal quality. They would not only have put the enterprise's operations and, therefore, the enterprise as a whole in danger, but would also have caused an even less favourable situation for the subordinated creditors.

Subordinated creditors agreed to the provision whereby they were entitled to request an early repayment of the loan only in the case of insolvency or liquidation of the enterprise and after the fulfilment of claims of all other creditors, but before the fulfilment of claims of members or shareholders. Therefore, subordinated creditors had to assume co-responsibility if the enterprise faced financial difficulties. The subordinated creditors retain their right to claim.

The contested provision does not violate the principle of legitimate expectations enshrined in Article 1 of the Constitution. Options with regard to the time of coming into force of the provisions were considered when drafting the legislation. The requirement for the timely coming into force of these provisions was connected with the fact that it was necessary to comply with Decision No 2015/162 and to ensure that the aid was compatible with the EU internal market.

Issuing special rules for enterprises receiving aid is justified by significant interests of taxpayers and society as a whole, namely, preventing the use of aid

funding to cover subordinated liabilities instead of repayment of the aid received. If such special rules were not prepared and adopted, claims of the subordinated creditors would be fulfilled before repayment of the aid (most likely, in the course of an insolvency procedure initiated by the subordinated creditors). It would result in the State's failure to recover the amount of the aid, in contradiction to the Decision of the European Commission and the burden-sharing principle.

Allegedly, the objective of the contested provision was not resolving the dispute in Civil Case No C04433312 in favour of *AS Reverta*. The contested provision applies in equal measure to any enterprise that receives aid. Section 8(1) of the Control Law equally applies to all enterprises that continued to receive aid or were granted aid after the coming into force of this provision. The contested provision does not establish differential treatment of groups of persons who are in equal or, according to specific criteria, comparable circumstances.

The right of claim makes it possible to request fulfilment of these liabilities, but does not guarantee their fulfilment, because there exist various risks that may affect the fulfilment. Financial difficulties faced by the persons responsible for the fulfilment of the liabilities are among such risks. Furthermore, the risk of financial difficulties specifically applies to unsecured liabilities. Subordinated creditors especially need to take into account the risk that the liabilities may not be fulfilled if the enterprise faces financial difficulties.

A deposit whereby subordinated liabilities are established in the credit institution differs from a regular deposit in that its position in the creditors' hierarchy is below a secured deposit, because the person making such a deposit participates in covering the enterprise's loss in the case of its liquidation. A deposit whereby subordinated liabilities are established is associated with a greater risk because the probability that the credit institution defaults on these liabilities is higher. However, the person gains greater benefit for such a deposit, i.e. the interest rate is higher. According to the theory of finance, higher return on deposits is associated with a higher degree of risk.

5. In the opinion of the joined party – the Ministry of Justice – the contested provision is in line with Articles 1, 91, 92 and 105 of the Constitution.

The contested provision does not deprive the Applicant of their right to property in the meaning of the fourth sentence of Article 105 of the Constitution. The contested provision infringes the subordinated creditors' right to property enshrined in the first three sentences of Article 105 of the Constitution.

The requirement to adopt the contested provision derived from the EU law. The objective of adopting the contested provision consisted in implementing the burden-sharing principle and preventing subordinated creditors from gaining unjustified benefit from the aid provided to the enterprise. The contested provision ensures that subordinated creditors assume a burden in proportion with the taxpayers' burden during the period of provision of the aid and that the State fulfils its commitments approved by Decision No 2015/162.

The contested provision establishes the procedure for the fulfilment of creditor's claims and does not stipulate that subordinated creditors may be deprived of their right. The contested provision does not comprise any obstacles preventing subordinated creditors, including the Applicant, from using their claim right; moreover, it does not stipulate expropriation of the claim right. Successful recovery of the principal amount of the deposit by the Applicant depends on the financial situation of *AS Reverta*. It should be remembered that, as in any legal relations, everything depends on the ability of the other party to meet their contractual obligations. Business is associated with risk, and it is possible that a debtor may be unable to meet their liabilities. This risk is even greater if the loan is transferred to the subordinated capital.

The Ministry of Justice doubts the Applicant's view that granting aid to *AS Parex banka* made their position worse. *AS Parex banka* faced significant financial difficulties and if it had not been granted aid, the Applicant's position would be worse than it currently is. Neither liquidation, nor insolvency rules which would have applied in that case would have allowed the payment of interest.

The restriction of the Applicant's right to property is connected with the protection of the rights of other creditors, including the State.

The contested provision was established by a duly adopted law, i.e. a law adopted in accordance with a procedure laid down in legislation, promulgated and publicly available in accordance with the law, and is formulated with sufficient

clarity. The Ministry of Justice doubts that the legislative procedure would have resulted in a different decision if the legislature had more thoroughly considered the fundamental rights restriction established by the contested provision and all the observations made and had conducted additional studies and risk assessment measures.

In the opinion of the Ministry of Justice, the principle of good legislation was not violated in the process of adopting the contested provision. It cannot agree with the claim that the legislature did not consider the compliance of the provision with the EU law, because with the contested provision the State had to implement the burden-sharing principle which it had committed to implement by 30 April 2015 in accordance with Decision No 2015/162. Likewise, the extent of discussions during the legislative procedure does not give reason to believe that the provision was not adopted in accordance with a due procedure. The fact that MPs for subjective reasons did not use their right to speak gives no reason to assume that the principle of good legislation was not observed.

The legislature adopted the contested provision in accordance with the principles of a rational legislature and integrity of the legal system. Rules established by the contested provision are closely interrelated. Section 8¹ of the Control Law logically follows from Section 8 of the same law, which corrects shortcomings in the legal provision.

The legitimate aim of the contested provision is ensuring the public welfare. The provision in question enables achievement of this objective because the means chosen by the legislature is in line with the international obligations of Latvia. A similar provision that enables liquidating an enterprise before the fulfilment of all creditors' claims already exists in the Credit Institution Law and the Insolvency Law, and therefore it can be deemed consistent with the Latvian legal system.

The benefit gained by society significantly exceeds the adverse consequences caused to the Applicant, because the contested provision enables the State to make sure that the funds used to provide the aid are repaid to the State Treasury and thus become available for use in the interests of the public and that subordinated creditors do not gain unjustified benefit from the State aid. Such

provision ensures legal stability and prevents the outflow of national funds, and therefore promotes the interests of society as a whole.

The legitimate objective of the contested provision could not have been achieved by more lenient means. Rules of insolvency procedure or liquidation procedure would have contradicted Decision No 2015/162 and would not have ensured the repayment of the aid in the same amount as the contested provision. The alternative means suggested by the Applicant would not have allowed achievement of the legitimate objective either.

The Ministry of Justice notes that the Applicant's legitimate expectations that they would retain the right to repayment of the principal amount of the deposit are affected by the contested provision. The adoption of the contested provision does not result in a situation where the Applicant cannot recover the principal amount of the subordinated loan due. The contested provision only establishes, firstly, the sequence in which the enterprise fulfils its liabilities to creditors, subordinated creditors and shareholders and, secondly, determines the procedure in cases where the enterprise is unable to meet its liabilities.

The provision of aid for enterprises cannot be deemed a regular event, which is why the State obtains the status of a creditor with the contested provision and, along with other creditors, takes a higher position in the creditors' hierarchy than subordinated creditors. This follows also from the burden-sharing principle. For that reason, claims by the State are to be fulfilled as a matter of priority, whereas claims of subordinated creditors can only be fulfilled after that.

The priority of fulfilment of claims of subordinated creditors, including the Applicant's claim, remains unchanged, i.e. they are still to be fulfilled after the claims of all other creditors, but before those of shareholders. This priority is also in line with the Time Deposit Agreement.

The ability of the Applicant to recover the principal amount of the deposit depends on the financial situation of the enterprise rather than the contested provision, and, therefore, the contested provision does not violate the legitimate expectations with regard of retaining the existing right.

Latvia gave no guarantee that legal provisions with regard to aid control would not be amended or supplemented in the future. Therefore, the Applicant

could not expect that the Control Law would never be amended and they could have no legitimate expectations with regard to retaining the specific right or the possibility to exercise it.

Section 8(1) of the Control Law was adopted on 19 June 2014 and came into force on 1 July 2014; however, after the provision came into force, specifically on 13 June 2016, a judgment in a civil case was made that upheld the Applicant's claim in full. It follows that Section 8(1) did not affect the outcome of the civil case two years after it came into force. Furthermore, the Applicant's claim was not declined on the basis of Sections 8¹(2) and (3) of the Control Law.

The comparable group of persons are subordinated creditors in an enterprise receiving aid, specifically in *AS Parex banka*, rather than subordinated creditors in an enterprise or a credit institution. All subordinated creditors in *AS Parex banka* are in an equal situation, as not only the Applicant, but also all other subordinated creditors can only recover their claims after the State aid has been repaid, and the contested provision does not establish differential treatment of any subordinated creditor.

Section 59⁶(1) of the Credit Institution Law is applicable to subordinated creditors, and, similarly to the contested provision, prohibits the fulfilment of subordinated liabilities before the provision of the aid has ended. Subjects of Paragraph 36 of the Transitional Provisions of the Credit Institution Law are also subordinated creditors; however, they are in a different situation than the subordinated creditors subject to the Control Law because the above transitional provision makes an exception from the restriction on the fulfilment of subordinated liabilities. However, as of the effective date of the contested provision, this rule applies to all subordinated creditors of *AS Parex banka*, including the Applicant, and therefore this paragraph of the Transitional Provision does not establish differential treatment either.

6. In the opinion of the joined party – the Financial and Capital Market Commission – the contested provision is in line with Articles 1, 91, 92 and 105 of the Constitution.

AS Parex banka was a systemically important credit institution on the Latvian financial market, which is why its acquisition and provision of aid to it were both justified and necessary. By acquiring *AS Parex banka*, Latvia did not only provide aid to *AS Parex banka*, but gave a strategic support to the entire financial sector of Latvia because exacerbation of problems in this credit institution would have caused long-term negative consequences.

In view of the specific nature of subordinated liabilities (their early repayment is only possible if the credit institution becomes insolvent or is liquidated and the creditor's claim can only be fulfilled after the fulfilment of claims of all other creditors), such a loan cannot be deemed an equivalent of a deposit – money held in a bank account for a specified or unspecified period of time, with or without interest – or a short-term loan taken by the credit institution in the course of its daily operations. Therefore, such funds are subject to the risks associated with operations of a credit institution.

Subordinated liabilities are deemed to involve a higher risk than regular deposits. Normally, the amounts of subordinated liabilities are greater than those of deposits, which is why the interest rates for funds loaned under subordinated liabilities are higher than those for deposits.

Assessment of the protection of the rights and interests of subordinated creditors in *AS Parex banka* in the case that no aid had been granted to the credit institution, in conjunction with the consequences that would have occurred in such a case, indicates that it is highly likely that claims of all categories of creditors specified in the Credit Institution Law would have remained unfulfilled under insolvency procedure and subordinated creditors would not have recovered their funds invested in the credit institution.

The reduction of value of the property of shareholders or subordinated creditors derives from the fact that the credit institution faces financial difficulties and possible failure to recover the invested values is directly associated with business risk. The State does not guarantee protection against such a business risk. This principle is reflected in Sections 139³ and 139⁵ of the Credit Institution Law. It follows that the State is not responsible for such relations.

7. The joined party – the Bank of Latvia – states that winding up the operations of *AS Parex banka* would have had a significant negative impact on both the financial sector in Latvia and the payments system, resulting in deterioration of foreign investors' trust in Latvian credit institutions and the State in general, would have caused a mass outflow of investment also from other credit institutions and would have increased mutual mistrust among players in the credit institution sector, as well as mistrust in the credit institution sector in general.

Winding up the operations of *AS Parex banka* would have caused liquidity problems also in other credit institutions, would have increased the systemic risk in the credit institution sector and caused the loss of trust to the payments system in general. Winding up the operations of *AS Parex banka* would have resulted in a significant further reduction of the gross domestic product. A more rapid decrease in economic activity and a deepening recession would have resulted in reduced tax revenues for the national budget and more rapid increase of unemployment and expenses of the national social budget.

8. The joined party – Finance Latvia Association – states that subordinated liabilities is an important instrument, which is necessary to enable a credit institution to exercise its task, i.e. to ensure stable operations and availability of resources in the case of a settlement. Such liabilities are high risk instruments: in the case that the credit institution faces solvency, such liabilities may be, and usually are, written down or converted; however, they are very profitable.

Restrictions that unjustifiably make assuming and using subordinated liabilities more difficult are not desirable. However, people should understand that such liabilities are a high-risk instrument and they may be written down or converted in the case that the credit institution faces solvency issues. The case under examination is not typical and in all likelihood would not have occurred if the current rules had been in place.

9. In the opinion of the joined parties – Professor of the University of Latvia Faculty of Law Jānis Kārklīņš, *Dr. iur.* and Pauls Zeņķis, *Mg. iur.* – the contested provision is in line with Articles 1, 91, 92 and 105.

The nature of subordinated liabilities can be explained with the notion of subordination. Subordination means that in the case of insolvency (or in the case of liquidation of the borrower) claims of all higher categories of creditors (including those whose right of claim derives from a deposit) are fulfilled first, then claims of subordinated creditors are fulfilled, and finally – those of equity investors.

Historically, the main difference between any other agreement and a subordinated liabilities agreement consists in the fact that in the case of the subordinated liabilities agreement subordinated liabilities are established along with the principal liabilities, whereby the person who lends their funds to the commercial operator cedes the right to request early repayment of the loan and agrees to be included in one of the last categories of creditors in case the commercial operator goes through an insolvency, liquidation or reorganisation procedure. In this way, already at the early stage of development of this institution it is admitted that a situation where repayment of subordinated liabilities occurs before the fulfilment of ‘regular’ liabilities is not permissible.

Pursuant to Paragraph 59 of Section 1 of the Credit Institution Law, creditors whose claims arise from subordinated liabilities are placed in a much more unfavourable situation than ‘regular’ creditors. The risk that the creditor may never recover the subordinated liabilities is justified by the economic aspect of subordinated liabilities, i.e. the fact that claims arising from subordinated liabilities (loans, bonds, etc.) usually involve especially high interest rates that are profitable for the creditor. In other words, the creditor potentially gains greater benefit by assuming a greater risk.

In fact, the subordination of the claim begins much earlier than the initiation of an insolvency or liquidation procedure. This should be understood when the lender signs the agreement, as by assuming the risk they gain a greater profit than in the case of a regular deposit. Primarily, such unfavourable treatment that the person agrees to is manifested in the fact that the creditor has no means of reclaiming their loan earlier, and in the case of liquidation, insolvency or reorganisation of the commercial operator the creditor’s claim will only be

satisfied after claims of all ‘regular’ creditors’ claims have been fulfilled but before the fulfilment of the shareholders’ claims.

The above differences between subordinated liabilities and ‘regular’ liabilities (e.g. deposits) indicate that subordinated liabilities are differentiated from regular liabilities mainly and essentially by the subordinated procedure of their fulfilment rather than details of legal regulation. Therefore, if the subordinated liabilities result from signing a loan agreement, these liabilities should be treated, primarily, as liabilities arising from the loan agreement, and the subordinated aspects of the liabilities are worth analysing additionally only when they become important (e.g. in the case of liquidation where creditors’ claims need to be satisfied).

Liabilities arising from a subordinated loan (in contrast to a deposit) do not give rise to an unconditional repayment obligation. The above repayment obligation is conditional; namely, it is contingent on the financial situation of the borrower and the consequences of fulfilling the liabilities. By contrast, a depositor essentially may request repayment of the deposit at any time.

It follows that a subordinated creditor may not request the fulfilment of the liabilities – the repayment – if this can put the debtor’s solvency in danger (and, on their part, the debtor may not offer such repayment). Furthermore, this rule applies not only to the principal debt, but also to the fee paid for the use of capital (interest) and is in force during the entire period of the legal relations. In a sense, agreement on the subordination clause for the legal purposes may be deemed a contract signed for the benefit of third parties, i.e. all other creditors.

All aid measures are based on three factors: the enterprise’s viability, the burden-sharing principle and competition. Therefore, aid needs to be limited to a necessary minimum and shareholders and the aid beneficiary should contribute accordingly from their own resources towards expenses associated with the restructuring.

If the State is involved in the rescue and restructuring of an enterprise which in the absence of aid would, most likely, become insolvent and can continue its operations as a direct result of the State aid, a situation where subjects that gained the greatest benefit when the enterprise operated soundly do not participate in its

rescue and restructuring would contradict the principle of fairness. Therefore, the contested provision ensures that subjects of subordinated liabilities do not gain unfair benefit from the aid provided to the enterprise and assume a burden which is proportionate to the burden borne by taxpayers when the State provides aid to the enterprise.

Thus, aid is provided only in order to protect depositors rather than any person connected with the credit institution. Since aid is provided from the national budget, it is the shared property of the entire society which is allocated in the interests of the entire society. It follows that the objective of the aid is to protect society, i.e. depositors, rather than specific persons – shareholders or subordinated creditors of the credit institution.

The general rules of satisfying claims of creditors of a credit institution provide for a far lower level of protection for the subordinated creditors and shareholders of the credit institution than for depositors. This principle is reflected in Sections 139² – 139⁵ of the Credit Institution Law. Therefore, aid is also to be repaid before satisfying claims of the subordinated creditors and shareholders. The State is under no obligation to use the aid mechanism to ensure that claims of subordinated creditors and shareholders are fulfilled. If the credit institution is not able to repay the aid, there is no reason for satisfying claims of the subordinated creditors and shareholders.

Thus, there is a risk that a creditor will not be able to exercise their right of subordinated claim because the debtor has no sufficient funds. However, the right to property does not guarantee protection against business risks. The State is under no obligation to prevent loss of property value caused by market factors. At present, there are no laws that guarantee that claims of a commercial operator will always be satisfied.

The prohibition for subordinated creditors to apply for insolvency procedure before repayment of the aid is to be deemed logical and adequate, taking into account the nature of subordinated liabilities. The contested provision ensures that an insolvency procedure of the enterprise that has received aid is not used as a means of satisfying the property-related interests of subordinated creditors and shareholders. Furthermore, the rules that allow excluding the aided enterprise from

the commercial register irrespective of repayment of the aid or fulfilment of subordinated liabilities is a logical step to enable exclusion of the enterprise from the commercial register without going through an insolvency procedure.

10. The joined party– Māris Onževs, *Dr. iur.* – notes that Section 8(1) of the Control Law does not have retroactive effect because at the time when the provision came into force the Applicant's deposit was not yet due for repayment.

The prohibition of repayment of deposits made under contractual obligations established between the Applicant and *AS Reverta* before 1 July 2014 (when Section 8(1) of the Control Law came into force) but the fulfilment of which became due after adopting the Control Law is to be deemed adopted with immediate effect. The repayment of a deposit is a one-time action which was to take place pursuant to the signed loan agreement after the coming into force of the Control Law.

Such legal provision can also infringe legitimate expectations of private individuals, especially provisions that affect legal relations and acquired rights of private individuals, including the Applicant. In this case it is important to assess if the Applicant's arguments about their investment into subordinated capital as a potentially low-risk transaction are well justified, especially as to the expectations to receive both interest and repayment of the principal amount. Investments of this sort are considered high-risk transactions that may be subject to changes in legislation in the course of ten years, especially when actual circumstances change (the borrower faces significant difficulties in meeting its liabilities).

Sections 8¹(2) and (3) of the Control Law govern the liquidation procedure of an enterprise which received aid but has not repaid it. This means that the contested provision lays down a special exception from the general principle of commercial law whereby enterprises can be liquidated only if they have satisfied all their liabilities to their creditors. From the point of view of time, it is important that two different legal consequences are not confused, i.e. the right to liquidate a commercial operator without fulfilling liabilities, on the one hand, and the prohibition to fulfil subordinated liabilities before the aid has been repaid, on the other hand. Sections 8¹(2) and (3) of the Control Law only govern liquidation of

enterprises before their liabilities to creditors are fulfilled. Therefore, in order to establish if a legal provision has retroactive effect, it is necessary to verify if the legal relations governed by the provision (in this case, the liquidation of *AS Reverta*) had been initiated, were ongoing or finished before Sections 8¹(2) and (3) of the Control Law were adopted.

The decision to liquidate *AS Reverta* was made on 29 May 2017, i.e. more than three months after adopting and coming into force of Sections 8¹(2) and (3) of the Control Law. It follows that, from the point of view of time, *AS Reverta* was liquidated pursuant to Sections 8¹(2) and (3) of the Control Law with a forward-going effect. There would be indications of a retroactive effect if the liquidation of *AS Reverta* had been completed by 2 February 2017 (when Sections 8¹(2) and (3) of the Control Law were adopted) and renewed again in accordance with the new rules of the Control Law. Furthermore, there would be indications of a retroactive effect if the liquidation of *AS Reverta* had been started before 2 February 2017 but were not completed and were to be continued in accordance with Sections 8¹(2) and (3) of the Control Law.

From the point of view of time, legal provisions governing the liquidation procedure are not as important with regard to the Applicant's legitimate expectations as legal provisions that, in essence, prohibit the fulfilment of subordinated liabilities assumed before the provisions were adopted until the aided commercial operator fulfils their liabilities to the State as a creditor (Section 8(1) of the Control Law). With regard to provisions that govern the procedure, such as Sections 8¹(2) and (3) of the Control Law, a democratic rule-of-law state allows wider freedom to amend the rules even in the course of the liquidation procedure.

11. The joined party – lecturer of the University of Latvia Faculty of Law Gaidis Bērziņš, *Mg. iur.* – observes that both the Credit Institution Law and the Control Law govern the procedure of fulfilling liabilities in the case of liquidation of a credit institution. The contested provision sought to ensure, to the extent possible, that the aid provided was repaid. The respective legal provisions are deemed specific provisions and are therefore applicable with immediate effect.

The Insolvency Law does not govern the fulfilment of subordinated liabilities. If a creditor's claim arising from subordinated liabilities were approved in the course of the insolvency procedure, following the coming into force of Sections 8(1) and (2) of the Control Law, it would be fulfilled only after the fulfilment of claims of all other creditors, but before the fulfilment of the shareholders' claims, provided that the aid received was repaid in full. Therefore, if the aid were not repaid in full because of insufficient funds, the debtor would be removed from the register irrespective of validity of Section 8¹(3) of the Control Law.

The insolvency procedure of a credit institution is not significantly different from the insolvency procedure of other legal entities. In the Applicant's situation, an insolvency procedure of the credit institution which would have triggered its liquidation may be deemed a more favourable legal situation, taking into account the fact that restrictions set forth in Section 59⁶ of the Credit Institution Law were not applicable to the Applicant. However, it would not have fully guaranteed the fulfilment of the Applicant's claim. Furthermore, the Applicant would have enjoyed this seemingly more favourable situation only until the coming into force of Section 8(1) of the Control Law. Therefore, insolvency of *AS Parex banka*, which would most likely have occurred unless it had not been provided aid in due course, could be considered the most favourable situation for the Applicant from the legal, but not factual perspective.

The Commercial Law does not directly govern subordinated liabilities and their fulfilment. However, if a credit institution is reorganised into a capital company, the procedure of fulfilling the respective liabilities needs to take account of the grounds of their establishment and the substance of the respective liabilities specified in a specific legal provision, namely, Section 1(1)(59) of the Credit Institution Law. The fulfilment of such liabilities until the coming into force of Section 8(1) of the Control Law (a specific legal provision) would have occurred along with the fulfilment of other liabilities and in accordance with a liquidation plan prepared by the liquidator. It follows that a liquidation procedure of *AS Reverta* would have been the most favourable situation for the Applicant from the legal and factual points of view until the coming into force of Section 8(1) of

the Control Law. Restrictions on claims for the fulfilment of liabilities set forth in Section 8(1) and Section 8¹(2) of the Control Law would have applied to the Applicant even if the liquidation of *AS Reverta* had to continue pursuant to the Insolvency Law.

12. The joined party – Jūlija Jerņeva, LL. M. – states the following: it does not follow from Decision No 2015/162 that Latvia could have made commitments which would have resulted in subordinated creditors recovering their funds partially or in full before the aid was repaid. However, approval of the aid by the European Commission does not mean that compatibility of the notified measures with the fundamental rights needs not be assessed, at least insofar as these measures are subject to the EU law. Such assessment is permissible and is to be conducted by the Member State's court.

The EU aid-related regulations seek to protect healthy competition and ensure the market's stability. However, during this process the State has to ensure that subordinated creditors do not suffer greater loss than they would suffer in the case of insolvency. In the specific case, it is possible that the State's commitments, that it itself formulated and submitted to the European Commission for approval and which resulted in Sections 8¹(2) and (3) being adopted, were only necessary because the procedure for notifying aid was not properly observed. The *Saeima* did not clarify why the Applicant's position would not have been better if no aid had been provided. Therefore, it is possible that there were other solutions that were more lenient to subordinated creditors and compatible with the EU law.

In the course of the proportionality test it is necessary to assess if and to what extent shortcomings in the plan for the restructuring of *AS Parex banka* (possibly including unbalanced distribution of subordinated creditors between *AS Citadele banka* and *AS Reverta*) and disproportionately large aid repayment burden on *AS Reverta* can result in incompatibility of the commitments with the EU law, specifically in violation of Article 17 of the Charter of Fundamental Rights of the European Union (hereinafter – the Charter) or, respectively, of Article 105 of the Constitution. Likewise, it could also be assessed what is the

impact on the case in question of placing the burden only on *AS Reverta*, although Decision No 2015/152 applies also to aid provided to *AS Citadele banka*.

Latvia's failure to notify the additional aid significantly restricted or even precluded the possibility of convincing the European Commission that the burden-sharing requirements may not have been applied and more lenient measures could have been chosen. Timely actions of Latvia in accordance with the TFEU could have significantly improved the Applicant's situation. The *Saeima's* claims as to the necessity to comply with the requirements of the European Commission are to be assessed in the context of the fact that all commitments were formally proposed by Latvia, whereas the European Commission only decided on their approval or rejection.

It should also be assessed what was the impact of the fact that Latvia adopted Section 8(1) of the Control Law prematurely, i.e. ten months before the date set by the European Commission (30 April 2015). A later adoption of the provision, even if it did not give rise to the obligation to fulfil liabilities arising from the Time Deposit Agreement, would have been permissible and compliant with the EU law. However, such premature adoption of the provisions does not contradict the EU law.

13. The joined party – Uģis Zeltiņš, LL. M. – states that the contested provision does not contradict the EU law.

The contested provision was adopted in connection with Decision No 2015/162 and it achieves the objective set by the decision, i.e. to prevent repayment of subordinated loans unless the aid has been repaid in full.

Application of the contested provision results in the entire subordinated capital being directed to cover the loss. Such consequences are essentially in line with Paragraphs 40–46 of the Banking Communication.

The 'no creditor worse off principle' means that the burden-sharing measures should not worsen a creditor's situation in comparison to what it would be if the aid were not granted. This principle does not mean that the claim of a creditor involved in the burden-sharing is to be fulfilled alongside other creditor's claims.

The commitments of the Member State on the basis of which the European Commission allowed the aid measure proposed by the Member State is an integral part of the respective measure, and their fulfilment is therefore mandatory. Latvia is obligated to fulfil the commitments set forth in Decision No 2015/162, including the requirement that granted and not yet repaid loans (the principal amounts) from legacy subordinated liabilities are not repaid before the aid has been repaid. Decision No 2015/162 requires that one of the three means below be chosen to fulfil these commitments: a legal instrument prohibiting the payments; converting the claim into equity without voting rights; the writing-down of the claim. Undoubtedly, the EU law allowed Latvia to choose any of these three options. By adopting the contested provision, Latvia opted for the first of the means listed above. Even within these limits Latvia could exercise discretion, because there are various legal mechanisms of creating a mandatory order. The contested provision is one of these mechanisms.

Member State's bodies, including the courts, cannot decide on the legitimacy of legal instruments made by the EU bodies. Latvia's EU membership is based in the presumption that EU bodies ensure a high level of protection of fundamental rights.

A person directly and individually affected by a legal instrument made by an EU body may appeal against this instrument in the Court of Justice of the European Union, which is to be done within two months of the publication, promulgation or receipt of the instrument. In the case under examination, the prohibition of subordinated capital repayment undoubtedly affects its holder. The prohibition leaves no space for the State's discretion with regard to the result to be achieved, making the infringement direct. The prohibition concerns a specific scope of persons that can be identified in advance, making the infringement individual. It follows that a holder of subordinated capital had the right to appeal against Decision No 2015/162. Legal proceedings in the European General Court and, if necessary, the Court of Justice of the European Union would have allowed assessing the compliance of this decision with fundamental rights, including the 'no creditor worse off principle' and other legal provisions of the EU. If a person has a definitive right to appeal against an instrument made by an EU body, such

appeal is a mandatory precondition also to challenge the legitimacy of the decision at a national court. Otherwise the appeal deadline of two months of the publication, promulgation or availability of the decision to the person concerned would not be respected.

Decision No 2015/162 would be compatible with a different provision, but it would in any case need to prevent repayment of subordinated capital before the aid has been repaid. If no outcome whereby *AS Reverta* could receive funds for the full repayment of the aid is theoretically possible, there are no alternative solutions that would affect the Applicant less.

14. The joined party – Solvita Harbaceviča, *Mg. iur.* – states that the contested provision is in line with the burden-sharing principle.

Market players, irrespective of their form, have no subjective right to receive aid, whereas states have no right to grant it. These rights can only be obtained under specific material and procedural conditions that are regulated by the EU legislation. The European Commission assesses the compatibility of the aid with the EU internal market, based on criteria set forth in the TFEU, as well as case law of the Court of Justice of the European Union and the European General Court, and guidelines (communications) prepared by the European Commission.

The differentiation of creditors is a legitimate practice observed in various daily situations and areas of law. In its turn, the State, in compliance with the ‘no creditor worse off principle’, has to ensure that subordinated creditors should not receive the amount which is less than what they would have received if no aid were granted. Aid to the credit institution at least gave hope of partial recovery of funds invested in it.

Case law of the Court of Justice of the European Union indicates that it is often impossible to make a clear distinction between Member States’ commitments and requirements of the European Commission. Member States often transpose requirements of the European Commission as their commitments. Latvia’s commitments set forth in Decision No 2015/162 are not to be perceived as an autonomous will; it is highly likely that they, at least in part, are the result of the Commission’s requirements.

In view of the general prohibition of aid, it can be concluded that the European Commission definitely has strong procedural positions in making decisions on compatibility of aid with the EU internal market. Latvia's position in the context of these talks was obviously made more difficult by the fact that the aid measures included in the last decision had not been officially notified to the European Commission.

It follows from the logics of the proceedings that the State made specific commitments to enable it to grant the aid. Therefore, the State's commitments, essentially, pursue interests of the aided enterprise. From the point of view of the EU law, Latvia had to adopt the contested provision. It was not just necessary, but also corresponded to the interests of all persons directly or indirectly involved in the process, including the Applicant.

Conclusions

15. Pursuant to Section 29(1)(3) of the Constitutional Court Law, judicial proceedings of a matter may be terminated until pronouncement of the judgment at the decision of the Constitutional Court if the Constitutional Court establishes that a decision regarding initiation of the matter does not comply with the requirements of Section 20(5). Section 20(5)(4) of the Constitutional Court Law: in examining applications, the Panel shall be entitled to refuse to initiate a matter if the application is submitted regarding a claim that has already been adjudicated.

On 13 October 2015, the Constitutional Court delivered a judgment in Case No 2014-36-01 which examined the compliance of Section 8(1) of the Control Law with Article 105 of the Constitution (hereinafter – Case No 2014-36-01). The case under examination also concerns the challenge of compliance of Section 8(1) of the Control Law with Article 105 of the Constitution.

The Constitutional Court has acknowledged that procedural matters are to be examined before assessing the constitutionality of a legal provision on merits (*see Paragraph 10 of the Constitutional Court Judgment of 11 October 2017 in Case No 2017-10-01*).

Therefore, the Constitutional Court primarily has to verify if a challenge concerning the constitutionality of Section 8(1) of the Control Law with Article 105 of the Constitution has not already been adjudicated.

15.1. The Applicant states that the challenge cannot be deemed adjudicated because both legal and factual circumstances have changed.

The Constitutional Court has acknowledged that it adjudicates a case by assessing the circumstances that exist at the time of making the judgment, and the challenge is deemed adjudicated in the specific circumstances and at the specific moment, and no new case may be initiated on the matter. However, the judgment in the specific case does not cover changes that can occur following its announcement. For that reason, in specific cases when it has established that there are significant new circumstances, the Constitutional Court may assess a challenge that has already been adjudicated. In deciding whether the specific challenge has already been adjudicated, it is necessary to assess not only the substantive part of the judgment in question, but also conclusions made in the judgment and the development of the legal system during the time since announcing the judgment (*see Paragraph 10.4 of the Constitutional Court Judgment of 29 April 2016 in Case No 2015-19-01 and Paragraph 17.2 of Judgment of 10 February 2017 in Case No 2016-06-01*).

In order to assess if the challenge has been adjudicated before, it is necessary to establish if: 1) the challenge has been formally adjudicated; 2) the challenge has essentially changed; 3) there are significant new circumstances because of which the challenge cannot be deemed previously adjudicated (*e.g. see Paragraphs 10.1–10.5 of the Constitutional Court Judgment of 29 April 2016 in Case No 2015-19-01*).

15.2. Section 8(1) of the Control Law has not been amended since the judgment in Case No 2014-36-01 was delivered. Therefore, this provision was in force when the judgment in Case No 2014-36-01 was delivered and is currently in force without amendments. Hence, the challenge in this part has been formally adjudicated.

In Case No 2014-36-01, the Constitutional Court concluded that Section 8(1) of the Control Law prevents the enterprise from fulfilling its liabilities

arising from the Time Deposit Agreement while receiving aid, and according to this provision, the Applicants cannot exercise their right to claim interest. Therefore, Section 8(1) of the Control Law was assessed as an infringement of the Applicants' right to property in the meaning of the first three sentences of Article 105 of the Constitution. The Constitutional Court declared the contested provision compliant with Article 105 of the Constitution and noted that it was a means by which the State could ensure that the funds invested were used to promote the public interests as far as possible and also to prevent subjects of subordinated liabilities, who accepted the business risk voluntarily, did not gain unjustified benefit from the State aid. Appropriate use of national budget funds and their prompt recovery is in the interests of society as a whole (*see Paragraphs 15 and 22 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

Factual circumstances in the case under examination differ from those in Case No 2014-36-01, and it contains new considerations about the scope of Article 105 of the Constitution. Specifically, the Applicant notes that Section 8(1) of the Control Law does not comply with Article 105 of the Constitution because it is clear that the Applicant will not be repaid the principal amount under the Time Deposit Agreement. The *Saeima* does not contest this. In the case under examination it is necessary to assess if the restriction established by the contested provision which prevents repayment of the principal amount of the deposit infringes the fundamental rights enshrined in the first three sentences or the fourth sentence of Article 105 of the Constitution. Furthermore, the Applicant has requested that the compliance of Section 8(1) of the Control Law with Article 105 be assessed.

Therefore, the challenge with regard to the compliance of Section 8(1) of the Control Law with Article 105 of the Constitution cannot be deemed previously adjudicated.

It follows that the court proceedings in this part of the challenge are to be pursued.

16. The Applicant requests that the Constitutional Court sends questions to the Court of Justice of the European Union for a preliminary ruling.

Firstly, it is important to establish if the EU law requires Member States to adopt legal provisions that include the burden-sharing principle. Secondly, it is important if a legal instrument whereby subordinated liabilities are written down comply with Article 107 of the TFEU, Article 17 of the Charter and the principle of legitimate expectations. Thirdly, did the Applicant as a subordinated creditor of *AS Reverta* have to appeal against the Decision No 2015/162 and does the failure to appeal against the decision affect the Applicant's eligibility and right to appeal to the Member State's court with a request to verify the legitimacy of the State's regulations.

16.1. Pursuant to Article 267 of the TFEU, the Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning the interpretation of EU Treaties and the validity and interpretation of EU acts. Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon. Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.

There is no judicial remedy against decisions of the Constitutional Court, and where the outcome of a case depends on interpretation of the EU law, the Constitutional Court has to verify if the specific matter has not already been clarified by the Court of Justice of the European Union, if provisions of the respective legislation are sufficiently clear and there are no reasonable doubts, and if a preliminary ruling of the Court of Justice of the European Union is required (*see Paragraph 14 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

16.2. In the Applicant's opinion, bringing the matter before the Court of Justice of the European Union is necessary because participants in the case and the joined parties have different opinions with regard to the Court of Justice of the

European Union Judgment of 19 July 2016 in Case C-526/14 *Kotnik and Others* and interpretation of the EU law.

It is obvious that parties' opinions differ in any court proceedings. However, it cannot serve as grounds for bringing the matter before the Court of Justice of the European Union. It is the court's task in any legal dispute to establish which of the parties makes justified arguments and which of them does not.

The Court of Justice of the European Union has established that the Banking Communication and the burden-sharing principle that arises from it are part of the EU aid rules and it complies with Articles 107–109 of the TFEU (see Paragraph 60 of the Court of Justice of the European Union Judgment of 19 July 2016 in Case No C-526/14 *Kotnik and Others*). The 'no creditor worse off principle' derives from Paragraph 46 of the Banking Communication. Provisions of the EU rules on State aid are clear and give rise to no reasonable doubt. This judgment will assess if granting aid initially to *AS Parex banka* and, following its reorganisation, to *AS Reverta* made the Applicant's situation worse than it would have been if the aid had not been granted. The Constitutional Court can answer this question without bringing the matter before the Court of Justice of the European Union.

Furthermore, the matter of the person's right to appeal against the decision of the European Commission has already been considered by the Court of Justice of the European Union. It follows from case law of the Court of Justice of the European Union that where a person seeking to challenge the decision of the European Commission undoubtedly has *locus standi* under the fourth paragraph of Article 263 the TFEU, that person is bound to make use of the remedy provided for. However, it is without prejudice to the possibility for that person to challenge the legality of national measures implementing that measure before the national courts having jurisdiction (see Paragraphs 18 and 22 of the Court of Justice of the European Union Judgment of 25 July 2018 in Case C-135/16 *Georgsmarienhütte and Others*). Therefore, the fact that the Applicant has not appealed against Decision No 2015/162 does not affect their right to request assessment of the constitutionality of the contested provision.

It follows that the request to send the question to the Court of Justice of the European Union to obtain a preliminary ruling is to be declined.

17. The *Saeima* has observed that the infringement of the Applicant's fundamental rights is not established by the entire Part 2 of Section 8¹ of the Control Law. Specifically, Paragraph 3 of the above provision is not applicable to subordinated creditors but prohibits the payment of liquidation quotas to members of the enterprise.

Pursuant to Section 19² of the Constitutional Court Law, a constitutional challenge can be made by any person who believes that their fundamental rights enshrined in the Constitution are affected by a legal provision that is not compliant with a legal provision of superior force. Normally, an infringement of the person's fundamental rights exists if the legal provision that the person believes to be non-compliant with provisions of superior legal force has been applied to the person in question. However, an infringement of fundamental rights can also be identified in cases where the contested provision has not been applied to the person, but there is a set of circumstances that enables the Constitutional Court to verify that the infringement exists (*e.g. see Paragraph 21.1 of the Constitutional Court Judgment of 10 May 2013 in Case No 2012-16-01*).

Section 8¹(2) of the Control Law sets forth numerous restrictions to be observed in the process of liquidating an enterprise granted aid. Paragraphs 1 and 2 of Section 8¹(2) of the Control Law set forth restrictions that apply to the Applicant as a subordinated creditor. Moreover, pursuant to Paragraph 3 of Section 8¹(2) of the Control Law, liquidation quotas may not be paid to members (shareholders, members, owners) of the enterprise until the aid has been repaid.

It follows from materials in the case that Paragraph 3 of Section 8¹(2) of the Control Law does not apply to the Applicant. Furthermore, in the Applicant's own opinion, the infringement caused by the contested provision infringes the fundamental rights of the Applicant as a subordinated creditor enshrined in Articles 1, 91, 92 and 105 of the Constitution.

Hence, Paragraph 3 of Section 8¹(2) of the Control Law is not applicable to the Applicant and cannot cause infringement of their fundamental rights.

Therefore, pursuing the court proceedings under this part of the claim is not possible.

It follows that, pursuant to Section 29(1)(6) of the Constitutional Court Law, the court proceedings in the case with regard to the compliance of Section 8¹(2)(3) of the Control Law with Articles 1, 91, 92 and 105 of the Constitution is to be terminated.

18. It follows from the argumentation in the constitutional challenge that the Applicant objects against the infringement of their fundamental right to a fair trial enshrined in Article 92 of the Constitution and violation of the principle of separation of powers that results from Section 8(1), Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law (hereinafter – also the contested provisions).

Pursuant to the Constitutional Court Law, the infringement of a person's fundamental rights can be identified, inter alia, when specific fundamental rights of the person are enshrined in the Constitution, i.e. the contested provision falls within the scope of specific fundamental rights (*see Paragraph 5 of the Constitutional Court Decision of 23 November 2016 terminating court proceedings in Case No 2016-02-01*).

Therefore, the Constitutional Court will establish if the contested provisions infringe the Applicant's fundamental rights that fall within the scope of the first sentence of Article 92 of the Constitution and if violation of the principle of separation of powers can be identified.

18.1. The first sentence of Article 92 of the Constitution: 'Everyone has the right to defend their rights and lawful interests in a fair trial.'

According to case law of the Constitutional Court, the notion of 'a fair trial' comprises two aspects: 'a fair court' as an independent body of judicial power and 'a fair trial' as a due process appropriate in a rule-of-law state in which a case is examined. The system of judicial bodies established in the state must be independent, unbiased and competent (*see Paragraph 22.3 of the Constitutional Court Judgment of 18 October 2007 in Case No 2007-03-01*). The notion of 'a fair trial' needs to be interpreted in conjunction with Chapter 6, and specifically

Article 86 of the Constitution, in accordance with which decisions in court proceedings may be made only by bodies upon which jurisdiction has been conferred by law, and only in accordance with procedures provided for by law (*e.g. see Paragraph 1.2 of Conclusions in the Constitutional Court Judgment of 27 June 2003 in Case No 2003-04-01*).

A fair result in court proceedings can only be ensured by independent judicial power (*see Paragraph 7.2 of the Constitutional Court Judgment of 18 January 2010 in Case No 2009-11-01*).

The principle of independence of judges enshrined in Article 83 of the Constitution requires that the judicial system ensures both independence of courts in general and independence of the judge in each specific case (*cf. Paragraph 17.3 of the Constitutional Court Judgment of 23 November 2015 in Case No 2015-10-01, Paragraph 10.3 of the Judgment of 28 September 2016 in Case No 2016-01-01 and Paragraph 15.2 of the Judgment of 15 March 2018 in Case No 2017-16-01*). The necessary independence cannot be guaranteed unless judicial power in general is not free from unjustified influence or political pressure of executive power or the legislature (*cf. Paragraph 8 of the Constitutional Court Judgment of 18 January 2010 in Case No 2009-11-01*).

If a case in court is examined by a judge appointed or approved in accordance with the procedure laid down by the Constitution and the Law on Judicial Power, it is presumed that the judge is independent and unbiased in examining the case and is able to ensure fairness of the court proceedings and the judgment (*see Paragraph 10.3 of the Constitutional Court Judgment of 28 September 2016 in Case No 2016-01-01*).

According to the principle of separation of powers, the entire operation of the State in essence is functionally divided into three types of activity or functional branches of the state power, i.e. legislative power, executive power and judicial power. The distribution of jurisdictions of the state bodies belonging to the three branches of power that makes up the system of ‘checks and balances’ is established by the Constitution (*see Paragraph 11 of the Constitutional Court Judgment of 18 December 2013 in Case No 2013-06-01*). The objective of separation of powers is to safeguard fundamental rights of the person by guaranteeing balance and

mutual control between bodies of state power (*see Paragraph 6.1 of the Constitutional Court Judgment of 20 December 2006 in Case No 2006-12-01*).

Therefore, the very notion of ‘a fair trial’ enshrined in the first sentence of Article 92 of the Constitution ensures that the case is examined by an independent court. In accordance with the principle of separation of powers, the court is to examine a case without influence or political pressure of executive power or the legislature. The notion of ‘a fair trial’ does not prevent other branches of state power from exercising their functions, insofar as they are in line with the general principles of law and other provisions of the Constitution. The principle of separation of powers gives rise to the requirement for cooperation and interaction between branches of state power in a way that ensures respect for the autonomy of each branch of state power and does not put in danger the exercise of important functions by any of the branches of state power. It is important that all branches of state power exercise their functions appropriately.

The converse situation would contradict the principle of inter-institutional loyalty that is derived from the principle of separation of powers, and bodies of a democratic rule-of-law state must comply with this principle in their relations. Constitutional bodies of a democratic rule-of-law state must respect the jurisdiction of other constitutional bodies in their mutual relations (*cf. Paragraph 18.3.1 of the Constitutional Court Judgment of 6 March 2019 in Case No 2018-11-01*).

18.2. The Applicant sees violation of the first sentence of Article 92 of the Constitution and the principle of separation of powers in the fact that the contested provisions were adopted at the time when their claim in Civil Case No C04433312 v.s. *AS Reverta* with regard to fulfilment of subordinated liabilities was heard by a court of general jurisdiction. The *Saeima* states that the legislature cannot ensure that, before a legal provision is adopted, no one will have brought action before the court in connection with the legal relations that are to be governed by the respective legal provision.

The task of judicial power is to make sure that, in examining a specific case, provisions of the Constitution, laws and other regulations are enforced and general principles of law and fundamental human rights are observed. In a rule-of-law

state, the courts are considered the most efficient mechanism that, by individual examination of each case, can establish if a reasonable balance between rights of the specific person and the public interests has been observed (*see Paragraph 11 of the Constitutional Court Judgment of 18 December 2013 in Case No 2013-06-01*).

The main task of legislative power is enacting laws. The legislative function consists in adopting legal instruments, regulating conduct of individuals and the State in accordance with the aims of society and creating a legal framework for the exercise of the State's power.

The fact that the legislature has adopted legal provisions with regard to subjects of the law and their mutual relations does not affect the provision of the first sentence of Article 92 of the Constitution that the specific dispute is to be examined in a fair trial. Every legal provision is adopted on the basis of some circumstances which, in the opinion of the legislature, require a response. The legislature must respond to the establishment and development of legal relations in the state.

Furthermore, pursuant to Section 19¹(1)(1) of the Constitutional Court Law, if in the court's opinion some of provisions applicable in Case No C04433312 did not comply with the Constitution, including preventing it from delivering fair justice, it had to bring the matter before the Constitutional Court.

In making decision in a case, the court is not bound and restricted only by requests of participants in the case. The court must verify the constitutionality of applicable legal provisions on its own initiative. According to case law of the Constitutional Court, in delivering the fairest and most appropriate result that best complies with the Constitution, the party responsible for the application of a legal provision may determine the applicable legal provision (*see Paragraph 7 of the Constitutional Court Decision of 13 December 2011 terminating legal proceedings in Case No 2011-15-01*). Application of legal provisions in accordance with the Constitution involves identification of the applicable legal provision and use of appropriate interpretation methods, assessment of intertemporal and hierarchical applicability, the use of case law and legal doctrine,

as well as advancement of the law (*see Paragraph 13 of the Constitutional Court Decision of 2 March 2015 terminating legal proceedings in Case No 2014-16-01*).

Materials in the case do not confirm that the contested provisions prevented any court of the three instances from exercising their constitutional duty of delivering fair justice in examining Civil Case No C04433312.

In view of the above, it can be concluded that the contested provisions do not give rise to violation of the principle of separation of powers and do not infringe the Applicant's right to a fair trial enshrined in the first sentence of Article 92 of the Constitution. Therefore, pursuing the court proceedings under this part of the claim is not possible.

It follows that the legal proceedings in the case with regard to compliance of Section 8(1), Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law with the principle of separation of powers and the first sentence of Article 92 of the Constitution is to be terminated pursuant to Section 29(1)(6) of the Constitutional Court Law.

19. The Applicant requests that compliance of numerous legal provisions with numerous provisions of the Constitution are assessed.

If compliance of numerous legal provisions with numerous provisions of superior legal force is challenged, the Court, taking account of the nature of the case, must determine the most efficient approach to assessing this compliance (*e.g. cf. Paragraph 13 of the Constitutional Court Judgment of 15 May 2020 in Case No 2019-17-05*).

19.1. The case under examination requires assessment of the constitutionality of Section 8(1), Paragraphs 1 and of Section 8¹(2) and Section 8¹(3) of the Control Law.

Section 8(1) of the Control Law prohibits the fulfilment of subordinated liabilities from the moment the aid is granted until provision of the aid ends. Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law are applicable in cases where it is established that the aid has not been repaid in full and will not be repaid until the end of the period of provision of the aid. When these circumstances are identified, operations of the enterprise are to be terminated

and a liquidation procedure is to be initiated, which must comply with provisions of Sections 8¹(2) and (3) of the Control Law.

The *Saeima* has observed that Section 8(1), Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law are mutually related legal provisions (*see vol. 4, p. 36 of materials in the case*). The Ministry of Justice has observed that Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law logically follow from Section 8(1) (*see vol. 5, p. 98 of materials in the case*).

Section 8(2) of the Control Law gives the definition of subordinated liabilities. Namely, they are the rights and obligations, including the obligation of a loan interest pay-out, caused to a commercial company by a loan (irrespective of the type of the concluded transaction) and which, based on the transaction concluded with the commercial company, entitles the lender to request pre-term repayment of the loan only in the case of insolvency or liquidation of a commercial company and after discharging the claims of creditors, but prior to discharging the claims of stockholders or shareholders. In their turn, the contested provisions set forth restrictions for the fulfilment of subordinated liabilities in specific cases. They govern a number of successive matters that may arise in connection with the fulfilment of subordinated liabilities in cases where the State has granted aid. The contested provisions thoroughly reflect the specific nature of subordinated liabilities and consequences that arise from it, which affect creditors of these liabilities where State aid is granted.

The only aspect differentiating the contested provisions is whether the beneficiary enterprise continues its operations or if a decision on its termination is to be made. However, irrespective of whether the commercial operations can continue and be resumed during the period of provision of the aid or whether they must be terminated and the enterprise must be liquidated, the contested provisions consistently require that subordinated liabilities not be fulfilled until the obligations to the State have been discharged. Section 8(1) of the Control Law governs these matters from the moment the aid is granted onwards, whereas Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) govern them in a situation where the enterprise needs to be liquidated. Therefore, provisions of Section 8¹ of

the Control Law follow from the restriction set forth in Section 8(1) in a situation where the enterprise is liquidated.

It follows from materials in the case under examination that after the granting of aid situation at *AS Parex banka* developed in such a way that the Applicant became subject to all the contested provisions. Namely, first of all, the fulfilment of all liabilities arising from the Time Deposit Agreement is prohibited entirely, and this prohibition remains in place also during the liquidation procedure of *AS Reverta* (e.g. see vol. 1, pp. 1-10, 39-41 and pp. 65-75 of materials in the case). This procedure will end with *AS Reverta* being excluded from the public register, pursuant to Section 8¹(3) of the Control Law. Therefore, the contested provisions with regard to the Applicant are a single legal provision, which initially prohibits the fulfilment of liabilities arising from the Time Deposit Agreement and eventually allows exclusion of *AS Reverta* from the public register even if these liabilities are not fulfilled.

All of the contested provisions restrict fulfilment of subordinated liabilities and are therefore closely related. For that reason, the Constitutional Court will assess the constitutionality of these provisions as a single provision. However, even though the contested provisions are to be assessed as a single provision, the Constitutional Court has to verify that each of them has been adopted in a due legislative procedure and how the effect of each provision in time might have affected legitimate expectations of the Applicant.

19.2. The Applicant claims that the contested provisions infringe their right to property enshrined in Article 105 of the Constitution and violate the principle of legitimate expectations enshrined in Article 1 of the Constitution. The Applicants' reasoning with respect to a possible violation of the principle of legal expectations is connected with their arguments with regard to the restriction of the fundamental rights enshrined in Article 105 of the Constitution. Specifically, the Applicant expected that they would be repaid the principal amount of the deposit, i.e. EUR 15 million, by the date specified in the Time Deposit Agreement, i.e. 12 May 2015.

When assessing compliance of a legal provision with general principles of law derived from substantive rules of a democratic rule-of-law state covered by

Article 1 of the Constitution, it should be taken into account that manifestations of these principles may differ in various areas of law. The control exercised by the Constitutional Court also depends on the nature of the contested provision, its connection with other constitutional provisions and its place in the legal system. Therefore, if the challenge in the case concerns compliance of a legal provision with both the principle of legal expectations and Article 105 of the Constitution, compliance of the contested provision with Article 1 of the Constitution is to be assessed in conjunction with Article 105 of the Constitution (*e.g. cf. Paragraph 16.3 of the Constitutional Court Judgment of 8 March 2017 in Case No 2016-07-01*).

In the opinion of the Applicant, the contested provision is not compliant also with Article 91 of the Constitution. It follows from the arguments presented in the applications and other materials in the case that the principal matter in the case consists in whether the restrictions on fulfilment of subordinated liabilities when the enterprise receives aid complies with Article 105 of the Constitution and the principle of legitimate expectations enshrined in Article 1 of the Constitution.

Therefore, the Constitutional Court will assess the compliance of the contested provisions with Articles 1 and 105 of the Constitution in the first place, and will then assess their compliance with Article 91 of the Constitution.

20. Article 105 of the Constitution: ‘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.’

In the Applicant’s opinion, the contested provisions enable expropriation of property because in practice they have been denied any right to dispose of their property for more than five years. The *Saeima* does not agree with this statement. The *Saeima* claims that the contested provisions only ensure that subordinated creditors, including the Applicant, do not gain further unjustified benefit from the aid granted.

20.1. The Constitutional Court has acknowledged that Article 105 sets forth a comprehensive guarantee of property rights and is not limited only to the right to own property. The ‘right to own property’ denotes all property rights that an entitled person may use for its own benefit and which it can dispose of in accordance with its will. Property rights comprise also contractual rights with an economic value (*see Paragraph 8.2 of the Constitutional Court Decision of 20 April 2010 terminating legal proceedings in Case No 2009-100-03*). A wide variety of claims can be deemed property, namely, claims the fulfilment of which can be requested if there are clear legal grounds (*see Paragraph 7 of the Constitutional Court Judgment of 27 October 2010 in Case No 2010-12-03 and Paragraph 15.2 of the Judgment of 3 November 2011 in Case No 2011-05-01*). Future income is also deemed property if it has already been earned or there is a claim that can be satisfied (*see Paragraph 15 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

Generally, the Applicant has a right to claim the fulfilment of the Time Deposit Agreement. Such claim constitutes ‘property’ in the meaning of Article 105 of the Constitution.

Article 105 of the Constitution provides for both unrestricted use of the right to own property and the right of the State to restrict the exercise of this right. Furthermore, the fourth sentence of this article enables the State to expropriate property rights in specific circumstances (*e.g. see Paragraph 13 of the Constitutional Court Judgment of 20 May 2002 in Case No 2016-08-01*). The first three sentences of Article 105 of the Constitution and the fourth sentence of that article set forth different criteria for evaluating the legitimacy of a restriction, wherefore it is necessary to establish which of these provisions is applicable to the contested provisions (*see Paragraph 15 of the Constitutional Court Judgment of 6 October 2010 in Case No 2009-113-0106*).

When establishing the content of the fundamental rights set forth by the Constitution, it is necessary to take account of Latvia’s international human rights obligations. Pursuant to Article 89 of the Constitution, the State shall recognise and protect fundamental human rights in accordance with the Constitution, laws and international agreements binding upon Latvia. It follows from this Article that

the aim of the legislature is to harmonise the human rights provisions enshrined in the Constitution with provisions of international law. International human rights provisions binding upon Latvia and the practice of their application at the constitutional level also serve as a means of concretisation in order to determine the content and scope of the principles of a democratic rule-of-law state, insofar as it does not reduce protection of the fundamental rights enshrined in the Constitution (*see Paragraph 18 of the Constitutional Court Judgment of 16 July 2020 in Case No 2019-25-03*).

20.2. The content of Article 105 of the Constitution is to be clarified in conjunction with Article 1 of Protocol No 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter – the Convention) and the practice of its application.

Pursuant to Article 1 of Protocol No 1 of the Convention,

‘Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.’

The European Court of Human Rights has acknowledged that Article 1 of Protocol No 1 of the Convention contains three separate provisions: the first one, which is contained in the first sentence and has a general nature, establishes the right to undisturbed enjoyment of the right to own property; the second provision, which is contained in the second sentence, governs expropriation of property and establishes specific conditions for it; the third provision, contained in the third sentence, gives States the power to control the use of property in accordance with general interests. However, all these provisions are mutually related: the second and the third provisions concern interference with the undisturbed enjoyment of the right to own property and therefore must be interpreted taking account of the principle enshrined in the first provision (*e.g. see Paragraph 76 of the European*

Court of Human Rights Grand Chamber Judgment of 28 October 1999 in Case of Brumărescu v. Romania, Application No 28342/95, and Paragraph 63 of the European Court of Human Rights Judgment of 23 September 1982 in Case of Sporrong and Lönnroth v. Sweden, Applications Nos 7151/75 and 7152/75).

If a person's right to own property is 'cancelled' in accordance with law, the European Court of Human Rights examines the person's complaint in accordance with the second provision which concerns expropriation of property. In accordance with case law of the European Court of Human Rights, in order to establish if property has been expropriated, it is necessary not only to take account of whether an official deprivation of property and transfer of rights to property has occurred, but also to study the actual situation. Given that the Convention seeks to guarantee practical and effective rights, it is necessary to verify if the right to own property has not been expropriated *de facto* (e.g. see *Paragraph 63 of the European Court of Human Rights Judgment of 23 September 1982 in Case of Sporrong and Lönnroth v. Sweden, Applications Nos 7151/75 and 7152/75, and Paragraph 76 of Judgment of 28 October 1999 in Case of Brumărescu v. Romania, Application No 28342/95*).

20.3. The Constitutional Court has already acknowledged in Case No 2014-36-01 that reduction of a potential income from return on capital or even the impossibility to receive the remaining payments of interest does not mean that the right to claim the interest has actually been expropriated. The property in question, i.e. the right to claim interest, is preserved because the State does not take over the right after the contested provisions have been adopted, as would be the case if the property were forcibly expropriated for the public needs (*see Paragraph 15.2 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

In the case under examination, the Applicant emphasises that they were deprived of the right to claim the repayment of the principal amount under the Time Deposit Agreement, wherefore, in contrast to the findings in Case No 2014-36-01, it must be acknowledged that property was expropriated in the meaning of Article 105 of the Constitution.

The contested provisions set forth restrictions on the use of property for the period from the granting of aid until the end of provision of the aid, and, where a

liquidation procedure of the enterprise has been initiated, until the aid received has been repaid in full. At the same time, the contested provisions also allow for claims of subordinated creditors to be potentially written down. However, the writing down of the liabilities does not arise from the fact that the State provided aid, but from the fact that, after the liquidation procedure has ended, the enterprise does not have sufficient funds to meet the claims of creditors of subordinated liabilities. Namely, Section 8¹(3) of the Control Law does not provide for expropriation of the right of claim of subordinated creditors, but rather requires that the liquidation procedure be completed and the enterprise be excluded from the public register even if these claims remain unfulfilled. Moreover, in accordance with this provision, failure to repay the aid does not prevent the enterprise from being excluded from the public register upon completion of the liquidation procedure.

It follows that the contested provisions do not enable expropriation of subordinated creditors' right of claim, but rather set forth restrictions on the use of this right for a specific period of time. The ability of subordinated creditors to use this right in practice depends on the development of the situation after aid has been granted, i.e. whether the enterprise has sufficient funds.

Expropriation of the right to own property in the meaning of the fourth sentence of Article 105 of the Constitution cannot depend only on the facts of a specific case. Namely, it is impossible to imagine a situation where specific property is and at the same time is not expropriated in accordance with the legal provision. Establishing that property has been or is forcibly expropriated for the public needs requires that the State acts with the aim of expropriating the specific property. However, the contested provisions do not enable such actions.

Therefore, the contested provisions are to be considered in the context of the first three sentences of Article 105 of the Constitution, and not in the context of the fourth sentence of that article.

It follows that the contested provisions restrict the right of subordinated creditors to own property set out in the first three sentences of Article 105 of the Constitution.

21. When establishing if the infringement of the Applicant's right to own property introduced by the contested provisions is justifiable, the Constitutional Court needs to assess the following:

- 1) if the infringement of the fundamental rights was introduced by law;
- 2) if the infringement has a legitimate objective;
- 3) if the infringement is proportionate to its legitimate objective (*e.g. see Paragraph 18 of the Constitutional Court Judgment of 12 February 2020 in Case No 2019-05-01*).

22. In order to assess if the infringement of the Applicants' right to own property was introduced by law, the Constitutional Court needs to verify the following:

- 1) if the law was adopted in accordance with the procedure established by legislation;
- 2) if the law was promulgated and publicly accessible in accordance with legislation;
- 3) if the law is formulated with sufficient clarity for a person to understand the essence of the rights and obligations derived from it and to anticipate the consequences of its application (*e.g. see Paragraph 14 of the Constitutional Court Judgment of 2 July 2015 in Case No 2015-01-01*).

A restriction of fundamental rights must be established in a legislative procedure that complies with the principle of good legislation (*see Paragraph 25 of the Constitutional Court Judgment of 20 March 2020 in Case No 2019-10-0103*).

23. It is the Applicant's opinion that adoption of Section 8(1) of the Control Law constitutes violation of the principle of good legislation. Their objections to the adoption of the above provision in essence point to its being adopted in haste and without due consideration. It is alleged that the legislature did not conduct any explanatory research, assessment of social impact, risk forecast and evaluation measures. Neither did the legislature consider all measures necessary for implementing and enforcing the contested provision in question.

The Constitutional Court already assessed the process of adopting the contested provision in Case No 2014-36-01, including the arguments with regard to their adoption as a matter of urgency and the legislature's assessment of its compliance with provisions of superior legal force. The Court has acknowledged that the necessity of Section 8(1) of the Control Law and its compliance with the Constitution and Latvia's international obligations were assessed. The responsible committee assessed the documents received from the Ministry of Finance and heard representatives of the Legal Bureau of the *Saeima* and experts in the field. Even though Section 8(1) of the Control Law was discussed over a very short period, it was adopted in accordance with the process and procedure set out in law (*see Paragraph 17 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

When giving proof of the violation of the principle of good legislation, the Applicant did not provide essentially new arguments that had not been assessed in Case No 2014-36-01. What is more, there is no dispute in the case under examination as to whether Section 8(1) of the Control Law was promulgated and is publicly available as required by law and whether its wording is sufficiently clear.

It follows that the restriction of the right to own property set out in Section 8(1) of the Control Law was enacted with a duly adopted law.

24. In the Applicant's opinion, the restriction introduced by Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law was not enacted with a duly adopted law because the principle of good legislation was violated.

24.1. Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law were enacted by the Law 'Amendments to the Law on Control of Aid for Commercial Activity' adopted on 2 February 2017.

Draft Law No 589/Lp12 'Amendments to the Law on Control of Aid for Commercial Activity' (hereinafter – the Draft Amendments Law) was submitted to the *Saeima* on 1 June 2016 and considered at three readings. The Draft Amendments Law was considered at first reading on 29 June 2016, at second reading on 22 December 2016 and at third reading on 2 February 2017. The

responsible committee and the Legal Bureau of the *Saeima* sent their proposals with regard to the Draft Amendments Law during its consideration, and these were discussed at meetings of the Budget and Finance (Taxation) Committee (*see vol. 7, pp. 9-10 and pp. 23-29 of materials in the case*). During consideration of the Draft Amendments Law, both the Ministry of Finance and the Ministry of Justice gave their opinions on the compliance of Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law with Article 105 of the Constitution and the principle of proportionality (*see vol. 7, pp. 15-16 and pp. 19-22 of materials in the case*).

The Law ‘Amendments to the Law on Control of Aid for Commercial Activity’ was adopted on 2 February 2017 and promulgated on 16 February 2017 in the official publication *Latvijas Vēstnesis* No 36. Therefore, Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law were promulgated in accordance with the procedure established by the Constitution and the Rules of Procedure of the *Saeima*.

The restriction on the fulfilment of subordinated liabilities from the moment of granting the aid until the end of provision of the aid established by Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law is worded with sufficient clarity. A person can understand the essence of the rights arising from these provisions and anticipate the consequences of their application.

Participants in the case agree unanimously and the Constitutional Court does not doubt that Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law are provisions that were promulgated and are available in accordance with the law and are worded with sufficient clarity.

24.2. The Constitutional Court has acknowledged that legislative procedure not only must comply with the formal requirements set out by law, but also must encourage trust in the State and law (*see Paragraph 21.3 of the Constitutional Court Judgment of 12 April 2018 in Case No 2017-17-01*). Legislative procedure must be in line with the general principles of law and procedural conditions and requirements established by the Constitution and the Rules of Procedure of the *Saeima*. The legislature must assess the compliance of provisions set out by a draft law with legal provisions of superior legal force, including the Constitution,

international and EU law, and must harmonise provisions of the draft law with legal provisions that already exist in the system of law in accordance with the principle of a rational legislature.

Requirements that arise from the principle of good legislation constitute elements of concretisation of the principle of good legislation that, inter alia, allow to understand why the legislature established a specific restriction of fundamental rights and what are the considerations that permit such a restriction in a democratic rule-of-law state. These requirements must be observed in establishing any restriction of fundamental rights (*see Paragraph 18.1 of the Constitutional Court Judgment of 6 March 2019 in Case No 2018-11-01*).

The principle of good legislation does not comprise anything that might hinder the adoption of a necessary provision. Good legislation also means that the legislature can take effective decisions on matters that are important to the State, on established relations and regulating them. Otherwise the legislative process would damage trust in the State and law rather than encourage it. It is important that the legislative process generally allows understanding why the legislature introduced a specific restriction and what are the considerations that make such a restriction necessary in a democratic rule-of-law state.

24.3. The Applicant claims that the legislature, when adopting Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law, did not assess the compliance of these provisions with case law of the Court of Justice of the European Union and did not conduct a research necessary for enacting these provisions, did not consider their compatibility with existing rules and the impact of these provisions on the Applicant. When adopting Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law, the legislature did not consider measures required for enacting and enforcing the legal provisions.

The annotation to the Draft Amendments Law states that the proposed provision directly derives from the EU guidelines and positions that act as grounds for declaring the aid compatible with the internal market. Therefore, it is necessary to prepare and adopt rules for liquidating enterprises that were provided aid and in respect of which the European Commission Decision on Compatibility of the Aid with the EU Internal Market specify a liquidation deadline. This ensures

compliance with Decision No 2015/162 and prevents the fulfilment of subordinated liabilities before the aid has been repaid in full (*see Paragraph 2 of Part 1 of the Draft Law 'Amendments to the Law on Control of Aid for Commercial Activity', available at: <http://titania.saeima.lv/>*).

When considering the Draft Amendments Law, the Budget and Finance (Taxation) Committee on 15 June 2016 asked the Ministry of Justice to prepare an assessment of compliance of Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law with Article 105 of the Constitution (*see vol. 7, p. 14 of materials in the case*). The Ministry of Justice prepared its assessment on 4 July 2016 (*see vol. 7, pp. 15-16 of materials in the case*). When preparing the Draft Amendments Law for considering at the *Saeima* sitting at first reading, the Budget and Finance (Taxation) Committee at its meeting on 20 September 2016 asked the Ministry of Finance to give an additional assessment of the compliance of Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law with Article 105 of the Constitution (*see vol. 7, pp. 3-5 of materials in the case*). The Ministry of Finance prepared its assessment on 4 October 2016 (*see vol. 7, pp. 19-22 of materials in the case*).

Initially, the Ministry of Finance provided its opinion to the Budget and Finance (Taxation) Committee at the meeting on 20 September 2016, clarifying what the draft law was intended to regulate and why it was necessary, noting, *inter alia*, that it derived from requirements of the EU law (*see the audio record of the meeting of the Budget and Finance (Taxation) Committee on 20 September 2016 in vol. 7 of materials in the case*). Following receipt of the opinion of the Ministry of Justice, the same meeting of the Committee heard this ministry and the Legal Bureau of the *Saeima*, which was followed by discussions (*see vol. 7, pp. 4-5 of materials in the case*). The opinions of the Ministry of Finance and the Ministry of Justice were assessed also at the meeting of the Budget and Finance (Taxation) Committee on 13 December 2016, where the Ministry of Finance was heard (*see vol. 7, pp. 9-11 and the audio record of the meeting of the Budget and Finance (Taxation) Committee on 13 December 2016 in vol. 7 of materials in the case*).

When the Draft Amendments Law was considered at first reading at the *Saeima* meeting on 29 September 2016, the reporter, MP Inguna Sudraba,

informed other MPs about the nature of the draft law and noted, inter alia, that provisions of the draft law ‘prevent distortion of the internal EU market if subordinated creditors receive aid’ (*see transcript of the Saeima meeting on 29 September 2016, available in the Saeima register of draft legislation*). It follows from the transcript of the *Saeima* meeting on 22 December 2016 that MPs knew about the opinions of the Ministry of Justice and the Ministry of Finance and were familiar with them (*see transcript of the Saeima meeting on 22 December 2016, available in the Saeima register of draft legislation*).

It follows that the analysis of the Ministry of Finance and the Ministry of Justice of the constitutionality of Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law and the information provided by the ministries with regard to requirements established by the provisions were assessed by the responsible committee and at the *Saeima* meetings.

Therefore, when adopting Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law, the legislature had sufficient information and it assessed the compliance of the provisions with both the Constitution and the EU law.

It follows that the restriction of the right to own property set out in Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law was enacted with a duly adopted law.

25. Any restriction of fundamental rights must be based on circumstances and arguments that justify its necessity; namely, the restriction needs to be established on the grounds of important interests, i.e. a legitimate objective (*e.g. see Paragraph 9 of the Constitutional Court Judgment of 22 December 2005 in Case No 2005-19-01*).

If rights of a person are restricted, the institution issuing the contested legislation, in this case the *Saeima*, is primarily responsible for demonstrating and justifying the legitimate objective of the restrictions at the Constitutional Court proceedings (*e.g. see Paragraph 18 of the Constitutional Court Judgment of 11 December 2014 in Case No 2014-05-01*).

According to the *Saeima*, the legitimate objective of the restriction of property rights of subordinated creditors set out by the contested provisions is to ensure the public welfare and protect the democratic state. The Applicant holds that the legitimate objective of the restriction is to ensure the public welfare, but the EU law did not require that Latvia adopt the contested provisions. Therefore, they are not aimed at meeting the commitments arising from Latvia's EU membership.

As part of considering the Draft Law 'the Law on Control of Aid for Commercial Activity' (hereinafter – the Draft Control Law), the Ministry of Finance submitted a proposal for Section (1). The Ministry of Finance formulated the objective of the provision as follows: '[..] to prevent enterprises that have received or expect to receive aid granted to enterprises that face financial difficulties and have subordinated liabilities from primarily fulfilling subordinated liabilities instead of repaying the aid, which contradicts the interests of society and taxpayers. [..] The Draft Law presumes that aid granted to enterprises will be used primarily to ensure operations of the enterprise rather than meeting economic interests of specific individuals' (*see vol. 7, p. 63 of materials in the case*).

The Annotation to the Draft Amendments Law states that the Draft Law sets out special liquidation provisions for all enterprises that have been granted aid. Issuing special rules for such enterprises is justified by significant interests of taxpayers and society as a whole, namely, preventing the use of aid funding to cover subordinated liabilities instead of repayment of the aid received. Without preparing and adopting such a special provision, the State would not recover the amount of the aid. This would contradict the burden-sharing principle set forth in Decision No 2015/126 (*see Paragraph 2 of Part 1 of Annotation to the Draft Law 'the Law on Control of Aid for Commercial Activity', available at: www.saeima.lv*).

As follows from materials on preparing Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law, the burden-sharing principle must be observed and the funds granted as aid must be recovered by the State as far as possible even when it is clear that the aid cannot be recovered and the aided enterprise is liquidated. The necessity of these provisions follows from Decision

No 2015/162 (*see the audio record of the Budget and Finance (Taxation) Committee meeting on 20 September 2016 in vol. 7 of materials in the case*).

In view of the above, it can be concluded that the contested provisions were adopted based on the EU requirement to prevent enterprises that receive or expect to receive aid and have subordinated liabilities from fulfilling subordinated liabilities instead of repaying the aid. The granting of aid is closely connected with EU rules. Generally, this matter is governed by Articles 107 and 108 of the TFEU, and numerous other EU legal instruments are based on these articles, including the Banking Communication, as well as Decision No 2015/162.

It follows that the restriction established by the contested provisions that prohibits the repayment of the principal amount of subordinated liabilities in accordance with EU requirements pursues the aim of preventing subordinated creditors from gaining unjustified benefit, preventing the waste of State funds and facilitating repayment of the aid amount to the national budget to the extent possible. The restriction pursues important interests of taxpayers and society as a whole. It is important that subordinated creditors assume proportionate burden compared to the burden assumed by taxpayers when the aid is granted.

Therefore, the legitimate objective of the restrictions of fundamental rights established by the contested provisions is the protection of public welfare.

26. When identifying the legitimate objective of a restriction of fundamental rights, it is important that compliance of the restriction with the principle of proportionality is assessed. The principle of legitimate expectations also requires that a person's legitimate expectations are balanced with the interests of society (*see Paragraph 25 of the Constitutional Court Judgment of 26 November 2009 in Case No 2009-08-01 and Paragraph 15 of the Judgment of 27 October 2010 in Case No 2010-12-03*).

In order to assess if the restriction of fundamental rights is proportionate, it is necessary to establish the following:

1) whether the means selected are appropriate for achieving the legitimate objective;

2) whether there are means that are less restrictive of individuals' fundamental rights (more lenient means);

3) whether the benefit gained by society exceeds the damage to the individual's rights and legitimate interests (*e.g. see Paragraph 23 of the Constitutional Court Judgment of 30 March 2011 in Case No 2010-60-01*).

If following the examination of the legal provisions it is found that it does not comply with at least one of these criteria, the legal provision will also be deemed non-compliant with the principle of proportionality and illegal (*e.g. see Paragraph 3.1 of Conclusions in the Constitutional Court Judgment of 19 March 2002 in Case No 2001-12-01*).

27. In examining whether the selected means are applied for the achievement of the legitimate objective, the Constitutional Court will verify if the selected means enable achievement of the legitimate objective.

In the Applicant's opinion, the contested provisions are not an appropriate means of observing the burden-sharing principle. By contrast, the *Saeima* holds that the contested provisions are appropriate for achieving the legitimate objective. They ensure that the rules of the EU aid-related law are complied with and the enterprise which has received aid repays it as far as possible. The recovered funds are transferred to the national budget and used for the benefit of the public.

Ever since the signing of the Treaty establishing the European Economic Community in Rome on 25 March 1957, state aid policy has been an integral part of competition policy and the European Commission has been in charge of preventing that aid granted by Member States unduly distorts competition. Competition policy rests upon the idea that a market-based economy provides the best guarantee for raising living conditions in the EU to the benefit of citizens, one of the primary objectives of the European Union. It is important to realise that aid is financed by taxpayers, and there are opportunity costs to it. Granting aid to enterprises results in funding being taken away from other policy areas. State resources are limited and they are required for many important purposes, such as education, health care, national security, social security and others

(see Paragraphs 5, 6 and 7 of the European Commission State Aid Action plan of 7 June 2005, available at: <https://eur-lex.europa.eu/>).

Article 107(1) of the TFEU establishes a general prohibition of aid granted by Member States. However, Parts 2 and 3 of this Article specify cases when aid is deemed compatible or may be deemed compatible with the EU internal market. One of such cases is specified in Article 107(3)(b) of the TFEU, i.e. aid to remedy a serious disturbance in the economy of a Member State may be considered to be compatible with the internal market.

Article 108 of the TFEU gives the European Commission extensive powers to decide on aid compatibility with the EU internal market. In order to ensure such compatibility, when making decision on aid, the European Commission may specify measures that the state must implement. In this specific case, Decision No 2015/162 sets out rules on measures to be implemented to reduce distortion of competition and strengthen the burden-sharing. In recital 113 of Decision No 2015/162, the European Commission states that aid has to be examined on the basis of the Banking Communication.

As follows from Paragraph 3 of the Banking Communication, that Communication, as well as all individual decisions on aid measures and schemes falling within the scope of those Communications, were adopted on the basis of Article 107(3)(b) of the TFEU. The Court of Justice of the European Union has acknowledged that the Banking Communication cannot establish independent obligations on the Member States; it only establishes conditions designed to ensure that aid granted to banks in the financial crisis is compatible with the EU internal market. This must be taken into account by the European Commission in the exercise of the wide discretion it enjoys under Article 107(3)(b) (see Paragraph 44 of the Court of Justice of the European Union Judgment of 19 July 2016 in Case C-526/14 *Kotnik and Others*).

In other words, the Banking Communication is not considered to establish obligations on the Member States to implement the burden-sharing measures set forth in Paragraphs 40-46. However, the Banking Communication has authority and the European Commission is likely to assess the notified aid taking into account the rules and conditions set forth in the Banking Communication. It is only

in exceptional circumstances that it approves draft aid projects that do not comply with criteria set forth in the Banking Communication (*cf. Paragraph 43 of the Court of Justice of the European Union Judgment of 19 July 2016 in Case C-526/14 Kotnik and Others*).

This also refers to the circumstances associated with the provision of aid to *AS Parex banka*, i.e. when deciding on measures necessary to ensure that aid that had already been provided was approved as compliant with the EU internal market.

Paragraphs 40-46 of the Banking Communication, *inter alia*, mention burden-sharing by the shareholders and the subordinated creditors among conditions for allowing aid. Pursuant to Article 41 of the Banking Communication, adequate burden-sharing will normally entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. Such contributions can take the form of either a conversion into Common Equity Tier 1 or a write-down of the principal of the instruments. In any case, cash outflows from the beneficiary to the holders of such securities must be prevented to the extent legally possible.

Recital 72 of Decision No 2015/162 states, *inter alia*, that *AS Reverta* had exceeded the previously authorised liquidity amounts in part due to the payment of interest to subordinated creditors. In order to prevent subordinated creditors benefiting from the additional aid, Latvia took the following commitments under recital 73:

1) to ensure that *AS Citadele* and *AS Reverta* as well as their affiliated undertakings do not pay any interest or dividends on existing capital instruments to any subordinated debtholders or shareholders, who are not strictly the Latvian State or the EBRD, until and unless the State aid to *AS Reverta* and/or *AS Citadele banka* has been fully repaid and unless there is a legal obligation to do so. To the extent such legal obligations exist, Latvia undertakes to remove them as soon as possible (and in any event by 30 April 2015 at the latest);

2) not to repay any outstanding principal debt of the Legacy Subordinated Loans unless and until all State aid to *AS Reverta/AS Citadele banka* has been fully repaid;

3) to undertake all necessary measures to ensure that any legal provisions needed to comply with the commitments above are put in place by 30 April 2015 at the latest.

It follows from recitals 147, 156, 165, 166, 167 and Article 2 of Decision No 2015/162 that the Commission approved of these commitments and found that the aid provided complied with requirements of the Banking Communication.

The Ministry of Finance holds that the burden-sharing principle ensures that the shareholders and investors participate in covering losses of the enterprise which faces financial difficulties (*see vol. 6, pp. 5 and vol. 7, p. 41 of materials in the case*). The contested provisions also ensure that funds invested in the enterprise in the form of aid are used for the needs of the enterprise and serve the purposes of the State's development, preventing, as far as possible, specific individuals (in this case, subordinated debt holders) from gaining unjustified benefit (*see vol. 6, p. 5 of materials in the case*).

The contested provisions prohibit the fulfilment of subordinated liabilities, including repayment of a loan, calculation, accumulation or payment out of an interest or other remuneration until the aid received has been repaid in full. This prohibition is in line with the above commitment of Latvia. The legislature must choose a means of meeting its commitments that is compliant with the Constitution and international obligations of Latvia. Latvia has transposed the principles and conditions it had to observe in order that the European Commission approve the aid granted as compatible with the EU internal market and thus ensure that the aid is provided in the interests of society.

The Constitutional Court has acknowledged that the aid protects the entire society from the negative consequences that could result from mismanagement of the enterprise and its subsequent insolvency. By granting aid, the State gains a controlling influence over the enterprise's funds, wherefore the State must ensure that the enterprise is managed in a way that protects society's interests best. The restrictions on the rights of the enterprise to fulfil subordinated liabilities ensure that the aid granted is used in the enterprise's interests, i.e. restructuring the enterprise and restoring normal business operations, in this way ensuring that the State's resources invested in the enterprise are used, as far as possible, in the

interests of society and additionally facilitating the recovery of funds invested by the State (*see Paragraph 20 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

After receiving the aid, the enterprise must operate in such a way that to the maximum extent optimises the recovery of the aid and its repayment to the national budget. This necessitates burden-sharing and restrictions preventing subordinated creditors from having their claims fulfilled. However, there may be cases where liquidation of the enterprise is initiated. It is important that also in such cases the recovery of resources invested by the State is facilitated. Preventing subordinated creditors from having their claims fulfilled during the entire time until the aid has been repaid is in the interests of society.

Therefore, the contested provisions ensure that the interests of society are protected.

It follows that the means selected by the legislature are appropriate for achieving the legitimate objective of the restriction of fundamental rights.

28. The fundamental rights restrictions imposed by the contested provisions were required if no other means existed that could be similarly efficient and the application of which would be less restrictive on the fundamental rights of persons. A less restrictive means is not any other means but only a means by which the legitimate objective can be achieved with at least the same quality (*e.g. see Paragraph 19 of the Constitutional Court Judgment of 13 May 2005 in Case No 2004-18-0106*).

The Applicant holds that the legitimate objective of the contested provisions can be achieved by other means that are less restrictive of their fundamental rights. According to the *Saeima*, the means suggested by the Applicant cannot be deemed more lenient means of achieving the legitimate objective. When adopting the contested provisions, the legislature assessed if there were more lenient means of achieving the legitimate objective. However, none of these means would have enabled achieving the legitimate objective with the same quality.

28.1. As has already been acknowledged in this judgment, adopting the contested provisions was made necessary by the EU law. Therefore, first of all it

is necessary to establish if the Banking Communication and Decision No 2015/162 allowed the State discretion in meeting these requirements.

The Court of Justice of the European Union has acknowledged that the Banking Communication does not require that the burden-sharing measures specified in its Paragraphs 40-46 are adopted in any particular form or procedure (*see Paragraph 72 of the Court of Justice of the European Union Judgment of 30 October 2016 in Case C-526/14 Kotnik and Others*). However, these measures should achieve the objective, which makes the burden-sharing necessary, i.e. preventing a situation where subordinated creditors gain unjustified benefit from the aid granted.

Therefore, generally, there may be various solutions and different rules for implementing requirements derived from the EU law, including the Banking Communication, but they must in any case ensure the achievement of the above burden-sharing objective.

According to recital 73 of Decision No 2015/162, Latvia uses one of the following three measures to fulfil its commitment to prevent cash outflows to subordinated creditors of *AS Reverta*: a binding order that no payments shall be made; converting the claim into non-voting Tier 1 capital; or writing the claim down. However, all these means would affect subordinated creditors in equal measure, i.e. the subordinated creditors would in any case have no way of having their claims fulfilled until *AS Reverta* repays the aid it received. This is emphasised also by the joined party Uģis Zeltiņš, LL.M. (*see vol. 6, p. 77 of materials in the case*).

28.2. The Constitutional Court has jurisdiction to examine if the legislature, when restricting the fundamental rights of an individual, adequately assessed the availability of alternative means that were less restrictive on the fundamental rights (*e.g. see Paragraph 19 of the Constitutional Court Judgment of 30 March 2010 in Case No 2009-85-01*). Likewise, the Court may establish that such alternative means exist (*see Paragraph 14.3 of the Constitutional Court Judgment of 4 November 2005 in Case No 2005-09-01*). If it is established that at least one less restrictive means exists, there are reasons to declare that the contested provision

disproportionately restricts the fundamental rights (*see Paragraph 17.2 of the Constitutional Court Judgment of 23 April 2009 in Case No 2008-42-01*).

28.2.1. The Applicant holds that the legitimate objective could have been achieved, firstly, if the contested provisions included the requirement to observe the ‘no creditor worse off principle’ and, secondly, if they enabled writing down the subordinated liabilities on a contractual basis or against a fair compensation in accordance with law.

Implementing the burden-sharing principle does not permit subordinated creditors to have their claims fulfilled before the aid has been repaid. Writing down subordinated liabilities on a contractual basis would mean that subordinated creditors have their claims fulfilled at least in part, because a contract is an expression of the parties’ will achieved as a result of a compromise. Furthermore, a fair compensation in accordance with the law would mean that subordinated creditors are granted funds.

Therefore, the alternative means suggested by the Applicant would not enable achieving the legitimate objective of the fundamental rights restriction with the same quality.

28.2.2. When adopting Section 8(1) of the Control Law, the legislature assessed two alternative means: a unilateral default on subordinated liabilities and initiation of an insolvency procedure. When submitting its proposal for inclusion of Section 8(1) in the Draft Control Law, the Ministry of Finance stated that a unilateral default on subordinated liabilities posed a significant risk of legal action, including the possibility of using claim security during the legal proceedings. Furthermore, such solution is deemed more unfavourable for subordinated liability holders. Initiation of an insolvency procedure is also less favourable for subordinated liability holders because it requires observing the State’s priority as the only secured creditor against other creditors of the enterprise (*see the letter of the Minister for Finance in vol. 5, pp. 70-71 of materials in the case*).

The Constitutional Court has already acknowledged that none of the above means would allow achieving the legitimate objective of the restriction set forth by Section 8(1) of the Control Law with the same quality. Not only would they pose a risk to operations of the enterprise itself and therefore to society in general,

but they would also put the Applicants and other subjects of subordinated liabilities in an even more unfavourable situation (*see Paragraph 21 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*). In the case under examination, the Constitutional Court has no grounds for concluding otherwise, even though this case concerns the repayment of the principal amount under the Time Deposit Agreement rather than the payment of interest. In both cases it is necessary to make sure that the invested State resources are not used contrary to the public interests and are repaid to the national budget as soon as possible.

28.2.3. When adopting Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law, the legislature considered two alternative means, i.e. liquidation of the enterprise and an insolvency procedure (*see vol. 7, pp. 21 of materials in the case, Part 1, Paragraph 2 of the Draft Law ‘Amendments to the Law on Control of Aid for Commercial Activity’*). At the meeting of the Budget and Finance (Taxation) Committee of 13 December 2016, where the Draft Amendments Law was considered before passing it to the *Saeima* for second reading, the Ministry of Finance stated that both this ministry and the Ministry of Justice had found that a legal provision for a liquidation procedure would not have been less restrictive on the subordinated creditors (*see the audio record of the Budget and Finance (Taxation) Committee meeting on 13 December 2016 in vol. 7 of materials in the case*). Claiming that the contested provisions do not implement the ‘no creditor worse off principle’, the Applicant stresses that insolvency of the enterprise and its liquidation would have been less restrictive of their rights.

Paragraph 46 of the Banking Communication requires that the ‘no creditor worse off principle’ be adhered to. According to this principle, subordinated creditors should not receive less than what they would have received if no aid were to be granted.

The Court of Justice of the European Union has acknowledged that the burden-sharing measures on which the grant of State aid in favour of a bank showing a shortfall is dependent cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within insolvency proceedings that followed such aid not being granted

(see Paragraph 78 of the Court of Justice of the European Union Judgment of 19 July 2016 in Case C-526/14 *Kotnik and Others*).

It follows from the above that the burden-sharing measures must not result in deterioration of subordinated creditors' situation compared to what their situation would be if no aid had been granted. However, this principle must not be construed to preclude the implementation of the burden-sharing principle, but rather to ensure proportionate burden-sharing, whereby the subordinated creditors do not have to bear an unjustifiably large burden. The 'no creditor worse off principle' does not require claims of subordinated creditors involved in the burden-sharing to be satisfied along with those of other creditors (see the opinion of the joined party *Uģis Zeltiņš, LL.M. in vol. 6, p. 76 of materials in the case*).

The *Saeima* notes that if the aid had not been granted, an insolvency procedure of *AS Parex banka* would have been initiated, and following its announcement the accumulation of interest on the loans would have ceased. This opinion is shared also by the Ministry of Justice (see *vol. 5, p. 103 of materials in the case*).

Interest payments undoubtedly have an economic value. They increase the amount of a person's funds, i.e. their property. The dispute in the case does not concern the fact that interest on subordinated liabilities was calculated and paid until 1 July 2014 when Section 8(1) of the Control Law came into force. However, pursuant to Section 63(1)(3) of the Insolvency Law and Section 149(3) of the Credit Institution Law, their accumulation would have ceased following the announcement of the insolvency procedure.

Hence, as a result of the granted aid, subordinated creditors gained benefit that they would not have gained if no aid had been granted and an insolvency procedure of *AS Parex banka* had been initiated. In that case the subordinated creditors' situation would have been even worse, because insolvency rules do not allow the payment of interest.

The Ministry of Finance states that if *AS Parex banka* had not been granted aid, it would be subject to liquidation and, pursuant to Section 139³(4) of the Credit Institution Law, the fulfilment of subordinated liabilities would not be possible because these claims take the lowest place in the creditors' hierarchy, with only

the shareholders' claims below them (*see vol. 6, p. 13 of materials in the case*). This opinion is shared also by the Financial and Capital Market Commission (*see vol. 5, p. 94 of materials in the case*).

The Constitutional Court has acknowledged that, in accordance with the general rules whereby claims of creditors of credit institutions are met, subordinated creditors and shareholders of credit institutions are given far less protection than depositors. Furthermore, no law guarantees that an economic operator can always have their claims met, because this ability is subject to various risks. For example, the enterprise may become insolvent, and in that case it cannot be guaranteed that claims of the creditors can be met (*see Paragraph 17.3 of the Constitutional Court Judgment of 30 March 2011 in Case No 2010-60-01*).

It follows from the statement of the joined party Gaidis Bērziņš, *Mg. iur.* that the insolvency rules for credit institutions are not substantially different from insolvency rules for other enterprises. If a creditor's claim arising from subordinated liabilities were approved in the course of the insolvency procedure, pursuant to Section 8(1) of the Control Law, it would be fulfilled only after the fulfilment of claims of all other creditors, but before the fulfilment of the shareholders' claims, provided that the aid received was repaid in full. Because of insufficient funds, the debtor would be removed from the register irrespective of validity of Section 8¹(3) of the Control Law. Even if the liquidation procedure of *AS Reverta* were to be continued in accordance with the rules of insolvency procedure, the Applicant would be subject to restrictions with regard to the fulfilment of liabilities set forth in the contested provisions (*see vol. 5, pp. 120 and 123*).

The contested provisions establish the procedure for the fulfilment of creditor's claims and allow a situation where claims of subordinated creditors are not fulfilled in full. Section 118 of the Insolvency Law also makes provisions for the grouping of creditors, and this law allows a situation where creditors' claims are not fulfilled in full before removing the enterprise from the public register (*see the opinion of the Ministry of Justice in vol. 5, p. 102 of materials in the case*). Likewise, Sections 139² and 139³ of the Credit Institution Law make provisions for the grouping of creditors.

Pursuant to Section 118(5) of the Insolvency Law, claims of unsecured creditors are fulfilled after claims of all other creditors previously specified in this Section. Pursuant to Section 118(10), claims of shareholders and members of the credit institution are fulfilled after claims of unsecured creditors have been fulfilled. Pursuant to Section 120(4) of the Insolvency Law, within five days of receipt of the court decision on the termination of the proceedings, the administrator submits to the Register of Enterprises an application for removal of the debtor from the respective register, enclosing a statement from the State Archive certifying the deposition of the debtor's documents.

Pursuant to Section 139³(4) of the Credit Institution Law, claims regarding the funds which creditors have loaned to the credit institution for a definite time period, with the condition that they may be requested before the expiration of such time period only in the case of liquidation of the credit institution, are fulfilled after claims of the creditors specified in Section 139² have been fulfilled in full and claims of creditors of the earlier paragraphs of Section 139³ have been fulfilled. Pursuant to Section 139⁵ of the Credit Institution Law, funds that remain after claims referred to in Sections 139² and 139³ of this law have been satisfied are distributed among the shareholders of the credit institution in proportion to the contribution of each.

Therefore, even if a liquidation procedure of *AS Parex banka* or, later, *AS Reverta* had been initiated, the Applicant's right to have their claim fulfilled would be restricted. The insolvency rules make provisions for the grouping of creditors, and according to this grouping the Applicant would be in one of the last categories of creditors. The insolvency procedure does not guarantee the right of a creditor to have their claim satisfied in full, and even this procedure allows removing the enterprise from the public register without satisfying claims of all creditors. This also follows from considerations on the need to initiate an insolvency procedure. Namely, initiating an insolvency procedure indicates that the enterprise does not have sufficient funds to fulfil claims of all creditors. Also the statements of the *Saeima* and numerous joined parties suggest the following conclusion based on the financial difficulties faced by *AS Parex banka* and, later, *AS Reverta*: even if an insolvency procedure of these enterprises had been initiated,

the Applicant's claim would not have been satisfied and would not have prevented *AS Parex banka* or, later, *AS Reverta* from being removed from the public register (see vol. 4, pp. 37-39, vol. 5, pp 95, 101, 116 and 120, vol. 6, p. 13 of materials in the case). Moreover, it should be taken into account that the subordinated creditors were paid interest until 1 July 2014. It follows that the contested provisions restrict the Applicant's right to property in an even smaller degree than they would have been restricted if no aid had been granted and an insolvency procedure of *AS Parex banka* or, later, *AS Reverta* had been initiated.

In view of the above, it can be concluded that none of the alternative means referred to above would achieve the legitimate objective with the same quality. They would pose a risk to the operations of the enterprise and to society in general, and would violate the EU rules for the provision of aid.

It follows that no other means exists that would enable achieving the legitimate objective of the restriction of the fundamental rights with the same quality.

29. The Applicant holds that the contested provisions establish a significant and irreversible infringement of their right to own property affecting the rest of their life, whereas society gains only financial benefit that is relatively small compared with the national budget funds used to provide aid to *AS Parex banka*.

The *Saeima* holds that appropriate use of the national budget funds and recovering these funds as quickly as possible is in the interests of society as a whole. The benefit gained by society exceeds the damage to the Applicant's right to own property.

In order to verify the proportionality of fundamental rights restrictions it is also necessary to make sure if adverse consequences for a person that result from restrictions of their fundamental rights do not exceed the benefit of the restrictions for society in general. In this respect, the Constitutional Court needs to establish which of the interests in the balance are to be given priority.

29.1. The contested provisions restrict subordinated creditors' right to own property. Subordinated liabilities are legal relations of a specific nature established between an enterprise and a creditor.

The joined parties Jānis Kārklīņš, *Dr. iur.* and Pauls Zeņķis, *Mg. iur.* hold that the essence of subordinated liabilities can be explained by the notion of subordination. It means that in the case of insolvency or liquidation, claims of all higher categories of creditors are fulfilled first, then claims of subordinated creditors are fulfilled, and finally those of equity investors. Therefore, a claim of a subordinated creditor belongs to one of the lower categories of creditors. What is more, subordination does not start with the initiation of the insolvency or liquidation procedure, but much earlier than that (*see vol. 5, pp. 126 and 129 of materials in the case*).

A deposit establishing subordinated liabilities is considered to involve risk. There is a higher probability that the credit institution defaults on these liabilities because claims arising from them are to be fulfilled only after all claims based on secured deposits and claims of other creditors, with the exception of the shareholders of the credit institution, are fulfilled. However, these liabilities generate greater profit because they involve more favourable interest rates for the creditor (*see the opinions of the Ministry of Finance, the Financial and Capital Market Commission, Finance Latvia Association, Jānis Kārklīņš and Pauls Zeņķis in vol. 5, pp 94, 128, 136 and vol. 6, p. 16 of materials in the case*).

Assessment of the proportionality of the restriction of the right to own property will take into account the specific nature of the legal relations in question.

The European Court of Human Rights has acknowledged that the right to own property does not guarantee protection from business risks. The State is under no obligation to prevent the loss of value resulting from market factors (*see: Harris, O'Boyle and Warbrick. Law of the European Convention on Human Rights, 4th edition, Oxford: Oxford University Press, 2018, p. 861*).

It follows from case law of the Constitutional Court that possible failure of shareholders or subordinated creditors to recover their invested value is directly associated with business risk. Shareholders and subordinated creditors can benefit from successful operations of the credit institution, but at the same time they are exposed to the most significant risk. On its part, the State does not guarantee the right of a participant of a high-risk business transaction to protection against business risk. This principle is reflected by the principle whereby claims of

subordinated creditors and shareholders of an insolvent credit institution are the two lowest categories in the creditor queue (*cf. Paragraph 17.3 of the Constitutional Court Judgment of 30 March 2011 in Case No 2010-60-01 and Paragraph 23.6 of the Judgment of 19 October 2011 in Case No 2010-71-01*).

The nature of subordinated liabilities gives rise to the business risk that the respective creditors have to assess and assume when handing over their funds to the credit institution, namely, the risk that the funds may be written down if the credit institution faces solvency issues. This risk does not concern only the insolvency or liquidation procedure, but the entire period when the enterprise faces financial difficulties. These difficulties may be resolved, and in the case under examination were resolved, by the State intervention whereby aid was granted to *AS Parex banka* and later to *AS Reverta*. The fulfilment of a subordinated creditor's claim is subject to the business risk also during the entire period of provision of aid. The provision of aid and the resulting consequences cannot be considered additional business risk. Financial difficulties amount to a business risk irrespective of the form and means of resolving them.

As has already been observed above, aid may only be granted in exceptional cases. Negative aspects of the provision of aid must be viewed not only in the market context, i.e. as a risk of enterprises' irresponsible behaviour and problems caused by competition, but also taking into account the public interests, i.e. concern for justified and rational use of the budget resources. Therefore, subordinated creditors must be aware that the provision of aid to the credit institution that faces financial difficulties will also affect their situation; namely, they must be aware that their claims will not be fulfilled until the aid has been repaid.

29.2. The Applicant holds that they had no reason to doubt that they would recover the principal amount of the deposit after the aid was granted. Likewise, from the moment they were donated the liabilities arising from the Time Deposit Agreement until the contested provisions were adopted they allegedly had no reason to believe that provision of aid to *AS Parex banka* might compromise their right for repayment of the principal amount under the agreement.

The *Saeima* emphasises that the legitimate expectations of the Applicant are neither justified nor reasonable. At the time when the Applicant obtained the right arising from the Time Deposit Agreement, there were no effective legal provisions that guaranteed that the Applicant would be repaid the principal amount of the deposit if *AS Parex banka* wound up its operations.

According to Article 1 of the Constitution, Latvia is an independent democratic republic. The Constitutional Court has acknowledged that Article 1 of the Constitution comprises the principle of legitimate expectations derived from substantive rules of a democratic rule-of-law state. The principle of legitimate expectations is associated with the principle of legal certainty and the stability it requires, which is ensured by prohibiting inconsistent conduct by the State (*cf. Paragraph 16.2 of the Constitutional Court Judgment of 8 March 2017 in Case No 2016-07-01*).

Understanding and respective application of the general principles of law always requires keeping in mind the highest and the most important objective of the legal system in a democratic rule-of-law state, i.e. fairness (*see: Dr.iur. Rezevska D. Vispārējo tiesību principu nozīme un piemērošana. (The Importance and Application of the General Principles of Law.) Riga: Published by D. Rezevska, 2015, pp. 129–130*). The principle of legitimate expectations is closely associated with the fundamental values of the legal system. Its application is not and cannot be an aim in itself. It is important that a fair end result is achieved in all cases.

The Constitutional Court has acknowledged that if the State is involved in the rescue and restructuring of an enterprise that without the aid is likely to become insolvent, and successful continuation of the enterprise's operations is a direct result of the aid, a situation where subjects that benefit the most from sound operations of the enterprise do not participate in its rescue is not compatible with the fairness principle (*see Paragraph 18 of the Constitutional Court Judgment of 13 October 2015 in Case No 2014-36-01*).

The fairness principle requires the legislature to be able to solve any practical issue by means of legal provisions. Legal relations are changeable and there may occur non-typical situations that need to be addressed immediately.

Absence of a legal provision may be unfair (*cf. Paragraph 18.1 of the Constitutional Court Judgment of 19 December 2012 in Case No 2012-03-01*). The fairness principle requires that as fair as possible balance between contradicting interests of various members of society be achieved (*see Paragraph 7 of Conclusions in the Constitutional Court Judgment of 13 May 2005 in Case No 2004-18-0106*).

In a general situation, the State creates circumstances that enable commercial operators to operate freely, which includes mutual competition. In exceptional cases the State may intervene and grant aid to the respective market player. However, in that case no one may gain unjustified benefit, i.e. benefit that they would not gain if in normal market conditions the market player in question were no longer able to act in the commercial environment and compete with other market players. The prevention of gaining unjustified benefit ensures normal operation of the market. The above is an element of concretisation of the fairness principle. In accordance with the fairness principle, the contested provisions create circumstances that are as close as possible to the situation as it would be if no aid had been granted.

Hence, the aid-related restrictions are aimed at the strengthening of the fairness principle enshrined in the Constitution. Issuing special rules for enterprises that have received aid is justified by significant interests of taxpayers and society as a whole, namely, preventing the use of aid funds to cover subordinated liabilities. If no such special rules were prepared and adopted, claims of subordinated creditors might be fulfilled before the repayment of aid for commercial activity. The aid is intended to help the enterprise facing financial difficulties and restore its solvency, rather than provide funds to fulfil claims of any creditors. Subordinated creditors cannot expect their claims to be fulfilled because the enterprise has been granted aid.

29.3. According to the principle of legitimate expectations, an individual can expect legitimate and consistent conduct by the State, whereas the State must protect the trust placed in it (*cf. Paragraph 16.2 of the Constitutional Court Judgment of 8 March 2017 in Case No 2016-07-01*). This principle requires that a person's expectations with regard to the preservation or exercise of a specific right

be protected. This comprises the State's obligation to fulfil the commitments it has made in respect of persons (*see Paragraph 25 of the Constitutional Court Judgment of 26 November 2009 in Case No 2009-08-01 and Paragraph 14 of the Constitutional Court Judgment of 6 December 2012 in Case No 2012-01-01*).

The Applicant argues that, pursuant to the provision that was in force before Section 8(1) of the Control Law was adopted, they had a right to receive the principal amount under the Time Deposit Agreement.

The legal relations between the Applicant and *AS Parex banka* (later *AS Reverta*) were established before Section 8(1) of the Control Law came into force and these relations continued also when the provision came into force. It follows that upon its coming into force this provision was applied to relations that had already begun but were not completed. For that reason, Section 8(1) of the Control Law affected the legal relations established by the Time Deposit Agreement with immediate effect.

The legislature may enact legal provisions with immediate effect. Therefore, applying an adopted legal provision also to legal relations that began before the coming into force of the legal provision and continue when the provision comes into force is permissible. However, when adopting a legal provision, the legislature must always assess its effect on existing legal relations (*see Paragraph 9.2 of the Constitutional Court Judgment of 29 April 2015 in Case No 2014-31-01 and Paragraph 24 of the Judgment of 13 November 2019 in Case No 2018-22-01*).

In order to establish if the Applicant had grounds for legal expectations with regard to their right to claim repayment of the principal amount under the Time Deposit Agreement, the Constitutional Court needs to assess if the person's reliance on the legal provision is legitimate, justified and reasonable and if the legal provision is in essence sufficiently clear and unchangeable to be relied on (*see Paragraph 13 of the Constitutional Court Judgment of 5 March 2021 in Case No 2020-30-01*).

According to the joined party Māris Onževs, *Dr. iur.*, investments in subordinated capital are considered high-risk investments that may become subject to changes in legislation, especially in cases where actual circumstances change,

i.e. the borrower faces significant difficulties in fulfilling their liabilities (see vol. 6, p. 101 of materials in the case).

The legislature is responsible for regularly assessing whether a specific legal provision is effective, adequate and necessary and whether it needs to be improved in any way. It means that the principle of legitimate expectations does not provide grounds to expect that an established legal situation will never change (cf. Paragraph 16.2 of the Constitutional Court Judgment of 8 March 2017 in Case No 2016-07-01). Not only does this principle not preclude amendments to an existing legal provision, but requires them in certain circumstances. If the reverse were true, the State would not be able to adequately respond to the changing daily circumstances (see Paragraph 19 of the Constitutional Court Judgment of 8 December 2015 in Case No 2015-07-03).

When adopting legal instruments, the legislature undoubtedly has a duty of protection against inconsistent conduct by the State that follows from the principle of legitimate expectations. However, it must not be viewed separately from the circumstances that necessitated the respective actions by the legislature. Considering how external factors affected the specific actions by the legislature has an important role in the assessment of legitimate expectations in the case under examination.

The financial difficulties of *AS Parex banka*, its possible insolvency and liquidation in 2008 caused a situation that Latvia had never experienced before, which required the State's involvement in rescuing the bank and granting aid. This also necessitated amendments in legislation. In these circumstances the Applicant could not reasonably expect that legal provisions related to the fulfilment of the Time Deposit Agreement and control of aid would remain unchanged and that their amendments would not affect the legal relations established between *AS Parex banka* (later *AS Reverta*) and the Applicant. The fact that for some time after the start of provision of aid to *AS Parex banka* there was no national legislation that restricted the use of the State aid in contradiction to its objectives does not mean that the Applicant could reasonably expect that these irregularities would not be corrected and their situation would never change. In other words, the Applicant

could not legitimately, justifiably and reasonably expect that the rules would remain unchanged.

The Applicant also notes that the legislature did not provide for a lenient transition to the new rules, i.e. there was neither a transitional period nor adequate compensation for subordinated creditors. It follows from the Applicant's arguments that a preferable transitional period for them would be at least 11 months from the coming into force of Section 8(1) of the Control Law (*see vol. 1, p. 39 of materials in the case*).

Even if the principle of legitimate expectations were affected, it would not give rise to a person's right to expect that a specific transitional period would be introduced that meets their preference. The Applicant unjustifiably states that the transitional period should have been at least 11 months long. This preference of the Applicant is understandable, because it would mean that Section 8(1) of the Control Law would have become effective after the maturity date of the liabilities under the Time Deposit Agreement; however, there are no grounds for it.

The Constitutional Court emphasises that the aid was granted to an enterprise that faced financial difficulties. It was an important signal for creditors, including subordinated creditors, about the enterprise's inability to fulfil its liabilities. In these circumstances the fact that Section 8(1) of the Control Law was adopted without a transitional period was not critically important.

As has already been acknowledged in this judgement, the rights restriction established by Section 8(1) of the Control Law is aimed at protecting the interests of society. The interests of society require that wasting the national budget funds be prevented, and in the case under consideration this can be achieved by preventing subordinated creditors, i.e. persons that voluntarily assumed a significant business risk, from gaining unjustified benefit from aid granted by the State to an enterprise that faces financial difficulties. Without the sharing of burden between these creditors and society the ability of the State to recover the funds it invested would be at risk.

29.4. The Applicant holds that Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law have a retroactive effect because these provisions were applied to an agreement with a due date almost two years earlier, i.e. to legal

relations that ended before these provisions came into force. Allegedly, such retroactive effect is not justified.

The joined party Māris Onževs, *Dr. iur.* states that Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law do not have retroactive effect, and these provisions have a forward-going effect (*see vol. 6, p. 103 of materials in the case*).

Therefore, the liquidation procedure of an enterprise that was granted aid is governed by Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law. The effects of these provisions ensue only in the case that the enterprise is liquidated. Therefore, the moment of initiation of the enterprise's liquidation procedure is important for assessing the effect of these provisions in time.

Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law came into force on 2 February 2017. The meeting of shareholders of *AS Reverta* adopted a decision to initiate the liquidation procedure of *AS Reverta* on 29 May 2017 (*e.g. see p. 8 of the AS Reverta 2019 Annual Report, available at: www.reverta.lv*), i.e. more than three months after the coming into force of Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Control Law. Therefore, these provisions had immediate effect with respect to the Applicant. It means that at the time when the liquidation *AS Reverta* was initiated, the Applicant was already aware of its consequences and they could take these consequences into account.

In view of the fact that aid is provided from the national budget funds which is common property of the entire society, the aid was granted in the interests of the entire society, and, therefore, the objective of the aid is to protect society rather than specific individuals, i.e. subordinated creditors. The State is under no obligation to use the aid mechanism to ensure that claims of subordinated creditors are fulfilled. If the credit institution is not able to repay the aid, there is no reason for satisfying claims of subordinated creditors.

The benefit gained by society from economic use of national budget funds and their quick recovery exceeds the loss incurred by specific subordinated creditors. The interest of specific individuals to recover their funds is not commensurate with the infringement of society's interests if failure to implement

the burden-sharing principle prevented society from recovering the funds it invested to as full extent as possible.

It follows that the benefit gained by society from the restriction of fundamental rights established by the contested provisions exceeds the damage caused to the rights and legitimate interests of the subordinated creditors.

Hence, the contested provisions comply with the principle of legitimate expectations enshrined in Article 1 of the Constitution and the first three sentences of Article 105 of the Constitution.

30. The Applicant requests that compliance of the contested provisions with Article 91 of the Constitution be assessed.

Article 91 of the Constitution: ‘All human beings in Latvia shall be equal before the law and the courts. Human rights shall be realised without discrimination of any kind.’

The Constitutional Court has acknowledged that the task of the principle of equality is to ensure meeting the prerequisite of a rule-of-law state whereby laws inclusively cover all persons and the law is applied without any privilege (*see Paragraph 7 of the Constitutional Court Judgment of 2 February 2010 in Case No 2009-46-01*). The principle of equality enshrined in the first sentence of Article 91 of the Constitution allows and even requires different treatment of persons whose circumstances differ, and it also allows different treatment of persons whose circumstances are equal if there are objective and reasonable grounds for such treatment (*see Paragraph 9 of the Constitutional Court Judgment of 29 June 2018 in Case No 2017-28-0306*).

The non-discrimination principle enshrined in the second sentence of Article 91 of the Constitution is an aspect of the equality principle used to specify this principle and help in its application in specific cases. The objective of non-discrimination is to eliminate unequal treatment based on impermissible criteria (*e.g. see Paragraph 15 of the Constitutional Court Judgment of 23 November 2015 in Case No 2015-10-01*).

Taking into account the arguments made in the constitutional challenge and other case-related materials, the Constitutional Court will assess compliance of the contested provisions with the first sentence of Article 91 of the Constitution.

31. In order to assess if the contested provisions comply with the principle of legal equality, it is necessary to establish the following:

1) if and which persons (groups of persons) are in circumstances that are comparable according to specific criteria;

2) if the contested provisions equally treat persons that are in different circumstances or treat differently persons that are in circumstances that are comparable according to specific criteria;

3) if such treatment is determined by a legal provision adopted in a procedure established by legislation;

4) if there exist objective and reasonable grounds for such treatment, i.e. if it has a legitimate objective and if the principle of proportionality has been observed (*cf. Paragraph 8 of the Constitutional Court Judgment of 2 November 2020 in Case No 2020-14-01*).

32. The Constitutional Court has acknowledged that assessing if and which persons are in circumstances that are comparable according to specific criteria requires establishing the main common denominator for the respective group of persons. The Constitutional Court also needs to assess if there are any significant additional considerations indicating that the groups of persons in question are not in mutually comparable circumstances (*see Paragraph 9 of the Constitutional Court Judgment of 2 November 2020 in Case No 2020-14-01*).

The Applicant essentially holds the following: if following the reorganisation of *AS Parex banka* their claim had been transferred to *AS Citadele banka* instead of *AS Reverta*, their situation would be better than it currently is. *AS Citadele banka* is subject to Section 59⁶ of the Credit Institution Law and Paragraph 36 of the Transitional Provisions that set forth an exception from the restriction on the fulfilment of subordinated liabilities, i.e. the restriction does not

apply to credit institutions that were granted aid before Section 59⁶(1) came into force.

According to the joined party – the Ministry of Finance – *AS Citadele banka* received subordinated liabilities of *Possessor* and EBRD. All other subordinated liabilities were transferred to *AS Reverta* (see vol. 6, pp. 14 and vol. 7, p. 35 of materials in the case). It is this fact that constitutes the violation of the first sentence of Article 91 of the Constitution according to the Applicant. The Applicant holds that, contrary to the principle of equality, the burden was shared only among the subordinated creditors of *AS Reverta*.

Therefore, it is necessary to assess if the subordinated creditors of *AS Citadele banka* and the subordinated creditors of *AS Reverta*, including the Applicant, are in circumstances that are comparable according to specific criteria. This requires clarifying the circumstances and the objective of establishing these liabilities in each of the enterprises.

A decision that Latvia acquires *AS Parex banka* was made on 8 November 2008. Shares of *AS Parex banka* were transferred to *Possessor* on 24 November 2009. In this way, *Possessor* received majority shares of the credit institution and became the administrator of *AS Parex banka* shares. On 16 April 2009, EBRD became a shareholder of *AS Parex banka* (see www.possessor.gov.lv and recital 15 of Decision No 2015/162).

On 22 May 2009, the Latvian State granted *AS Parex banka* a subordinated loan that was later transferred to *AS Citadele banka*. As follows from recital 19 of Decision No 2015/162, it formed part of the aid provided. Part of this loan was later, on 3 September 2009, refinanced by EBRD. It means that EBRD held part of the subordinated loan granted to *AS Parex banka* that was later transferred to *AS Citadele banka*. However, these loans were not granted as part of normal operations of the market players. With these loans, both *Possessor* and EBRD participated in the rescue measures for *AS Parex banka* (later *AS Citadele banka* and *AS Reverta*). The subordinated loans granted by Latvia and EBRD sought to provide aid to *AS Parex banka* that faced financial difficulties.

It follows from the case materials that the subordinated loan the principal amount of which the Applicant wishes to recover was provided with a different

aim, i.e. that of gaining profit. This loan was provided to *AS Parex banka* in normal market conditions. It means that investments of the subordinated creditors of *AS Citadele banka* and *AS Reverta* pursued different aims. In the first case this aim consisted in rescuing the bank that faced financial difficulties, and in the second case the investment sought to gain profit in the long term.

Therefore, in the context of the case under examination, there are significant differences between the subordinated creditors of *AS Reverta* and *AS Citadele banka* and they do not belong to comparable groups in the meaning of the first sentence of Article 91 of the Constitution.

It follows that the contested provisions comply with the first sentence of Article 91 of the Constitution.

Substantive Part

Pursuant to Section 29(1)(6) and Sections 30–32 of the Constitutional Court Law, the Constitutional Court

held:

1. To terminate the proceedings with regard to the compliance of Section 8¹(2)(3) of the Law on Control of Aid for Commercial Activity with Articles 1, 91, 92 and 105 of the Constitution of the Republic of Latvia.

2. To terminate the proceedings with regard to the compliance of Section 8(1), Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) 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 Constitution of the Republic of Latvia.

3. To declare Section 8(1), Paragraphs 1 and 2 of Section 8¹(2) and Section 8¹(3) of the Law on Control of Aid for Commercial Activity compliant with Article 1, the first sentence of Article 91 and the first, second and third sentences of Article 105 of the Constitution of the Republic of Latvia.

The judgment is final and not subject to appeal.

The judgment enters into force on the day of its publication.

Chairperson of the court hearing

Sanita Osipova