THE CONSTITUTIONAL COURT
OF THE REPUBLIC OF LATVIA

J U D G E M E N T
On Behalf of the Republic of Latvia
Riga, 19 October 2011
Case No. 2010-71-01

The Constitutional Court of the Republic of Latvia composed of the Chairman of the Court session Gunārs Kūtris, and justices Kaspars Balodis, Aija Branta, Kristīne Krūma, Uldis Ķinis, and Sanita Osipova,

having regard to a constitutional complaint of the following companies registered in the Grand Duchy of Luxembourg: limited partnership "Amber Trust S.C.A. SICAF-SIF", investment company with variable capital "DCF FUND" and open investment company "East Capital (LUX)", non-taxable limited liability companies registered in the Cayman Islands "Firebird Republics Fund, Ltd", "Firebird New Russia Fund, Ltd" and "Firebird Avrora Fund, Ltd", as well as private limited liability company registered in the Swedish Kingdom "East Capital Asset Management Aktiebolag" (hereinafter – the Applicants),

with the participation of Mr. Viktors Tihonovs and Mr. Aivars Lošmanis, attorneys at law representing of the Applicants,

with the participation of Mr. Mārtiņš Paparinskis, attorney at law representing the institutions that adopted the contested act, the Saeima [Parliament],

with the secretary of the court hearing Ms. Līva Rozentāle,

according to Article 85 of the Satversme [Constitution] of the Republic of Latvia, Article 11 1st indent and Article 17 (1) 11th indent of the Constitutional Court Law,

on 6 September and 20 September 2011, in Riga, in a public hearing, examined the case

"On Compliance of Section 59.[5] of the Credit Institution Law with Article 1 and Article 105 of the Satversme of the Republic of Latvia".

The Facts

1. The Credit Institutions Law was adopted on 5 October 1995. Pursuant to Section 1 (1) of the above mentioned law, "credit institution" means "a capital company, which accepts deposits and other repayable funds from an unlimited circle of clients, issues credits in its own name and provides other financial services". Pursuant to Section 3 (2) of the same law, "in the Republic of Latvia, a bank may be founded only as a stock company". Section 4 (2) of the Credit Institutions Law provides that "the founding, operation, reorganisation and liquidation of a credit institution shall be regulated by this Law, the Commercial Law, the Financial Instrument Market Law and other laws, observing the provisions included in this Law". Before February 2009, the Credit Institutions Law failed to regulate issues related with increase in equity capital of credit institutions.

1.1. The Commercial Law was adopted on 13 April 2000 and it came into effect on 1 January 2002. Division XIII thereof entitled "Stock Companies" contains Chapter 2 "Increase and Reduction of Equity Capital" containing Section 249 "The Right to Increase or Reduce Equity Capital" and Section 251 "Priority Right of Stockholders".

As to the procedure of increase in equity capital, initially Section 249 of the Commercial Law provided: "The equity capital may be increased or reduced only on the basis of a decision of a meeting of stockholders, in which the regulations for an increase or reduction of the equity capital shall be approved, and amendments to the articles of association of the company made".

By 24 April and 18 December 2008 laws "Amendments to the Commercial Law", Section 249 of the Commercial Law was amended, which resulted in the following wording of Section 249 (1) and (4) of 21 January 2009 Commercial Law:

"(1) The equity capital may be increased or reduced only on the basis of a decision of a meeting of stockholders, in which the regulations for an increase or reduction of the equity capital shall be approved, and amendments to the articles of association of the company made, except the case referred to in Paragraph four of this Section. [..]

(4) The authorisation for the board of directors may be specified in the articles of association for a period of time up to five years to increase the equity capital in amount specified in the articles of association or in the meeting of stockholders, not exceeding

30 per cent of the equity capital of the company at the time of coming into effect of the authorisation. The authorisation of the board of directors to increase the equity capital shall not apply to increase of the equity capital in the case referred to in Section 254 of this Law."

Section 254 of the Commercial Law regulates increasing of equity capital for a special purpose.

As to the priority right of a present shareholder to purchase newly issued stock (hereinafter – the priority right of shareholders) in case of increase in equity capital, Section 251 (1) and (3) of the Commercial Law (wording of 14 February 2002) provides the following:

"(1) In the case of the increase in equity capital the current stockholders have priority right to purchase the newly issued stock in proportion to the total of the nominal value of the stock already owned by them. [..]

(3) If any of stockholders do not exercise their priority right within the specified time period, the relevant newly issued stock shall be offered for subscription according to the procedures specified in the regulations for increasing equity capital, to those current stockholders who have already exercised their priority right."

1.2. At the end of September 2008, the joint-stock company "Parex banka" (hereinafter – Parex banka) was the second largest bank in Latvia by its stock amount, and its assets constituted 13.8 per cent of the total assets of the banking sector in Latvia. On October 2008, deposits started to flow away from Parex banka and availability of its capital fell below the necessary minimum, which continued decreasing. At the beginning of November 2008, the Financial and Capital Market Commission (hereinafter the FCMC), the Ministry of Finance (hereinafter – the MF), and the Bank of Latvia (hereinafter – the BL) concluded that Parex banka may soon become insolvent without any state aid. On 4 November 2008, the State Chancellery received a request of Mr. V. Kargins and Mr. V. Krasovickis, majority shareholders of Parex banka, to provide State aid to Parex banka and, at a meeting of the Cabinet of Ministers (hereinafter – the CM), conclusion of respective agreement was conceptually confirmed. On 10 November 2009, an investment agreement between a public joint-stock company "Latvijas Hipotēku un zemes banka" (hereinafter – LHZB), Parex banka, the Republic of Latvia and Mr. V. Kargins and Mr. V. Krasovickis, shareholders of Parex banka (hereinafter – former majority shareholders) was signed, the agreement dealing with the sale of 51 per cent of Parex banka stocks to LHZB for the price of two lats. Pursuant to the above mentioned agreement, purchase of stocks was postponed based on several conditions, one of them establishing that the European

Commission (hereinafter – the EC) would permit providing state aid (*see: Informative material "Overtakig and Restructurization of Parex banka" ["Parex bankas pārņemšana un restrukturizācija"], case materials, Vol. 2, pp. 172 – 192*).

On 24 November 2008, the EC adopted a decision wherein it concluded that the above mentioned purchase cannot be regarded as aid to former majority shareholders and state aid to be granted to Parex banka does not contradict the common market of the European Union (hereinafter – the EU); therefore the EC decided not to object to the aforementioned (*see: Decision of the EC in the case NN 68/2008 "Public support measures to JSC Parex banka", Official Journal of the EU C 147, 27 June 2009, pp. 1, or http://ec.europa.eu/eu_law/state_aids/comp-2008/nn068-08.pdf).*

On 3 December 2008, the CM decided to purchase all stocks pertaining to the former majority shareholders of Parex banka for the total purchase price of two lats. A respective agreement was signed, as a result of which LHZB obtained all stock once pertained to the former majority shareholders, which constituted 84.83 per cent of shares of Parex banka. The rest of 15.7 per cent remained to the former majority stockholders.

On 15 December 2008, the CM decided to increase its participation share in Parex banka by purchasing shares of Parex banka pertaining to "Svenska Handelsbanken AB" for the price of 1 euro cent per share. This transaction resulted in increase of the participation share of LHZB in Parex banka up to 85.15 per cent (*see: Informative material "Overtakig and Restructurization of Parex banka" ["Parex bankas pārņemšana un restrukturizācija"], case materials, Vol. 2, pp. 172 – 192*).

On 18 December 2008, the Saeima adopted the Bank Overtaking Law that was proclaimed on 30 December 2008 and came into effect on the next day of its proclamation. Section 3 (2) of the Bank Overtaking Law provides that overtaking of a bank shall take place on contractual basis (voluntary overtaking) or for a fair compensation based on an appropriate law (compulsory overtaking).

On 19 December 2008, an extraordinary meeting of shareholders of Parex banka took place. At the meeting, present shareholders were summoned and new members of the Board of Parex banka were elected. When announcing candidates, the Applicants exercised their right to jointly announce a candidate for the office of a member of the Board taking into account the fact that their capital share did not exceed 5 per cent of equity capital. The particular candidate was not elected (*see: Minutes of 19 December 2008 extraordinary meeting of shareholders, case materials, Vol. 1, pp. 103 – 108*).

On 11 February 2009, the EC expressed its regret for Latvia having introduced changes in public support measures by failing to observe Article 88 (3) of the EC

Treaty; however, it concluded that these measures are compatible with the common market and therefore decided not to raise any objections (*see: Judgment of 11 February 2009 in the case NN 3/2009 "Modifications to the public support measures to JSC Parex banka", Official Journal of the EU, C 147, 27 June 2009, pp. 2 – 3, or http://ec.europa.eu/eu_law/state_aids/comp-2009/nn003-09-en.pdf).*

1.3. On 29 January 2009, in the second reading, the Saeima adopted a draft Law No. 963/Lp9 "Amendments to the Credit Institutions Law" (hereinafter – the Draft Law No. 963) by determining 11 February 2009 as the term for submitting suggestions for the third reading of the draft law. The committee responsible for the above mentioned draft law was the Saeima Budget and Finance (Tax) Committee (hereinafter – the Budget Committee). On 16 February 2009, the MF, in the letter No. 7-4/127 addressed to the Budget Committee, submitted several suggestions to the above mentioned draft law, including the suggestion to supplement Section 59.[5] of the Credit Institutions Law, in the frameworks of which it asked to regard it as a suggestion by the responsible committee. At the Budget Committee meeting of 17 February 2009, when preparing the draft law No. 963 for the third reading, the above mentioned suggestions was incorporated into the draft law as a suggestion of the responsible committee.

1.4. On 16 and 17 February 2009, the CM examined the issue on Parex banka. It decided, among the rest, to support increase in equity capital of Parex banka and commissioned the MF to prepare and submit to the CM all necessary draft documents to increase equity capital before the annual report is confirmed (*see: minutes of the CM meeting of 16 February 2009 No. 12 1. § 10, case materials, Vol. 3, pp. 93, and minutes of the CM meeting of 17 February 2009 No. 13 63. § 4, case materials, Vol. 3, pp. 92*).

On 24 February 2009, the CM examined the issue on Parex banka and decided, among the rest, to commissioning the JSC "Privatizācijas aģentūra" (hereinafter - Privatizācijas aģentūra) to overtake 85.15 per cent of Parex banka shares, as well as took note of the information provided on negotiation with the European Restructuration and Development Bank (hereinafter – ERDB) and conditions set by the letter regarding its involvement in increase of equity capital of Parex banka (*see: Minutes of MC meeting of 24 February 2009 No. 14 1. § 4 – 5, case materials, Vol. 3, pp. 69*).

1.5. On 26 February 2009, the Saeima adopted the Law "Amendments to the Credit Institutions Law" that was proclaimed on 11 March 2009 and came into effect

on 25 March 2009. Consequently, Section 59.[5] of the Credit Institutions Law (hereinafter also – the Contested Norm) provides:

"(1) If the Cabinet of Ministers, based on a request of a credit institution, has adopted a decision regarding acquisition of substantial assistance provided by the State or increase of equity capital of a credit institution, a credit institution council shall have the right, without summoning a meeting of shareholders, to adopt a decision on behalf of the meeting of shareholders regarding increase of equity capital of a credit institution and to approve provisions for increasing of equity capital.

(2) In cases mentioned in Paragraph 1 of this Section, present shareholders of a credit institution shall not have the priority right to obtain shares of the new issuance.

(3) By increasing equity capital in the case mentioned in Paragraph 1 of the first part, amendments to articles of association of a credit institution shall be adopted by its council. If within the term established in the provisions regarding increase of equity capital, the nominal value of all shares of the new issuance has not been paid, then increase of equity capital shall not be regarded as executed and amendments introduced into the articles of association shall become null and void as from the date of adopting them."

1.6. Pursuant to the Contested Norm, equity capital of Parex banka was increased by several times.

On 20 March 2009, the Board of Parex banka adopted a decision "On Addressing the Cabinet of Ministers regarding Material Increase of Participation Share of the State" (*see: Decision of 20 March 2009 by the Board of Parex banka No. 2/44/09, case materials, Vol. 3, pp. 133 – 134*).

On 24 March 2009, the CM reviewed the issue on Parex banka and *inter alia* decided to, indirectly by means of Privatizācijas aģentūra, materially increase the participation share of the State in Parex banka by purchasing 165 million newly issued voting shares with the nominal value 1 lat after the Contested Norm would come into force and after the decision of the EC on compliance of the planned State aid with the provisions of the EC Treaty would be adopted (*see: Minutes of the MC meeting of 24 March 2009 No. 21 76.§ 3.1, case materials, Vol. 3, pp. 96*).

On 26 March 2009, by referring to 24 March 2009 CM decision, the Council of the Parex banka adopted the decision on behalf of the meeting of shareholders to increase equity capital of Parex banka by 165 million lats by issuing 160 000 000 registered voting shares and the nominal value of 1 lat, to approve provisions of increase in equity capital (12^{th} issuance), and to introduce respective amendments into

the Articles of Association of Parex banka (*see: Decision of the Council of Parex banka of 26 March 2009, case materials, Vol. 1, pp. 100*).

On 16 April 2009, Privatizācijas aģentūra, the Republic of Latvia, the ERDB and Parex banka concluded a share purchase agreement and a shareholders' agreement which provided, among the rest, that before the transaction with the ERDB equity capital of Parex banka was increased by issuing 165 million registered voting shares and the nominal value of 1 lat, Privatizācijas aģentūra would subscribe to the above mentioned shares and pay for them, whist the ERDB would purchase 57 506 825 of these shares. The increase in equity capital at the above mentioned amount has not been co-ordinated with the EC because, in the frameworks of the urgent procedure, the EC regarded the issuance of permission for the increase in equity capital by the above mentioned sum as impossible. According to the EC, such a large equity capital would exceed the minimum state aid necessary to eliminate insolvency of the bank (*see: Informative report of Mr. E. Repše, Minister of Finance, on Parex bank, case materials, Vol. 3, pp. 197*).

On 8 May 2009, the CM committed Privatizācijas aģentūra to ensure increase in equity capital of Parex banka in accordance with the EC co-ordinated amount of the state aid (*see: Minutes of the CM meeting of 8 May 2009 No. 30 1.§ 3*). The CM also decided to support restructuration of the State aid to Parex banka in accordance with the elaborated State aid restructuration plan and to submit it to the EC for approval thereof.

On 11 May 2009, the EC adopted the decision No. 189/2009 "Modifications to the public support measures to the JSC Parex banka" (hereinafter – the EC 11 May 2009 decision), wherein it recognized that the public support that *inter alia* included increase in equity capital of Parex banka by 140 million lats does not contradict the common European market and therefore decided not to object thereto (*see: EC Judgment of 11 May 2009 in the case N 189/2009 "Modifications to the public support measures to JSC Parex banka", Official Journal of the EU, C 176, 29 June 2009, pp.3, or http://ec.europa.eu/eu_law/state_aids/comp-2009/n189-09-en.pdf).*

On 11 May 2009, Parex banka restructuration plan was also submitted to the EC.

On 14 May 2009, by referring to CM 24 March 2009 decision and 8 May 2009 decision, as well as 11 May 2009 decision, the Council of Parex banka on behalf of the shareholders' meeting decided to increase equity capital of Parex banka by 140 million 750 thousand lats by issuing 140 750 000 registered voting shares and the nominal value of one lat. Likewise, the Council of Parex banka again confirmed amendments to provisions regulating increase of equity capital (12^{th} issuance) and introduced

respective amendments into the Articles of Association of Parex banka (*see: Council of Parex banka 14 May 2009 decision, case materials, Vol. 1, pp. 98*).

Having reviewed the public support plan to Parex banka submitted on 11 May 2009, on 29 June 2009 the EC declared its decision regarding initiation of procedure established in Article 88 (2) of the EC Treaty in respect to Latvia [*see: State aid C 26/09 (ex N 289/09) – Restructuring aid to JSC Parex banka. Invitation to submit comments pursuant to Article 88 (2) of the EC Treaty. Official Journal of the EU, C 239, 8 October 2009, pp. 11*].

On 23 July 2009, amendments were introduced into the share purchase agreement and shareholders agreement concluded between Privatizācijas aģentūra, the Republic of Latvia, the ERDB and Parex banka. On 3 September 2009, the ERDB took possession of 51 444 325 shares of Parex banka, which constituted 25 per cent plus one share of the entire amount of Parex banka's shares (*see: Informative report of Mr. E. Repše, Minister of Finance, on Parex bank, case materials, Vol. 3, pp. 197*).

On 29 September 2009, after having obtained permission of the ERDB and consent of the Council, the Board of Parex banka decided to address a request to the CM to materially increase the participation share of the State in equity capital of Parex banka (*see: Board of Parex banka 29 September 2009 decision No. 3/106/09, case materials, Vol. 3, pp. 204 – 205*). On 8 October 2009, the Council of Parex banka adopted a decision "On Increase of Equity Capital of the Bank", wherein it agreed that the Board would request the CM to adopt a decision regarding material increase of participation share of the State in equity capital of Parex banka (*see: Council of Parex banka 8 October 2009 decision, case materials, Vol. 3, pp. 206*).

On 13 October 2009, the CM reviewed "The Informative Report on Parex banka" and, to ensure sufficiency of capital of Parex banka, it decided that according to EC 11 May 2009 decision the State would indirectly by mediation of Privatizācijas aģentūra materially increase its participation share in Parex banka by purchasing 24 million 250 thousand registered voting shares of new issuance and the nominal value of one lat (*see: Minutes of MC 13 October 2009 meeting, No. 69 78.§, case materials, Vol. 3, pp. 136*).

On 15 October 2009, by referring to CM 13 October 2009 decision, the Council of Parex banka adopted a decision on behalf of the shareholders' meeting to increase equity capital of Parex banka by 24 million 250 thousand lats by issuing 24 250 000 registered voting shares and with the nominal value of one lat. Likewise, the Council of Parex banka confirmed amendments to provisions regulating increase of equity capital (13^{th} issuance) and introduced respective amendments into the Articles of

Association of Parex banka (*see: Council of Parex banka 15 October 2009 decision, case materials, Vol. 1, pp. 94*).

On 29 January 2009 the Board of Parex banka decided to address a request to the CM to permit increasing equity capital of Parex banka and to ask consent of the Council of Parex banka (*see: Board of Parex banka 29 January 2009 decision No. 1/9/10, case materials, Vol. 4, pp. 37*). On 5 February 2010, the Council of Parex banka decided to give its approval to the Board of the bank to submits its request to increase equity capital to the CM (*see: Council of Parex banka 5 February 2010 decision, case materials, Vol. 4, pp. 38*).

On 23 February 2010, the CM decided to, indirectly by means of Privatizācijas aģentūra, materially increase the participation share of the State in Parex banka by purchasing 31 million 500 thousand newly issued voting shares and with the nominal value 1 lat (*see: Minutes of the MC meeting of 23 February 2010 No. 10 86 § 5, case materials, Vol. 4, pp. 1*). According to the aforementioned, on 24 February 2010, the Council of Parex banka decided to increase equity capital of Parex banka by 31 million 500 thousand lats by issuing 31 million 500 thousand registered voting shares and with the nominal value of one lat. Likewise, the Council of Parex banka confirmed amendments to provisions regulating increase of equity capital (14^{th} issuance) and introduced respective amendments into the Articles of Association of Parex banka (*see: Council of Parex banka 24 February 2010 decision, case materials, Vol. 1, pp. 91*).

On 15 September 2010, the EC adopted the decision C 26/09 (ex N 289/09) – on state aid that Latvia is planning to grant for restructuring of Parex banka (hereinafter – EC 15 September 2010 decision). The EC concluded that taking into account the restructuring plan and liabilities undertaken by the Republic of Latvia, restructuration aid that Latvia is planning to grant to Parex banka and JSC "Citadele banka" shall be regarded as compatible with the internal market in the meaning of Section 107 (3) indent "b" of the Treaty on the Functioning of the European Union (hereinafter – the TFEU) (*see: Official Journal of the EU, L 364, 23 June 2011, pp. 28 – 51*).

2. The Applicants hold that the Contested Norm infringes the right to property established in Article 105 of the Satversme of the Republic of Latvia (hereinafter – the Satversme), as well as breaches the principle of legitimate expectations following from Article 1 of the Satversme; therefore they ask to recognize the Contested Norm as null and void as from the date of adopting it.

It was indicated in the Application that the Applicants are investment deposit funds with internationally recognized reputation. They have made investments into Parex banka – a Latvian credit institution performing its basic activities. All Applicants have purchased registered voting shares, whilst a part of the Applicants also possess registered voting shares. The initial total participation share in equity capital of Parex banka constituted 8.4 per cent of equity capital of the bank. Pursuant to the Contested Norm, the Council of Parex banka adopted several decisions regarding increase of equity capital of Parex banka by amending the Articles of Association and confirming provisions for the increase of equity capital (share issuance). Equity capital of Parex banka, the initial amount of which was 65 027 295 (consisting of 60 633 439 registered voting shares and 4 393 856 registered shares without the right to vote, both with the nominal value of one lat), was increased in total by 196 500 000 lats in the result of the above mentioned decisions, and at the date of submitting the application it constituted 261 527 295 (consisting of 201 383 439 registered voting shares and 60 143 856 registered shares without the right to vote, both with the nominal value of one lat. Consequently, at the date of submitting the application, the total participation share of the Applicants in equity capital of Parex banka constituted only 2.1 per cent.

Reduction of the participation share in equity capital of Parex banka caused legally and economically unfavourable consequences to the Applicants, namely, it has reduced its influence over administration of the company, the amount of shares owned and the amount of dividends to be disbursed, possible liquidation quota in case of liquidation of the company, as well as the value of the shares.

At the court hearing, **Mr. Viktors Tihonovs and Mr. Aivars Lošmanis, the attorneys at law representing of the Applicants** indicated that after initiation of proceedings at the Constitutional Court, increase of equity capital of Parex banka took place once more in December 2010 in accordance with the procedure established in the Contested Norm.

Representatives of the Applicants emphasized that the Applicants wanted to participate in Parex banka rescue measures and they had necessary free financial means at their disposal for this purpose; however, neither the former majority shareholders, nor the State have addressed them a proposition to participate in solving financial problems of Parex banka. By failing to establish summoning of a shareholders' meeting, the Contested Norm has denied the Applicants information on the planned increase of equity capital and also the possibility to suggest alternative solutions. However, denial of the priority right of shareholders has deprived the

Applicants of the possibility to offer their own assets to rescue Parex banka and thus preserve their participation share in Parex banka.

2.1. By referring to the Judgment of 4 February 2009 by the Constitutional Court in the case No. 2008-12-01, as well as case-law of the European Court of Human Rights (hereinafter – the ECHR), it was indicated in the application that the right to property also includes the right to decide on issues related to the property, including the issues regarding changes in participation share. Adoption of the decision regarding changes in equity capital amount cannot be commissioned to any other administration institution or person of a joint-stock company but the body of shareholders. The regulatory framework, according to which shareholders' meeting of a credit institution is denied participation in decision-making process on such an important issue as increase of equity capital restricts the right to own property established in Article 105 of the Satversme.

The Applicants emphasize that the Contested Norm has been adopted after the State became a shareholder of Parex banka as the result of a civil transaction of the State. By means of the Contested Norm, one shareholder, i.e. the State, obtained a considerable advantage over other shareholders of the same status, the advantage being the possibility to freely obtain and increase its participation share by reducing percentage of shares owned by the present shareholders and influence of the latter in decision-making process.

Mr. V. Tihonovs, a representative of the Applicant suggested that increase of equity capital, introduction of amendments into the Articles of Association and denial of the priority right to the shareholders having taken place pursuant to the Contested Norm is, in fact, nationalization of shares possessed by the Applicants; therefore it contradicts the fourth sentence of Article 105 of the Satversme.

The Applicants do not deny that the fundamental right to own property established in Article 105 of the Satversme can be restricted; however, they hold that the restriction of the right established in the Contested Norm does not comply with the criteria of restriction of the right elaborated in the case-law of the Constitutional Court.

Neither in the frameworks of their application, nor at the court hearing the Applicants questioned the fact that the restriction has been established by a property adopted law.

It is suggested in the application that the above mentioned restriction might have a legitimate aim, namely, assuring stability of the banking and financial system. At the court hearing and documents submitted to the court during the hearing, the

representatives of the Applicant emphasized that reduction of participation share of minority shareholders cannot be regarded as a legitimate aim.

According to the Applicant, insofar as the Contested Norm does have a legitimate aim, it is necessary to recognize that the Contested Norm, in fact, fails to reach the aim. The regulatory framework prohibiting shareholders to purchase shares of new issuance by making additional investments into equity capital of the company and thus improving its financial status is not aimed at improvement of financial status of the company. At judicial debate, the representative of the Applicants V. Tihonovs emphasized that using of tax payers' money to rescue a bank by prohibiting its shareholders to rescue their bank and invest money therein does not comply with the interests of the society. There is no benefit to the society from such restriction of property right of shareholders. Consequently, the regulatory framework established in the Contested Norm cannot be regarded as a proportional measure for reaching of the legitimate aim.

According to the Applicants, there exist several measures for reaching of the above mentioned legitimate aim that would restrict the fundamental rights at a lesser extent. First, the State can obtain a material participation share in equity capital by overtaking shares owned by shareholders, including minority shareholders of the credit institution and them making investments into equity capital of the credit institution. Moreover, the State has the right to amend regulatory framework of the Commercial Law and establish a shorter term for summoning the shareholders' meeting. For instance, in the legal regulatory framework of Germany adopted in 2008 to overcome financial crisis, the legislator has provided the possibility to summon shareholders' meeting within one day in such an extraordinary case. Moreover, it is possible to establish such regulatory framework in the Commercial Law that would permit the shareholders to independently decide on refusal from shareholders' priority right.

2.2. It was indicated in the application that proportionality of restrictions of the fundamental rights included in Article 105 of the Satversme should be assessed in conjunction with the Second EU Council 13 December 1976 Directive 77/91/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (hereinafter – Directive 77/91/EEC), the purpose of which is to ensure minimum equivalent protection of rights of shareholders in the EU Member States. The regulatory framework established in the Commercial Law is

coordinated with the Directive 77/91/EEC. Pursuant to conclusions made in case-law of the Court of Justice of the European Union (hereinafter – the CJEU), provisions of Directive 77/91/EEC are also applicable to credit institutions. According to Article 1 of the Directive 77/91/EEC, any increase in capital must be decided upon by the general meeting. This competence cannot be denied to them or appointed to other institutions even in a crisis situation. A conditional exception is only "authorized" increase in capital established in Article 25 (2) of the Directive No. 77/91/EEC and regulated by Section 249 (4) of the Commercial Law. However, a pre-condition for application of such institute of increase in equity capital is authorization of the company established in its articles of association. It clearly follows from the Directive No. 77/91/EEC that the Member States do not have the right to establish such a procedure by means of legal norms.

At the court hearing, the representatives of the Applicants emphasized that the EC assesses admissibility of state aid based on the TFEU. State aid is a constituent part of competition law and therefore that of public law, too. Company law, however, is a part of private law. It is important to separate these domains. In judgments of the EC on Parex banka, it is not necessary to look for approval of the procedure for increase in equity capital. The EC has not ruled on this issue, neither has it the right to do so. Even if the EC would have provided its opinion in the above mentioned decisions, its statement could not be interpreted as permission to deviate from regulatory framework of a directive.

2.3. The Applicants hold that interference with voluntarily established liabilities and rights of shareholders in favour of the State as a subject-matter of private law should be regarded as non-compliant with a law-governed State. The Contested Norm contradicts the principle of proportionality and that of legitimate expectations.

By referring to Section 276 (1), Section 249 (1) and Section 268 (1) indent 6 and 7 of the Commercial Law, the Applicant has expressed the opinion that the legal regulatory framework, pursuant to which this is only the shareholders' meeting that is entitled to decide on increase in equity capital, introduction of amendments into articles of association of the joint-stock company and confirmation of provisions for the increase in equity capital, should be regarded as a fundamental principle of company law that has remained in force of a long time. This legal regulatory framework has been enough certain and stable to trust into.

By referring to Section 46 (1) of 18 May 1993 Law "On Joint Stock Companies", as well as Section 251 (1) of the Commercial Law, the Applicants suggest that the

former legal regulatory framework on the priority right of shareholders to purchase shares of new issuance has been certain and stable enough to trust into.

Moreover, the Applicants acting as investors and shareholders of a credit institution had the right to count on the fact that Latvia as a Member State of the EU would fulfil its liabilities that follow from its participation in the EU and it would not amend legal regulatory framework so that it would fail to comply with requirements of secondary EU legal acts.

2.4. The Applicants hold that they have no general legal remedies at their disposal to prevent the infringement of their rights. At judicial debate, Mr. A. Lošmanis, a representative of the Applicant indicated that norms of the Commercial Law directly establish cases when a shareholder has the right to contest decisions made by company administration institutions. There exists a *numerus clausus* principle that is related to a general consideration that courts should not be entitled to interfere with mutual relations of shareholders and company administration institutions in all cases except for cases established by law. By means of strict pre-conditions, the Commercial Law provides a possibility to appeal against decisions of only one institution, which is the shareholders' meeting. In one particular case, however, it is possible to contest even decisions taken by a board. The law does not provide the possibility to appeal against a decision taken by a council of a joint-stock company. No such case has even occurred in practice.

3. **The institution that adopted the contested act, the Saeima** holds that the Contested Norm does comply with legal norms of a higher legal force and asks the Constitutional Court to recognize it as compliant with Article 1 and Article 105 of the Satversme.

Mr. Mārtiņš Paparinskis, an attorney at law acting as a representative of the Saeima requested to terminate legal proceedings in the present case because not all legal remedies have been exhausted and therefore the applications fails to comply with the principle of subsidiarity established in the Constitutional Court Law. By referring to Para 15.3 of the Constitutional Court Judgment of 30 March 2011 in the case No. 2010-60-01, he indicated that non-existence of a particular norm does not prohibit a person to address the court. According to Mr. M. Paparinskis, the possibility to appeal against a decision adopted by the council of a credit institution can be determined by applying the systemic interpretation method and general provisions of the Civil Procedure Law. The fact that the Commercial Law does not directly provide the possibility to appeal against a decision of the council of a credit institution does not

deny the possibility to appeal against an unlawful decision by the council. The Applicants could appeal against the decision of the Council based on the analogy to the right of a shareholder to appeal against a decision of the board of a credit institution established in Section 249 and 310^1 of the Commercial Law or by referring to the duty of the council to act as an honest and careful manager established in Section 169 of the Commercial Law. Existence of general legal remedies was already proven by the Riga City Northern District Court [*Ziemeļu rajona tiesa*] in the decision of 17 January 2011 in the case initiated based on an application submitted by minority shareholders of Parex banka. In the field of EU law, however, the Applicants had three different ways of protection of their rights.

3.1. It has been indicated in the reply that adoption of the Contested Norm was related with the global financial crisis caused by international financial market problems in 2008 – 2009, in the result of which one of credit institutions of Latvia, namely, Parex banka needed State support. The Contested Norm includes a recapitalization scheme, which is one of the instruments applied by financial institutions in case of crisis. Namely, the Contested Norm contains a special regulatory framework to be applied in case when this is the credit institution itself that request the State to obtain a material participation share in the credit institution and grants commercial support to the first, which would ensure fast, operative and effective action in extraordinary situations.

3.2. As indicated in the reply, the Saeima shares the opinion of the Applicants, namely, that the Contested Norm restricts the property right of shareholders. However, the restriction of the fundamental rights established in Article 105 of the Satversme complies with the Satversme, i.e. it has been established by law, it has been established to reach a legitimate aim and it complies with the principle of proportionality.

At the hearing, however, the Saeima representatives referred to case-law of the ECHR and suggested that the Contested Norm does not restrict the right of shareholders to own property. Namely, it follows from conclusions made by the ECHR in its judgments that only if shares of applicants have economic value they shall be regarded as property in the meaning of the European Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter – the Convention). Consequently, the scope of Article 105 of the Satversme includes only shares having market value; however, shares of the Applicants have no such value. This is also indicated in the MF 2 September 2011 letter No. 7-3-02/5778, and proven by the opinion expressed in Para 147 of the EC 15 September 2010 decision.

At the hearing, the Saeima representative indicated that none of the shares of the Applicants has changed its ownership or been destroyed. Consequently, the fourth sentence of Article 105 of the Satversme does not apply to the situation of the Applicants.

3.3. It was emphasized in the reply that the restriction of the fundamental rights established in the Contested Norm has a legitimate aim, which is protection of the rights of other persons and assurance of welfare of the society. At the court hearing, the Saeima representative also drew attention to the possibility established in Article 105 of the Satversme to restrict the rights established therein. The legitimate aim includes fast and effective increase in equity capital of a credit institution, as well as the necessity to fulfil requirements that follows from legal norms regulating granting of state aid.

3.4. According to the Saeima, the restriction of the fundamental rights is proportional. The benefit gained by the society from the Contested Norm overweighs the restriction of the rights of the shareholders. Since commercial companies providing services in financial field are established a special regulatory framework, and the State has introduced a deposit guarantee mechanism, the State has undertaken, at a considerable extent, responsibility (liability) for licenced credit institutions. The primary aim of norms regulating work of credit institutions undergoing solvency difficulties is not to permit and to reduce possible losses in the financial sector and economy in general, as well as losses to depositors and the deposit guarantee fund. Therefore legal norms aimed at restoring of solvency are mainly aimed at continuing work of the credit institution and protecting of the depositors.

The Saeima indicates that the fall of share value follows from the fact that the credit institution undergoes financial difficulties rather than the fact that a credit institution is provided State support. The general regulatory framework for satisfying claims of creditors of the credit institutions protects shareholders at a lesser extent if compared to depositors. The shareholders of the credit institution had to be aware of the risks.

The Saeima holds that the Contested Norm works in the interests of the Applicants. If the credit institution would inevitably become insolvent in case of the State would refuse providing its aid, the present shareholders would lose not only their shareholder’s right to participate in administration of the credit institution but would also be denied their economic rights, i.e. in case of insolvency shareholders would have only an insubstantial possibility to receive liquidation quota. Nonetheless, in case of effectiveness of state aid, the shareholders would obtain different new opportunities,

including the probability that the participation share of the Applicants in equity capital would increase.

The Saeima emphasizes that the State is committed to act, as effectively as possible, with financial means at its disposal taking into account the interests of the body of taxpayers rather than those of individual third persons. The situation that state resources are used in a way to permit present shareholders of the bank to preserve their amount of shares in the bank equity capital at the expense of support for commercial activities is inadmissible.

3.5. It has also been indicated in the reply that the Directive 77/91/EEC includes requirements of general regulatory framework that are, in fact, aimed at assurance of everyday economic activities of a joint-stock company and it sets forth no conditions for increase in equity capital applicable to special persons subject to law or regulating increase in equity capital observing particular conditions.

At the Court hearing, the Saeima representative expressed a viewpoint that the Directive 77/91/EEC plays no legal role in the issue regarding constitutionality of the Contested Norm. Moreover, the Applicants have not contested EC decisions regarding provisions of state aid. According to the Saeima representative, the Directive 77/91/EEC is only a secondary and technical norm of the European law that is not related with the fundamental rights established in Europe or Latvia (*see: Transcript of the Constitutional Court hearing of 20 September 2011, case materials, Vol. 7, pp. 134*).

3.6. The Saeima does not share the opinion of the Applicant regarding the fact that the Contested Norm breaches the principle of legitimate expectations. The Contested Norm does not change the general procedure established in respect to commercial companies for increase of equity capital. It only provides respective regulatory framework for one particular persons subject to law, which is a failing credit institution and not being able to resolve them by itself.

It has been emphasized in the reply that Article 1 of the Saeima does not prohibit the legislator to introduce the new regulatory framework in the interests of the shareholders and the society. In the particular case, the principle of legitimate expectations cannot be interpreted in a way that the Contested Norm could be applied only to those credit institutions that have been established after its coming into force.

4. The summoned person, **the Saeima Budged and Finance (Tax) Committee** holds that the Contested Norm has been adopted in accordance with the procedure

established in the Saeima Rules of Procedure (hereinafter – the Rules of Procedure) and it does comply with Article 1 and 105 of the Satversme.

At the hearing, **Mr. Kārlis Leiškalns, Chairman of the 9th Saeima Budget and Finance (Tax) Committee** (in the period from 17 November 2009 to 21 April 2009) an authorized representative of the Budget Committee informed the Court that the suggestion to supplement the respective draft law with the Contested Norm was received by the Budget Committee on 16 February, at 5 p.m.; however, members of the Committee and he personally had already participated in elaboration of the particular norm. Although the necessity to urgently elaborate the Contested Norm was related with the situation at the bank, the purpose of the norm was to regulate similar situations. Latvia has encountered two bank crisis, and each of them "gave the legislator the opportunity to express itself in a creative way to get prepared for the future" (*see: Transcript of Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 53*). In case if the aim of the legislator were to adopt a norm to be applied only to the case of Parex banka, it would have accepted the proposition of a member of the parliament Mr. Krišjānis Kariņš regarding elaboration of a separate law. Moreover, the Contested Norm is applicable not only to financial crisis situation of the national level but also in case "when there are no financial crisis, but crisis situation or pre-bankruptcy situation has occurred in one of the credit institutions" (*see: Transcript of Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 49*).

Mr. K. Leiškalns emphasized that problems of Parex banka were caused by actions or inactivity of its shareholders. The Latvian State was bound to get involved in solution of the problem only with a view to prevent negative impact of insolvency and bankruptcy of the bank on the State budget and the Latvian financial system. Shout the State provide no aid, Parex banka would inevitably go bankrupt. In February 2009, the Budget Committee discussed at least four ways of solving the situation, the versions including also the one suggested by Mr. K. Kariņs that provided elaboration of a special law for the purpose of Parex banka only.

When deciding on adoption of the Contested Norm, members of the Budget Committee were informed on the following opinion of the EC and the International Monetary Fund: if minority shareholders would ensure proportional participation in increase of equity capital of the bank, the EC would not confirm the particular state aid.

It is indicated in the written reply of the summoned person that, at the meeting, the Budget Committee did not assess compliance of the draft law with Article 1 and

Article 015 of the Satversme because usually this is the Ministry of Justice or the Saeima Legal Bureau that assesses constitutionality of norms. At the court hearing, Mr. K. Leiškalns emphasized that urgent adoption of the Contested Norm was necessary due to extraordinary situation. The Budget Committee did not question constitutionality of the Contested Norm. Initially there were certain doubts regarding the Commercial Law, though possible non-constitutionality of norms was eliminated. A representative of the Saeima Legal Bureau also participated at the meeting of the Commission. Opinion of 17 February 2009 of the Saeima Legal Bureau (hereinafter – Opinion of 17 February) was at the disposal of the members of the Committee. At the Budget Committee meeting, this opinion was discussed. The Committee concluded that, when adopting the Contested Norm, it would comply with all laws effective at that time. Unlike the general norms included in the Commercial Law, the Contested Norm as a special legal norm regulates the situation in respect to a specific person subject to law, i.e. a failing credit institution.

M. K. Leiškalns notidied that no versions requiring shortening of the term for summoning shareholders' meeting or other seminal solutions were suggested for discussions at the Budget Committee.

According to Mr. K. Leiškalns, it is not possible to consider that the State would be able to recover means invested in Parex banka even in case of a successful situation development (*see: Transcript of Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 51*). At the initial stage of settling the Parex banka issue, he personally has discussed the situation with a minority shareholder of Parex banka who suggested that minority shareholders are not ready to solidarity invest necessary means into Parex banka because the bank is impossible to be saved.

5. The summoned person, the Saeima Legal Bureau (hereinafter – the Legal Bureau) indicates that the suggestion of the Opinion of 17 February cannot be regarded as suggestion in the meaning of Section 104 and Section 95 of the Rules of Procedure because it was not submitted within the established term and it did not concern the draft law wording adopted at the second reading. Therefore it was not to be included into the draft law table for the third reading. Representatives of the Legal Bureau were invited to the Budget Committee meeting of 17 February 2009. Chairman of the Budget Committee had informed the Committee on the Opinion of 17 February by drawing attention of the members of the parliament on the highlighted document.

At the court hearing, **Mr. Gunārs Kusiņš, Head of the Legal Bureau** provided information that, pursuant to the by-laws of the Legal Bureau, it is committed to make

analysis of draft laws and suggestions submitted to the Legal Bureau with in order to assess their compliance with the Constitution, international liabilities of Latvia and the EU law, as well as with the legal system in general. In the case under consideration, however, when taking into account the fact that the suggestion was submitted at 5 p.m. whilst the meeting of the Budget Committee would take place on the following morning at 10 a.m., the Legal Bureau performed initial assessment of the suggestion at the extent possible to be done in such a short timeframe. In its opinion, the Legal Bureau drew attention of the Budget Committee to the fact that, after initial assessment of the suggestion, it was found as contradictory to the Commercial Law and considerably restricting rights of shareholders.

Mr. G. Kusiņš indicated that in 1994 when the Rules of Procedure were adopted, it was necessary to decide on affiliation of the Latvian legal system to a certain legal system. When adopting Section 111 of the Rules of Procedure, affiliation of Latvia to the continental or romano-germanic law was approved, this legal system being characterized by the encoring feature. Draft Rules of Procedure has been elaborated simultaneously with a draft law "Law on the Procedure for the Proclamation, Publishing, Entry into Force, and Validity of Laws and other Legislative Acts Issued by the Parliament (Saeima) State President and Cabinet of Ministers". Section 111 of the Rules of Procedure shall be interpreted in conjunction with Section 8 of the above mentioned law that includes a general norm on solution of collisions. Nonetheless, a special norm on solving collisions in included in Section 4 of the Credit Institutions Law. The purpose of Section 111 of the Rules of Procedure is to avoid adopting contradictory norms ad excluding requirements that would be difficult to be solved by methods of collision solution. The second part of Section 111 of the Rules of Procedure does not automatically mean that amendments should be introduced in another law. It does not exclude the possibility and sometimes even requires adopting a special legal norm in respect to what has been established in another norm.

According to the legal bureau, the Contested Norm is a special legal norm aimed at the regulatory framework of the Commercial Law. In the Credit Institutions Law, several norms establishing differences from the Commercial Law are included, including norms that the Constitutional Court has already found compliant with the Satversme.

6. The summoned person, **the Cabinet of Ministers** holds that the Contested Norm does comply with Article 1 and Article 105 of the Satversme.

As to investments into equity capital in a company, it is necessary to distinguish between increase in equity capital pursuant to the Commercial Law, this being performed according to an everyday economic procedure, and increase in equity capital of a failing company, this preventing threat to financial stability of the credit institution. Investments into equity capital of a failing company shall be classified as state aid pursuant to Section 7 of the Law on Control of Aid for Commercial Activity and Section 107 (1) of the TFEU. The Contested Norm establishes the procedure only in case if the board of a failing credit institution, i.e. the credit institution itself adopts a decision to request state support and the state obtains on increases its participation share in the credit institution. Pursuant to the EC declaration of 13 October 2008, public support measures to failing financial institutions shall be assessed in accordance with Section 107 (3) Indent "b" of the TFEU providing that aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State can be considered to be compatible with the internal market (*see: Official Journal of the EU, C 270, 25 October 2008, pp. 8 – 14*).

At the Constitutional Court hearing on 6 September 2011, **Mr. Mārtiņš Brencis, a representative of the Cabinet of Ministers and Head of the Legal Acts Department of the Ministry of Finance** (hereinafter – CM representative) indicated that the Contested Norm was necessary to be able to urgently and effectively make investments into equity capital of a bank undergoing crisis. The State has undertaken responsibility for Parex banka at the moment when present shareholders were not able to ensure sufficiency indices of bank capital and thus prevent possible insolvency of the bank. Effectiveness of the Contested Norm is manifested by the fact that increase in equity capital of Parex banka in May 2009 lasted 15 days, namely, from the date of adoption of a EC decision to the date of adoption of the Enterprise Register decision, whilst the procedure in autumn 2009 lasted 14 days, in February 2010 – only to days, and at the end of 2010 - 28 days. In total 206 million 200 thousand lats were invested pursuant to the Contested Norm. The ERDB did not participate in increase in equity capital of Parex banka; it always refused investing additional financial resources in the bank.

In the written reply, the CM emphasized that, in the field of financial services, the State has introduced restrictions for launching and performing commercial activities, as well as established strict criteria because it has undertaken responsibility for licenced credit institutions by introducing deposit guarantee mechanism. Interests of depositors should be regarded as priority when solving financial problems of a credit institution. The purpose of legal norms regulating insolvency of businessman is to

ensure preservation of value of the company; whilst the purpose of legal norms regulating insolvency of credit institutions is to reduce losses to depositors, the deposit guarantee fund and the entire financial sector.

The Contested Norm pertains to the scope of Article 105 of the Satversme; however, the established restriction of fundamental rights is lawful. It does have a legitimate aim, which is assuring of functioning of a credit institution undergoing crisis situation and thus to preserve reliability of the financial market and stability of the financial system. The restriction does comply with the principle of proportionality. Since provision of state aid is ensured by means of public funding, it is necessary to balance interests of the Applicants with those of the society and tax payers. It is not admissible to provide support to a failing credit institution in a way that would permits its present shareholders to preserve their former amount of participation share in equity capital of the bank ensured at the expense of State aid, especially taking into account the fact that inability of present shareholders of the bank caused its insolvency.

The CM does not share the opinion of the Applicants, namely, that the rights would be restricted at a lesser extent if the State would have completely overtaken Parex banka by performing compulsory alienation of shares for a fair compensation. Section 8 (1) of the Bank Overtaking Law provides: if the overtaken bank has received State aid or the BL has granted funding before or along with the proposal to overtake the bank, then the State aid and financing of the Bank of Latvia shall be excluded from estimates when establishing the amount of compensation.

According to the CM representative, in case if the situation would have been solved pursuant to Section 8 (1) of the Bank Overtaking Law, the value of shares of the Applicants would be "negative, below zero". It was emphasized in the opinion of the CM, however, that the Applicants' statement regarding the fact that the right to receive dividends was restricted is ungrounded. It is always possible to receive dividends from a solvent bank. Moreover, pursuant to Section 161 (4) of the Commercial Law, dividends may not be determined, calculated and paid out if it arises from the annual accounts that the own funds of the company is less than the total amount of the equity.

The CM holds that, in the present case, it is not possible to consider legitimate expectations in respect to actions taken by the State because the particular legal consequences do not follow from voluntary action taken by the State. The State has taken necessary measures after it has received a request from the board of such a credit institution that underwent difficulties and was no more able to solve the situation. At the court hearing of 6 September 2011, the CM representative emphasized that it was

the State, not the Applicants that rescued Parex banka. Consequently, shares owned by the Applicants have lost their value.

7. The summoned person, **Ms. Daiga Lagzdiņa, Head of the Commercial Support Control Department of the Ministry of Finance** was of the viewpoint that the Contested Norm shall be regarded in close connection with the legal regulatory framework on providing State aid. One of the main principles enshrined in the Treaty Establishing the European Community, respectively the TFEU, is the prohibition of public support. Public support is permitted only in certain exceptional cases when the EC regards it as compatible with the EU internal market. It is possible to apply the Contested Norm only in case if a EC decision is received.

Application of the Contested Norm in the case of the Applicants cannot be assessed separately from the set of state support measures provided to Parex banka that started in November 2008 by establishing a State treasury deposit in the bank and confirming State guarantee for syndicated credits. Initial consents provided by the EC applied to investments into subordinated capital. After execution of all transactions, which were investments into liquidity, granting of respective guarantees and payment of partially syndicated credits, the FCMC concluded that Parex banka needs also investments into its equity capital. Since the particular State aid was not co-ordinated with the EC, on 29 March 2009 addressed a new notice to the EC. Adoption of a EC decision was delayed *inter alia* due to discussions dealing with the issue whether Parex banka can still be rescued and whether it is necessary to submit a restructuring plan. On 11 May 2009, a positive EC decision on planned State aid to Parex banka to rescue the bank was received. The decision included a reference to investments into capital and a clear indication that this is the State ensuring increase in equity capital and increasing its participation share. Consequently, in case if the Applicants did not approve such increase in equity capital, they had the duty to appeal the respective EC decision before the Court of Justice of the EU. Now when the present case is reviewed at the Constitutional Court, the above mentioned decisions can no more be appealed against.

However, reviewing by the European Commission of public support necessary for restructuring Parex banka lasted from 11 May 2009 when Latvia submitted the first restructuring plan up to 15 September 2010 when the EC adopted a positive decision regarding the improved restructuring plan. The first restructuring plan that was submitted to the EC was not satisfactory because the EC failed to establish vital

capacity of the bank and therefore it launched respective examination procedure on 29 July 2009.

Ms. D. Lagzdiņa emphasized that the respective decision to launch the procedure was published in the Official Journal of the EU, and any interested party, including the shareholders, had the right to submit their opinion on the actual and desired course of restructuring procedure. The Applicants submitted no considerations to the EC. The EC decision of 15 September 2010 provided that preserving of present shareholders at Parex banka and reduction of their participation share is a due burden imposed for their failure to participate in rescuing the bank. The Applicants have not appealed against this decision. Now, then the present case is reviewed by the Constitutional Court, the EC 15 September 2010 decision can no more be appealed against.

According to Ms. D. Lagzdiņa, proportional participation of the Applicants in increase of equity capital of the bank without any adequate participation in payment of syndicated credits and deposits would create ungrounded advantages to them. In case if the Applicants would have considered that the State aid granted to Parex banka was compatible with the European internal market even in the Applicants would have exercised their priority right, they could take advantage of the possibility to appeal against the EC decision.

When replying to the question set by a representative of the Applicants, Ms. D. Lagzdiņa admitted that, when confirming public support, the EC took into account the fact that investments into equity capital of Parex banka would be made only by the State. However, the question on the fact whether the decision is to be taken by the Council of the bank or any other institution, does not fall within the scope of public support.

8. The summoned person, **the Financial and Capital Market Commission** holds that the Contested Norm does comply with Article 1 and Article 105 of the Satversme. The restriction of the rights of shareholders established in the Contested Norm does not breach Article 105 of the Satversme because the particular restriction of property right is justifiable by a legitimate aim and its proportionality. It shall be considered in conjunction with the state aid institute for commercial activities. Provision of aid for commercial activities shall be regarded as an extraordinary measure that provides a possibility to present shareholders of the credit institution not to lose their participation share in the credit institution (at the amount of the paid share of equity capital of the credit institution) at the expense of means invested by an

indirect shareholder and continue exercising the rights established to the shareholders in normative acts.

At the Constitutional Court hearing, **Mr. Gvido Romeiko, a representative of the FCMC and Head of the Legal and Licencing Department of the FCMC** drew attention to four risks of different levels related with functioning of a credit institution. State aid is permitted only in a situation when the credit institution causes the gravest of the risks, which is threat to national economy. Consequently, the regulatory framework of the Contested Norm is appropriate only in case if such threat is real and very serious.

According to the representative of the FCMC, it is possible to assume that issuance of new shares received by the State is a sort of remuneration for recapitalization of the bank ensured by the State. Moral risk in case if the priority right of shareholders were preserved is hidden in the fact that persons, who are unable to make a financial deposit to rescue the bank, invest insignificant financial means that give them the hope that their shares would have at least some value.

The FCMC emphasizes that the Contested Norm as an extraordinary legal instrument to be applied on urgent basis to prevent insolvency of a credit institution does comply with the Directive 77/91/EEC. It follows from opinions of international institutions and experience of the Member States in application of requirements of the Directive 77/91/EEC that the rights of shareholders established in the Directive are not absolute and restriction thereof is justifiable by extraordinary circumstances.

By referring to case-law of the ECHR, the FCMC indicates that pursuant to the principle of legitimate expectations, a legal norm has to be lawful, reasonable and clear, as well as it must ensure foreseeability of normative regulation of respective situation. However, as the economic situation change, addressee of a legal norm cannot unilaterally trust into the fact that normative acts dealing with a particular field of law would not be amended. Creation of unbeneficial situation to an addressee of a legal norm shall not as such be regarded as breach of the principle of legitimate expectations. Trust of a person into the rights established in normative acts cannot be absolute and can be restricted in case if the restriction is grounded, proportional and indispensible for protection of interests of the society.

9. The summoned person, **an association "Latvijas Komercbanku asociācija"** (hereinafter – the Association) indicates that a recapitalization scheme is included into the Contested Norm, it being one of the instruments applied by financial institutions in crisis situation. The Association holds that the Contested Norm does not contradict

Article 1 and Article 106 of the Satversme of the Republic of Latvia. The Contested Norm restricts the property right of shareholders; namely, it denies them the right to vote on increase in equity capital, confirmation of provisions regarding increase in equity capital and introduction of amendments into articles of association, as well as the right to exercise the priority right of shareholders. However, the above mentioned restriction does comply with the Satversme.

At the court hearing, **Ms. Ketija Tola, an attorney at law representing the Association** indicated that there are several ways how the State can provide aid to a credit institution, namely, recapitalization, granting bank liabilities guarantee, full or partial nationalization, assurance of liquidity of a credit institution. Not each of these cases can be regarded as State aid, though scheme of recapitalization shall always be regarded as State aid. However, State aid in accordance with the TFEU is impermissible because it distorts competition. State aid is admitted only in extraordinary cases and based on consent of the EC.

The Association holds that the restriction of the fundamental rights established in the Contested Norm has a legitimate aim – prevention of threats to financial stability of a credit institution, which would protect interests of depositors, restore trust into domestic banking system, and ensure the general financial stability. At the hearing, Ms. K. Tola suggested that denial of the priority right to the shareholders can be justified by three following reasons: 1) necessity to urgently launch the procedure; 2) necessity to know the amount by which equity capital would be increased; 3) the necessity to restrict distortion of competition. Namely, after receipt of State aid, the joint-stock company becomes larger and, in case if previous shareholders would have the right to exercise their priority right, they could gain ungrounded benefit from the State aid.

The Contested does reach its legitimate aim because in case if the credit institution represented by a member of the board asks increasing equity capital of the credit institution, attraction of financial means is ensured, which permits the credit institution to continue working in crisis situation.

The Association holds that there are no other measures that would restrict the rights of shareholders at a lesser extent and ensure reaching of the legitimate aim. By preserving the right of shareholders to vote on the above mentioned questions at a shareholders' meeting, as well as preserving the priority right of shareholders, the process of capital attraction would be extended in an inadmissible manner. However, the model that was recognized as a more favourable one by the Applicants providing that shares owned by shareholders should first be overtaken and them equity capital

should be increased would cause negative consequences to the State and the credit institution. For instance, financial means invested by the State into credit institution to improve its financial situation would be transferred to the shareholders. Moreover, the above mentioned model cannot be regarded as measure that would infringe the rights of shareholders at a lesser extent because actions of the State that increase financial situation of a credit institution permit shareholders to continue exercising their property right in respect to shares.

According to the Association, the restriction of the rights of shareholders established in the Contested Norm does not cause any negative material consequences to them. The participation share is reduced only proportionally, though no absolute figures are changed, namely, neither the number, nor value of shares is changed.

The amount of dividends to be disbursed, market value of shares or possible liquidation quota in case of liquidation of the joint-stock company neither change. If a credit institution would become insolvent as the result of failure to obtain State aid, then present shareholders would not only loose the right to participate in management of the credit institution, but also their economic rights because, in case of insolvency, they would have only a small possibility to receive liquidation quota.

10. According to a decision of a Constitutional Court justice Mr. Viktors Skudra, **an expert examination in the present case on compliance of the Contested Norm with the EU Law was performed**. The expert examination was commissioned to Ms. Esmeralda Balode-Buraka, L.L.M. in EU Law.

The expert indicates that Article 25 of the Directive 77/91/EEC shall be applied to the situation regulated by the Contested Norm and transposed to Section 249 of the Commercial Law, as well as Article 29 (1) of the 77/91/EEC transposed to Section 251 of the Commercial Law. When adopting the Contested Norm, the legislator was determined to adopt a special norm deviating from the principles included in Section 249 (1) and Section 251 of the Commercial Law in case when the following two circumstances are present: a) the board of a credit institution has requested to the State to obtain or materially increase its participation share in the credit institution; b) the CM has adopted a decision approving the above mentioned request. However, deviations mentioned in the Directive 77/91/EEC have not been *expressis verbis* mentioned. The purpose of the Directive is to ensure minimum protection of shareholders in all Member States. The CJEU has concluded that the purpose of Directive 77/91/EEK would be materially endangered if the Member States would have the right to deviate from provisions of the above mentioned the Directive and

preserving even such provisions that are classified as special or exceptional ones (*see: Judgment of 30 May 1991 by the* CJEU *in joined cases No. C-19/90 and No. C-20/90 "Marina Karella and Nicolas Karellas v Minister for Industry, Energy and Technology and Organismos Anasygkrotiseos Epicheiriseon AE").*

Moreover, the right of the shareholders' meeting to adopt decisions included in Section 25 (1) of the Directive 77/91/EEC shall also be applied in situation related with commercial activities undergoing substantial financial difficulties [*see: Judgment of 12 May 1998 by the* CJEU *in the case No C-367/96 "Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE)"*]. Consequently, the expert concludes that the Contested Norm fails to comply with Article 25 (1) of the Directive 77/91/EEC.

The expert indicates that the CJEU did not have yet the opportunity to provide a detailed interpretation of Article 25 (1) of the Directive 77/91/EEC; however, applying similar argumentation based on the purpose of the above mentioned Directive, it is possible to make an identical conclusion, namely, that the Contested Norm fails to comply with what has been established in Article 29 (1) of the Directive 77/91/EEC. Moreover, the CJEU has found that Article 25 (1) and Article 29 (1) of the Directive 77/91/EEC have unconditional wording, they have a clear and precise enough wording for them to be directly applied (*see: Judgment of 30 May 1991 by the* CJEU *in joined cases No. C-19/90 and No. C-20/90 "Marina Karella and Nicolas Karellas v Minister for Industry, Energy and Technology and Organismos Anasygkrotiseos Epicheiriseon AE").*

It has been indicated in the expert opinion that a EU primary law norm, namely, Article 107 (3) indent "b" of the TFEU (former Article 87 (3) indent "b" of the Treaty Establishing the European Community also apply to the situation regulated by the Contested Norm. Exceptions referred to in the above mentioned article are applied by the EC. In the context of the global financial crisis, on 13 October 2008 the EC published a communication, wherein it was indicated that in the light of the level of seriousness that the current crisis in the financial markets has reached and of its possible impact on the overall economy of Member States, the Commission considers that Article 87(3) (b) is, in the present circumstances, available as a legal basis for aid measures undertaken to address this systemic crisis. This applies, in particular, to aid that is granted by way of a general scheme available to several or all financial institutions in a Member State (*see: Communication from the Commission "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", Para 8 and 9, Official Journal of the EU, 25 October 2008, No. C 270*). The EC has preserved the above mentioned position

by adopting secondary EU legal acts on compliance of the Latvian State aid to Parex banka with Article 107 of the TFEU. Consequently, the expert concluded that the Contested Norm does comply with Article 107 (3) indent "b" of the TFEU.

It has been indicated in the expert opinion on non-compliance of the Contested Norm with the Directive 77/91/EEC is based on previous interpretation of the respective legal norms provided by the CJEU. Namely, pursuant to the above mentioned case-law of the CJEU, the situation regulated by the Contested Norm is similar to those already considered by the CJEU especially in respect to a company suffering financial difficulties in the CJEY case No. C-367/96 "Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE)". However, the CJEU has failed to provide interpretation of the particular EU law norms in respect to a situation when many credit institutions in several EU Member States might simultaneously undergo financial difficulties as the result of global processes. Integration of EU financial markets has facilitated amalgamation of EU internal market, which permits distinguishing a situation regulated by the Contested Norm and those previously considered by the CJEU.

Should the Constitutional Court consider that, first, the issue regarding application of the EU law is substantiation in adjudication of the case and, second, it would take into account the fact that the CJEU has never assessed conjunct application respective norm of the Directive 77/91/EEC and Article 107 (3) indent "b" of the TFEU, as well as the fact that interpretation of the particular EU law norms is not evident, it would have the duty to address a request to the Court of Justice of the European Union to provide preliminary ruling pursuant to Article 267 (3) of the TFEU and what has been established in 6 October 1982 CJEU judgment in the case No. 283/81 "Srl CILFIT and Lanificio di Gavardo SpA v Ministry of Health".

The Findings

11. At the hearing, the Saeima representative asked to terminate proceedings in the present case due to the following:

1) no fundamental rights have been restricted;

2) the Applicants have failed to exhaust all legal remedies.

Consequently, the Constitutional Court shall investigate whether proceedings in the present case should be terminated.

11.1. Pursuant to Article 17 (1) indent 11 of the Constitutional Court Law, the right to submit an application regarding initiation of a matter established in Article 16 (1) of the Constitutional Court Law is held by a person in the case of the fundamental rights being infringed upon as defined in the Constitution, i.e. in the form of a constitutional complaint. Article 19^2 (1) of the Constitutional Court Law provides that "a constitutional complaint (application) may be submitted to the Constitutional Court by any person who considers that their fundamental rights as defined in the Constitution infringe upon legal norms that do not comply with the norms of a higher legal force", whilst Article 19^2 (1) indent 6 establishes in addition to the content of an application defined in Article 18 (1) of this Law a constitutional complaint shall justify the fundamental rights of the applicant defined in the Constitution have been infringed upon. Consequently, in the case of a constitutional complaint, it is necessary to establish whether the fundamental rights of the applicant established in the Satversme have been infringed.

If in the present case there are doubts regarding the fact whether the Contested Norm infringes the fundamental rights of the Applicant established in Article 105 of the Satversme, then this is the first issue to be investigated by the Constitutional Court (*see: Judgment of 20 April 2010 by the Constitutional Court on termination of proceedings in the case No. 2009-100-03, Para 8*).

11.2. Such assessment is related with establishing of the scope of the rights established in Article 105 of the Satversme and the content of the Contested Norm. In case if the Contested Norm does not infringe the fundamental rights of the applicant established in the Satversme, it is possible to terminate proceedings in the case pursuant to the case-law of the Constitutional Court (*see: Judgment of 20 April 2010 by the Constitutional Court on termination of proceedings in the case No. 2009-100-03, Para 8*). However, in case if the Contested Norm establishes restriction to the fundamental rights, the Court shall proceed assessing its constitutionality.

12. The Applicants hold that their property right has been infringed. The property right is enshrined in Article 105 of the Satversme that provides: "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."

By referring to case-law of the Constitutional Court, participants of the matter and all summoned persons initially held that the Contested Norm establishes

restriction of the fundamental rights of the Applicants established in Article 105 of the Satversme. Their opinions differed only in respect to the extent of the restriction. However, at the hearing, the Saeima representative maintained that the term "property" used in Article 105 of the Satversme shall only to apply to shares having economic value. Shares of the Applicants, however, have no economic value and therefore they do not pertain to the scope of Article 105 of the Satversme.

Consequently, the Constitutional Court will first investigate whether the term "property" used in Article 105 of the Satversme was applicable to shares of the Applicants at the time when the Contested Norm was applied to increase equity capital of Parex banka.

12.1. In its case-law, the Constitutional Court has several times interpreted Article 105 of the Satversme and has already rules on method of interpretation and content thereof. It has been concluded in case-law of the Constitutional Court that Article 89 of the Satversme determines that the State recognizes and protects the fundamental rights of a person in accordance with the Constitution, the laws and international agreements binding on Latvia. The purpose of the legislator has was to harmonize norms of human rights included in the Satversme with those of the international ones (*see, e.g.: Judgment of 30 August 2000 by the Constitutional Court in the case No. 2000-03-01, Para 5 of the Findings*). When establishing the content of the fundamental rights included in the Satversme, it is necessary to take into account international liabilities of Latvia in the field of human rights. International norms of human rights and practice of their application serve as means of interpretation on the level of constitutional law to determine the contents and scope of fundamental rights and the principle of the law-governed state, as far as it does not lead to decrease or limitation of fundamental rights included in the Satversme (*see, e.g.: Judgment of 13 May 2005 by the Constitutional Court in the case No. 2004-18-0106, Para 5 of the Findings*). Consequently, if it follows from norms of the Convention and practice of their interpretation at the CJEU that the human rights enshrined in the Convention apply to the particular situation, then such a situation usually pertains to the scope of the respective human rights enshrined in the Satversme. However, if the human rights enshrined in the Convention do not apply to the particular situation, this does not mean that such situation does not pertain to the scope of respective fundamental rights established in the Satversme. In such a case, the Constitutional Court is committed to investigate whether there are any circumstances proving that the Satversme provides a higher level of protection of the fundamental rights.

12.2. The Constitutional Court has already concluded the following: "There is no doubt that shares shall be regarded as "property" in the meaning of Article 105 of the Satversme of the Republic of Latvia" (*see: Judgment of 6 October 2010 by the Constitutional Court in the case No. 2009-113-0106, Para 14*). The Saeima representative does not agree with the above mentioned conclusion and holds that the property right of a shareholder is protected only the shares have economic value. The Saeima representative ground the above mentioned opinion by a sentence included in one of decisions of the ECHR: "[..] A company share has an economic value, therefore it can be considered as possession in the meaning of Article 1 of Protocol No. 1 of the Convention" (*see, e.g.: Judgment of 7 November 2002 by the ECHR in the case "Olczak against Poland", application No. 041/96, Para 60*). This makes the Saeima representative to conclude the opposite (*per argumentum e contrario),* and to hold that the words "economic value" should be understood as share market value.

12.2.1. When interpreting a legal act, the conclusion *per argumentum e contrario* is possible only in case if it does not contradict other provisions of the legal act. It is possible to agree that, in certain cases, essence of conclusions made in ECHR judgments can be established also by means of *per argumentum e contrario*; however, in the case under consideration, no such approach has been applied. The conclusion of the Saeima representative contradicts the facts mentioned in the decision regarding financial situation of the bank, shareholder of which was an applicant of the respective complaint (*see: Judgment of 7 November 2002 by the ECHR in the case "Olczak against Poland", application No. 041/96, Para 9*). If the opinion of the Saeima representative regarding position of the ECHR would be grounded, the ECHR would have to conclude that shares of the applicant had no market value and therefore they do not pertain to the scope of Article 1 of Protocol No. 1 of the Convention. However, the EHCR concluded in the above mentioned case that the applicant as a shareholder of a public company could request the status of a victim based on Article 1 of Protocol No. 1 of the Convention (*see: Judgment of 7 November 2002 by the ECHR in the case "Olczak against Poland", application No. 041/96, Para 61 and 62*).

12.2.2. The Constitutional Court has already concluded that the term "property" ("possession") has an independent meaning in the light of Article 1 of Protocol No. 1 of the Convention. It means both, immovable and movable property; moreover, the term includes contractual rights with economic value and different economic interests (*see, e.g.: Judgment of 20 April 2010 by the Constitutional Court in the case No. 2009-100-03, Para 8.2*).

According to the Saeima representative, the term "economic value" used by the ECHR in the above mentioned judgment shall be understood as share market value.

However, in cases when the subject-matter is property market value, the ECHR uses the term "market value" or "full market value" in its case-law (*see, e.g.: Judgment of 21 February 1986 by the ECHR in the case "James and others v. the United Kingdom", application No. 8793/79, Para 54, and judgment of 5 April 2011 in the case "Yildirir v. Turkey", application No. 21482/03, Para 19*).

In the context of Article 1 of Protocol No. 1 of the Convention, the term "economic value" is used on a broader meaning of compared to the term "market value" and it means property character of a claim in a wide context with the purpose to distinguish between property claims from those that do not deal with property at all.

By referring to conclusions of the EHCR and opinion of Latvian law experts, the Constitutional Court has already concluded in its case-law that "Article 105 of the Satversme provides a comprehensive guarantee of property right. Property rights means all property-related rights that a person can exercise in his or her own favour and based on his or her free will, for instance, [..] the right that follows from shares (and other securities)" (*see, e.g.: Judgment of 20 April 2010 by the Constitutional Court on termination of proceedings in the case No. 2009-100-03, Para 8.2.*).

12.2.3. The term "share value" can be used based on its various meanings.

This is the nominal value of a share that proves its property-related nature. It also indicates that certain property investment has been made into equity capital. Pursuant to Section 230 (1) of the Commercial Law, "the par value of stock shall be determined by the articles of association of the company and shall be expressed in lats". Pursuant to Section 259 of the Commercial Law, the par value of newly issued stock shall be determined in the regulations for increasing equity capital. For each newly issued stock shall be paid the selling price of such stock, which shall be determined by the board of directors, but which may not be less than the par value of the stock. The selling price of stock is composed of the par value of the stock, and the additional payment and the mark up of the issue.

Section 43 (2) of the Annual Accounts Law provides that Stock companies shall always set out the number of stock and their nominal value. The first sentence of Section 32 of 4 August 2008 Cabinet of Ministers Regulation No. 618 "On processing the inheritance register and inheritance matters" provides in respect to inherited property and its assessment that "value of shares, other kinds of participation, as well as securities of capital companies shall be their nominal value".

Before the Contested Norm was adopted, as well as after it was applied, the Applicants possessed shares with one and the same nominal value. It cannot be stated that, at the time of adoption or application of the Contested Norm, the shares owned by the Applicants had no economic value and that the rights following from the shares were not property-related ones.

The Constitutional Court has already concluded in its case-law that Article 105 of the Satversme protects the right of a person to own property remaining after exclusion of a company, shares of which he or she owned, from the Enterprise Register (*see: Judgment of 6 October 2010 by the Constitutional Court in the case No. 2009-113-0106, Para 14*).

Consequently, the fact that the Applicant owns shares in a company that undergoes financial difficulties does not exclude him from the scope of Article 105 of the Satversme.

12.2.4. The Association representative indicated that share market value reflects the price that a person agrees to pay for a share in case if he or she sells it. Share market value depends on different factors, including demand and offer of respective shares in the market. If we take into account the fact that ERDB, a person subject to private law, showed its interest in purchase of shares of Parex banka and did purchase them, this does not mean that the shares had no market value at the tame of adoption and repetitive application of the Contested Norm.

The value calculated and established for a special purpose differs from nominal value and market value of shares. For instance, when expropriating property pursuant to the procedure established in Article 1 of Protocol No. 1 of the Convention, the compensation should be related with property market value; however, this norm does not guarantee the right to full compensation in all events. The term "fair compensation", used in Article 105 of the Satversme shall not always be understood as the market price of the real estate to be expropriated *(see: Judgment of 16 December 2005 by the Constitutional Court in the case No. 2005-12-0103, Para 22.3*).

Pursuant to Section 8 (1) and (4) of the Bank Overtaking Law, in case of expropriation of shares, property, denial of rights or liabilities, the procedure for establishing fair compensation, its amount and disbursing to bank shareholders or the bank shall be established by the CM, whilst in a case of a dispute – according to civil procedure based on a request of the bank of its shareholders.

The Saeima representative submitted the letter No. 7-3-07/5778 of 2 September 2011 of the MF to the Constitutional Court, wherein the following is stated: "According to the information provided by the PJSC "Privatizācijas aģentūra", share

market value assessment could not be performed because the value of the shares was symbolic, which is testified by their purchase price (in total, two lats and two euro cents)" (*Case materials, Vol. 4, pp. 163*). The above mentioned opinion of the MF contradicts its opinion expressed in the letter of 24 February 2009 addressed to the Prime-Minister: "For ERDB to be able to decide on possible participation in equity capital of Parex banka, it is necessary to establish the per value of shares of Parex banka. In calculations made by several institutions, different nominal value of a share was mentioned. The liquidation value could be 0.01 lat per share" (*see: Letter of 24 February 2009 of the MF No. 7/VK-74/540, case materials, Vol. 3, pp. 72*).

Taking into account the amount of shares owned by the Applicants, particularly, one of them owns more than two million shares, whilst the other – one million shares, even in case if the share value would be limited to the symbolic one, it could not be regarded as non-pertaining to the scope of Article 105 of the Satversme.

Moreover, in the audited 2008 annual report of the Applicant "East Capital (Lux)" , the market value of 28 900 shares of Parex banka pertaining to "East Capital (Lux) Eastern European Fund" was 40 thousand dollars according to what has been indicated [*East Capital (Lux). Société d'investissement à capital variable incorporated in Luxembourg. Audited Annual report 2008, case materials, Vol. 6, pp. 104*].

Consequently, it is not possible to agree with the opinion that the term "property" used in Article 105 of the Satversme does not apply to the shares owned by the Applicant and therefore the restriction of the fundamental rights of the Applicants established in Article 105 of the Satversme does not exist.

Consequently, the request to terminate legal proceedings in the present case shall be rejected.

13. In order to decide on the Saeima representative's request to terminate proceedings in the present case due to the fact that the Applicants have failed to exhaust all legal remedies, first it is necessary to determine the rights established in which sentence of Article 105 of the Satversme have been restricted in respect to the Applicants, namely, which sentence of Article 105 of the Satversme and to what extent is applicable to the Contested Norm. The Constitutional Court has concluded in its case-law that Article 105 of the Satversme establishes both, undisturbed enjoyment of property right and the right of the State to restrict use of property in the interests of the society. However, the fourth sentence of Article 105 of the Satversme, like Article 1 of Protocol No. 1 of the Convention, entitles the State to deny property right *de jure* in certain cases (*see, e.g. Judgment of 20 May 2002 by the Constitutional Court in the*

case No. 2002-01-03, the Findings). "The above mentioned norms establish different criteria for lawful assessment of restriction; therefore it is necessary to establish which of the criteria shall be applied to the Contested Norm in particular" (*see: Judgment of 6 October 2010 by the Constitutional Court in the case No. 2009-113-0106, Para 14*).

It should be taken into account that, in case if the fourth sentence of Article 105 of the Satversme is applicable to a situation, the Constitution establishes specific requirements that might influence existence and character of possible legal remedies. Namely, expropriation of a property is admissible only on the basis of such a specific law that the legislator has adopted as an exception" (*see: Judgment of 16 December 2005 by the Constitutional Court in the case No. 2005-12-0103, Para 22.2*).

13.1. The Applicants hold that, in fact, the Contested Norm conceals nationalization of property without disbursement of proper compensation, and they contest compliance of the norm with the fourth sentence of Article 105 of the Satversme.

Nominal value of shares owned by the Applicants has not changed, and they owned equal number of shares before and after adoption of the Contested Norm, the shares having the same nominal value as previously unless the owner has not voluntarily expropriated them. The Contested Norm as such neither deprives the status of an owner, nor rejects the possibility to receive dividends or liquidation pertaining due to shares already possessed in case if financial status of a credit institution permits it. Likewise, the right to participation in shareholders' meetings of a credit institution, if any, and other stipulated rights of shareholders are not denied.

Consequently, the Contested Norm pertains to the scope of the fourth sentence of Article 105 of the Satversme.

13.2. "The first sentence of Article 1 Protocol 1 of the Convention guarantees the right of any natural or legal person to peacefully enjoy his possessions, that is, the right to run or administer the possession, use it, procure benefit and handle it" [*see: Judgment of 30 April 1998 by the Constitutional Court in the case No. 09-02(98), Para 1 of the Findings*]. The first sentence of Article 17 (1) of the Charter of Fundamental Rights of the European Union provides: "Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions [..]". The above mentioned norm *expressis verbis* establishes the right not only to expropriate property but also to use it.

The ECHR indicates that share is regarded as a complex object that proves that shareholders own it with its inherent rights; consequently, shareholders not only have the right to a part of company property in case of discontinuance of its functioning but also other unconditional rights, especially the right to vole and influence the work of

the company (*see: Judgment of 27 December 2001 by the ECHR in the case "Sovtransavto Holding v. Ukraine", application No. 48553/99, and Judgment of 7 November 2002 in the case "Olczak against Poland", application No. 041/96, Para 60*). In the matter reviewed by the ECHR, the applicant initially had 49 per cent of shares, thought after repetitive increase in equity capital of the company his participation share became only 20.7 per cent. The ECHR concluded that the possibility of the applicant to influence the work of the company and implement control over its property changed (*see: Judgment of 25 July 2002 by the ECHR in the case "Sovtransavto Holding" v. Ukraine", application No. 48553/99, Para 92).*

When interpreting the fundamental rights enshrined in Article 105 of the Satversme, the Constitutional Court has already referred to norms enshrined in constitutions of other Member States of the EU and their interpretation in case-law of constitutional courts of respective states. The German Federal Constitutional Court has indicated that the law that established the right of representatives of employees to participate in decision-making regarding certain issues in bodies of capital companies shall be assessed as a restriction of the property right (*see: Judgment of 1 March 1979 by the German Federal Constitutional Court in the joined cases No. 1BVR 532, 533/77, 419/78 and 1 BvL 21/78 BVerfGE, 50, 290*). The Constitutional Court of the Republic of Austria has concluded that the possibility to push out shareholders out of a company shall be regarded a property right restriction that needs justification due to interests of the society and appropriateness and proportionality of the restriction (*see: Judgment of 16 June 2005 by the Constitutional Court of the Republic of Austria in the case No. G129/04 http://www.ris.bka.gv.at).*

When considering finding of case-law of the ECHR in conjunction with the historical and the legal regulatory framework effective in Latvia, as well as conclusions made in the field of law in respect to legal nature of shares, the Constitutional Court has concluded that "The right to own property also include the right to decide on issues related with the property" *(see: Judgment of 4 February 2009 by the Constitutional Court in the case No. 2008-12-01, Para 8*).

13.3. The Constitutional Court has also concluded that a stock company creates the content of human rights regarding property rights for, and natural stockholders only have the right to decide on issues mentioned in the second part of Section 284 of the Commercial Law, namely, making of amendments to the articles of association, the issuance of convertible debentures, the reorganisation of the company, entering into a group of companies agreement, amending or termination thereof, inclusion of the company, consent for inclusion and the termination or continuation of operations.

The decisions mentioned in the second part of this section apply to shares of the company; and these decisions are substantial since they can affect the extent of property rights of each stockholder. Stockholders are forbidden to deliberately establish the procedure for taking such decisions. Consequently, if the shareholders cannot freely establish the procedure of adopting the above mentioned decisions, the right to own property established in Article 105 of the Satversme is restricted (*see: Judgment of 4 February 2009 by the Constitutional Court in the case No. 2008-12-01, Para 9*).

The regulatory framework included in respect to competence of shareholders' meeting and the fundamental rights of shareholders established in the Commercial Law shall be assessed in conjunction with the Directive 77/91/EEC. The first sentence of Article 25 of the Directive 77/91/EEC provides the following: "Any increase in capital must be decided upon by the general meeting", whilst the first part of Article 29 establishes: "Whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares."

At the national referendum of 1 September 2003, the people of Latvia decided for Latvia to become a member state of the EU. The Constitutional Court has indicated that after joining the European Union the Republic of Latvia has to honour the liabilities, following from the European Union membership, including requirements of directives (*see: Judgment of 7 June 2004 by the Constitutional Court in the case No. 2004-01-06, Para 7*). This does not mean, however, that norms included in directive would at all times influence the scope of the fundamental rights included in the Satversme.

In the present matter, it is necessary to take into account the special character and place in commercial law of the Directive 77/91/EEC as an instrument establishing minimum standards for protection of shareholders' rights. Article 25 and Article 29 of the above mentioned Directive has been elaborated taking into account protection of the fundamental rights of shareholders effected in the Member States.

13.4. Consequently, taking into account all above mentioned aspects, it is possible to conclude that the scope of the first sentence of Article 105 of the Satversme applies to the rights of shareholders to decide issues related with functioning of a joint-stock company at a shareholders' meeting, these issues including those related to increase in equity capital, confirmation of provisions regarding increase in equity capital, as well as the fact that present shareholders would enjoy the priority right to purchase shares of new issuance.

These rights of shareholders pertain to the scope of Article 105 of the Satversme disregarding the fact how successful economic activities of the credit company are, and it embraces the right to participate in decision-making process regarding issues related with rescuing of a failing credit institution by mediation of shareholders' meeting.

The Contested Norm provides that the council of a credit institution is entitled, in certain situation, to adopt a decision regarding increase in equity capital and confirm provisions regarding the increase in equity capital without summoning a shareholders' meeting. However, the second part of the Contested Norm provides that in the above mentioned cases present shareholders of the credit institution shall not have the priority right to purchase shares of new issuance.

The Contested Norm prohibits shareholders to exercise their rights following from shares, namely, to participate in a shareholders' meeting, to adopt decision regarding substantial issues of the company, as well as to preserve their participation share in the company.

Consequently, the Contested Norm does pertain to the scope restriction of the fundamental rights established in the first, the second and the third sentence of Article 105 of the Satversme of the Republic of Latvia.

14. The Saeima is of the viewpoint that proceedings in the present case should be terminated because the Applicants have failed to exhaust all legal remedies and therefore their constitutional complaint does not comply with the principle of subsidiarity.

Article 19.^{2} indent 2 of the Constitutional Court Law provides that a person shall have the right to submit a constitutional complaint "only if all the options have been used to protect the specified rights with general remedies for protection of rights (a complaint to the higher authority or higher official, a complaint or statement of claim to a general jurisdiction court, etc.) or if such do not exist".

"A constitutional complaint is a measure for protection subsidiary right and it has been established in the Constitutional Court Law together with the institute of application. A constitutional complaint and an application to the Constitutional Court are mutually related institutes. The legislator has presumed that in cases when in a particular civil, criminal or administrative case the applicable legal norm infringes the fundamental rights established in the Satversme, the court would suspend legal proceedings and address the Constitutional Court" (*see: Decision of 31 August 2005 by the Constitutional Court "On refusal to suspend execution of decision of a judge of the*

Zemgale Regional City Court in the civil case No. 31249605,2496/05 and decision of 29 August 2005 of a judge of the Zemgale Regional City Court in the case No. 31247205, 2472/05", Para 2 of the Findings). The purpose of the principle of subsidiary is to ensure that a court, when examining a case on its merits, would first apply legal application and interpretation methods at its disposal to reach a result compliant with the Satversme; only in case if it is not possible, the court would have the right to lodge an application before the Constitutional Court. It has been established in the case-law of the Panels of the Constitutional Court that it is necessary to exhaust real and effective options to protect the fundamental rights infringed to ensure observance of the principle of subsidiary rather than to apply any theoretically feasible legal remedies that are somehow related with the situation of the applicants.

Pursuant to the above mentioned case-law, the following has been concluded in Para of the decision regarding initiation of a case under consideration "The applicants have no possibilities to protect their fundamental rights by mans of general legal remedies" (*see: Case materials, Vol. 1, pp. 115*).

14.1. The Saeima representative has provided information to the Constitutional Court testifying that the Riga City Northern Region Court, based on claims of several persons, has initiated a civil case on the assurance of the right of Parex banka minority shareholders to purchase shares of JSC "Citadele banka" issued as the result of reorganization of Parex banka and to receive compensation for moral harm resulting from the reorganization (*see: Case materials, Vol. 4, pp. 164*). By referring to a judgment in the case No. 2010-60-01, the Saeima representative holds that submission and review of analogous civil claims of the Applicants would serve as pre-condition for submission of a constitutional complaint.

However, in the above mentioned judgment, it is dealt with the legal remedy of civil rights in the meaning of Article 92 of the Satversme rather than legal remedy of fundamental rights in the meaning of the Constitutional Court Law. Without denying that in certain cases indemnification of loses can be regarded as legal remedy in the meaning of the Constitutional Court Law, the Constitutional Court shares the viewpoint of the Applicant, namely, that such claim is not aimed at protection of fundamental rights that follow from the right of the Applicants as shareholders to participate in administration of Parex banka. Consequently, a claim to indemnify losses in the present case cannot serve as a pre-condition for submitting a constitutional complaint.

14.2. Section 286 and 287 of the Commercial Law regulate appealing against a shareholder's meeting decision, though Section 310.[1] – that of a board decision.

Neither the Commercial Law, nor the Credit Institutions Law *expressis verbis* establish the possibility to appeal against a decision of a council of a capital company. Therefore, it has been indicated in the application that, by rejecting the right of the shareholders' meeting to decide on increase in equity capital, the Contested Norm has also prohibited shareholders the right to appeal against such decision.

The Saeima representative holds that a bank council decision can be appealed against based on analogy and such appeal would serve as pre-condition for submitting a constitutional complaint.

It should be taken into account that the aim of sections of the Commercial Law is to exhaustively enumerate cases, in which a shareholder has the right to appeal against decisions of bodies of a company. A situation, when shareholders would try to influence economic activities of the company by means of a court in cases when the law does not establish it, would fail to comply with the principles of the rights of the society.

As it has already been mentioned, the principle of subsidiary requires exhausting real and effective options to protection the fundamental rights infringed rather than to apply any theoretically applicable legal remedies.

14.3. The Saeima representative holds that the Applicants had to appeal, according to the procedure of administrative proceedings, against the decision of State Notary of the Enterprise Register regarding registration of amendments into the Articles of Association. Section 19 of the Law "On the Enterprise Register of the Republic of Latvia" provides: "The decisions and actions of State notaries of the Register of Enterprises of the Republic of Latvia may be contested in accordance with the procedures specified by law by submitting a relevant submission to the Chief State Notary of the Register of Enterprises of the Republic of Latvia [..]".

However, it should be taken into account that pursuant to Section 14 (2) of the Law "On the Enterprise Register of the Republic of Latvia", the competence of the Enterprise Register shall not include examination of the factual circumstances of the decision-making of the merchant. Jurisdiction of the Enterprise Register includes only examination of lawfulness of form and content of submitted documents. Since documents submitted testify legal facts, officials of the Enterprise Register shall be committed to verification of compliance of the facts established in the documents with requirements of law rather than compliance of all facts mentioned in the documents with factual situation" (*Strupišs A. Komerclikuma komentāri. Jurista Vārds, 3 June 2003, No. 21).*

Consequently, in the light of the Constitutional Court Law, appeal against a decision of the Enterprise Register in the present case cannot be regarded as an option to protect the fundamental rights infringed by means of general legal remedies.

14.4. At the judicial debate, the Saeima representative indicated that "[..] the Applicants have failed to exhaust the general legal remedies of the European law" (*see: Transcript of the Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 134*). Since the Applicants refer to two articles of the Directive 77/91/EEC, they had to address the court by requesting effective application of the EU law or – according to the "Frankovitch doctrine" – indemnification of losses from the State due to breach of the directive (*see: Transcript of the Constitutional Court hearing of 20 September 2011, case materials, Vol. 7, pp. 133*). During adjudication of the case, the Saeima representative also maintained that the Applicants had to appeal against the EC decision regarding compliance of the State aid to Parex banka with the common market of the EU.

The Constitutional Court has already concluded in its case law that: "It follows from Article19.^{2} (2) of the Constitutional Court Law, as well as from the essence of Constitutional Court as a national mechanism for protection of rights that the duty to exhaust all general legal remedies apply only to national measures for protection of rights" (*see: Judgment of 6 October 2010 by the Constitutional Court in the case No. 2009-113-0106, Para 14*).

Exhausting of such legal remedies that are not directly related with protection of the fundamental rights established in the Satversme and are aimed only at assurance of application of the EU law shall not be regarded as pre-condition for a person to be able to lodge a constitutional complaint before the Constitutional Court.

Consequently, the Applicants do not have the possibility to prevent infringement of their fundamental rights by means of general legal remedies, and the request of the Saeima representative regarding termination of the legal proceedings shall therefore be rejected.

15. According to the Applicants, the Contested Norm contradicts the principle of proportionality and that of legitimate expectations, and therefore it fails to comply with Article 1 of the Satversme.

When assessing the conformity of the impugned norm with legal principles that follow from constitutional values included in Section 1 of the Satversme, one shall take into consideration the fact that manifestation of these principles may differ in different domains of law. The nature of the impugned norm, its connection with other

norms of the Satversme and their place in the system of fundamental rights, inevitably influence the scope of the control realized by the Constitutional Court. If compliance of a contested norm with the principle of legitimate expectations and Article 105 of the Satversme is contested, then compliance of the Contested Norms with Article 1 of the Satversme must be assessed in conjunction with Article 105 of the Satversme (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 4*).

"Assessment of the principle of proportionality is aimed at norms that include restrictions of rights. Consequently, restriction of particular rights shall be subject to assessment of its proportionality" (*see: Judgment of 30 March 2011 in the case No. 2010-60-01, Para 11*).

Consequently, compliance of the Contested Norm with the principle of proportionality and that of legitimate expectations shall be assessed, if necessary, in conjunction with the assessment of restriction of the fundamental rights established in Article 105 of the Satversme.

16. The Contested Norm has been adopted and applied at the time what was already characterised as crisis period in judgments of the Constitutional Court. The Constitutional Court has indicated in its case-law that in 2009 "Latvia underwent the most rapid reduction of economic activities in the entire European Union. For instance, the revenues of the State consolidated budget during the first six months of 2009 were for 15 per cent lower than those of the corresponding time period in 2008. At the same time, the expenditures of the State consolidated budget during the first six months of 2009 were for 7.2 per cent higher than those of the corresponding time period in 2008. The Gross Domestic Product drop in comparison to the first six months of 2008 was 18.7 per cent. The drop persisted also in the third quarter of 2009, reaching 18.4 per cent" (*see: Judgment of 15 March 2010 by the Constitutional Court in the case No. 2009-44-01, Para 20*). Consequently, it is not possible to share the opinion of the Applicant representative Mr. V. Tihonovs that there was no crisis (*see: Transcript of the Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 17*).

However, the Constitutional Court had already indicated that **the fundamental rights of persons established by the Constitution are binding to the legislator irrespective of the economic situation in the State** (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 24*).

17. Article 105 of the Satversme provides not only the right of a person to own property, but also the right of the State to restrict exercise of property right in the interests of the society (*see, e.g. Judgment of 20 March 2002 by the Constitutional Court in the case No. 2002-01-03, the Findings*). In order to assess constitutionality of the restriction of the rights established in Article 105 of the Satversme, it is to be investigated whether it is statutory, whether it is provided for protection of a legitimate objective and whether it complies with the principle of proportionality (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 22*).

18. When preparing the case, the Constitutional Court started doubting compliance of the procedure of adoption of the Contested Norm with Section 95 (1) indent 6, Section 106 (1) and Section 111 (1) of the Rules of Procedure. Therefore, the Constitutional Court shall assess whether the Contested Norm has been adopted pursuant to the above mentioned norms.

18.1. Legislation process is a special procedural order, according to which the Saeima or the people achieve that a draft law elaborated in advance becomes a law, i.e. a normative enactment that occupies a certain place in the system of normative enactments. The legislation process can be divided into the following stages: legislation initiative, discussing of the draft law, adoption of a law, publishing of the law *(see: Judgment of 16 December 2008 by the Constitutional Court in the case No. 2008-09-0106, Para 6.1, and judgment of 30 October 2009 in the case No. 2009-04-06, Para 11*).

When preparing the draft law for the third reading, the Contested Norm was incorporated into the respective drat law as a suggestion of the responsible committee, namely, the Budget Committee. Consequently, no annotation has been elaborated in respect to the Contested Norm, which would have provided insight into the course of elaboration of the Contested Norm, its compliance with the fundamental rights of a person, international liabilities of Latvia and other important issue of the draft law. Other Saeima commissions and members did not have the opportunity to express their viewpoint or submit suggestions regarding the particular norm before review of the draft law at the third reading. However, "according to the Saeima Rules of Procedure, during revision of a draft law, the respective section, a part thereof or any amendment can be included into a legal norm in both, the second and the third reading. The aforesaid does not apply only to the cases when, according to Article 76 of the Satversme, those are amendments to the Satversme considered. In such a case, proposals can be submitted for the second and the third readings only regarding those

articles (regarding amending or repealing of those articles) that have already been present in the draft law approved at the first reading" *(see: Judgment of 16 December 2008 by the Constitutional Court in the case No. 2008-09-0106, Para 6.5*). The Constitutional Court has already concluded in its case-law that, at the third reading, the Saeima is entitled to adopt norms also in respect to the issue initially not included into a particular draft law (*see: Judgment of 30 October 2009 by the Constitutional Court in the case No. 2009-04-06, Para 11.2*).

18.2. "The Rules of Procedure commissions a considerable part of elaboration of draft laws to Saeima committees. The responsible committee ensures that a draft law is properly elaborated for examination thereof at the Saeima meeting (*see: Judgment of 16 December 2008 by the Constitutional Court in the case No. 2008-09-0106, Para 6.4, and judgment of 30 October 2009 in the case No. 2009-04-06, Para 11.2*). Section 106 (1) of the Rules of Procedure establishes: "A draft law shall be prepared for the third reading by the responsible committee, together with the Saeima legal service and experts in the official language. The committee shall provide its opinion concerning the submitted proposals and, if necessary, add its own proposals."

Pursuant to Section 95 (1) indent 7 of the Rules of Procedure, proposals for amendments to a draft law or a draft resolution of the Saeima may be submitted by the Saeima legal service if the proposals are related to the legislative technique and codification. When considering the draft Rules of Procedure at the second reading at the Saeima meeting of 25 May 1994,Mr. Aivars Endziņš, Head of the Committee for elaboration of the Saeima Rules of Procedure indicated the following: „When preparing a draft law for the second reading, it is necessary to involve, along experts of the State language, experts of the Legal Bureau in order to prevent all possible contradiction with norms of a particular law and other norms of an effective law after adoption of the law" (*see: Transcript of the Saeima meeting of 25 May 1994, http://www.saeima.lv/steno/st_94/st2505.html).*

The Constitutional Court has already concluded in its case-law that the Saeima procedure is established also by parliamentary traditions insofar as they do not contradict the Saeima Rules of Procedure: [*see: Judgment of 13 July 1998 by the Constitutional Court in the case No. 03-04(98, Para 3 of the Findings*]. Pursuant to the Rules of Procedure and normative acts regulating work of the Legal Bureau, as well as parliamentary traditions of the Saeima, the duty of the Legal Bureau is to procure, as far as possible that members and committees of the Saeima would have professional information on compliance of a draft law, suggestion or proposal with the Constitution, international liabilities of Latvia and EU law, as well as compatibility

thereof with the legal system of Latvia at their disposal. However, the task of the responsible committee is to timely submit to the Legal Bureau all materials to be reviewed at a committee meeting, to hear opinion of the Legal Bureau on a particular draft law and suggestions, as well as to assess arguments of the Legal Bureau.

18.3. At the Opinion of 17 February addressed to the Budget Committee, the Legal Bureau indicated that, when getting acquainted with the table of suggestions in respect to the draft law No. 963 for the third reading, it has established that the possible suggestion of the Budget Committee to supplement the draft law by Section 59.[5] of is included. It is not possible to generally assess compliance of it with other laws and legal norms of a higher legal norm in such a limited timeframe; however, having made initial analysis of the suggestion, the Legal Bureau held that "it contradicts the Commercial Law and considerably restricts the rights of present shareholders of a credit institution". By referring to Section 111 (2) of the Rules of Procedure, the Legal Bureau indicates that such suggestions shall be transferred to the Ministry of Justice for assessment. However, should the Budget Committee decide to support the suggestion regarding supplementing the law by Section 59.[5], the Legal Bureau suggested supplemented the draft law with the following norm: "Amendments regarding supplementing the draft law by Section 59.[5] shall come into force along with respective amendments into the Commercial Law" [*see: Opinion of 17 February 2009 by the Saeima Legal Bureau No. 12/17-3-9-(9/09), case materials, Vol. 2, pp. 48*].

In minutes of meeting of 17 February 2009 of the Budget Committee No 227, there are no entries regarding the fact whether the respective opinion of the Legal Office was reviewed at the meeting and the fact that the Budget Committee would have assessed compliance of the draft law prepared with Section 111 (2) of the Rules of Procedure (*see: Minutes of the meeting of 17 February 2009 by the Budget Committee No. 227, case materials, Vol. 2, pp. 42 – 45*). On February 2009, meetings of the Budget Committee were not recorded (*see: Letter of 30 March 2011 by the Saeima Chancellery No. 12/1-3-n/57-2011, case materials, Vol. 2, pp. 41*). However, it can be concluded from written opinions submitted by the summoned persons, namely, the Budget Committee and the Legal Bureau, and information provided by representatives of the summoned persons that at the Budget Committee meeting of 17 February, the opinion of the Legal Bureau was heard and assessed. As the result of discussions, it was decided, however, that adoption of the Contested Norm would cause no contradictions with the effective laws. The Commercial Law establishes a general regulatory framework, though the Contested Norm as a special legal norm regulates the situation in respect to a specific subject-matter, namely, a credit

institution. Application of the Contested Norm is established by Section 8 of the Law on the Procedure for the Proclamation, Publishing, Entry into Force, and Validity of Laws and other Legislative Acts Issued by the Parliament (Saeima) State President and Cabinet of Ministers, as well as Section 4 of the Credit Institutions Law. Consequently, it is not necessary to introduce, into Transitional Provisions, the regulatory framework established in Section 111 (2) of the Rules of Procedure.

18.4. When responding to the question whether constitutionality of a suggestion is assessed when it is introduced at the third reading of a draft law, the Budget Committee informs that it is usually assessed by the Ministry of Justice or the Legal Bureau. However, the Legal Bureau representative indicated that the Legal Bureau could assess compliance of the Contested Norm with the Satversme and liabilities of Latvia as an EU Member State only at a limited extent.

The Constitutional Court has already indicated that in cases when the Rules of Procedure establish a particular right to a person, for instance, the right to submit an suggestion, though the term for exercise of the right is to be determined by the Saeima, for instance, the term for submitting suggestions for an urgent draft law, the term should be of the length permitting a person to exercise his or her rights established in the Rules of Procedure (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 17.1*).

Article 75 of the Satversme and the Rules of Procedure establish the procedure for adopting urgent draft laws. As to procedure of adoption of urgent draft laws, the Constitutional Court has recognized that the timeframe for submitting suggestions, i.e. 15 minutes shall not be regarded as breach of the Rules of Procedure (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 17.1*). However, the Contested Norm has been enshrined into the draft law, on urgency of adoption of which the Saeima members had not decided.

The Constitutional Court draws attention to the fact that filature to reflect substantial conclusions in minutes of committee meeting prohibits having a full insight into the course of the committee meeting and decisions adopted. However, the fact that the Legal Bureau is not given enough time to assess constitutionality of suggestions causes risk that a norm infringing the fundamental rights is adopted. Such action of the Budget Committee contradicts Section 106 of the Rules of Procedure and Saeima traditions. Consequently, such procedure shall be regarded as breach of parliamentary procedure.

However, the Constitutional Court has already concluded in its case-law that not every violation of the parliamentary procedure can serve as the reason of

considering it an act without a legal force. To declare an act null and void because of violation of parliamentary procedure, one should have well–founded doubt, that – in case – if the procedure was observed, the Saeima would have adopted a different resolution (*see: Judgment of 13 July 1998 by the Constitutional Court in the case No. 03-04(98), Para 3 of the Findings*]. In the present matter, there exist no such doubts.

Consequently, the restriction of the fundamental rights has been established by a law adopted and proclaimed according to proper proceedings.

19. Any restriction of the fundamental rights must be based on circumstances and arguments of necessity of it, namely, that the restriction is established for purpose of important interests, namely, a legitimate aim (*see, e.g.: Judgment of 22 December 2005 by the Constitutional Court in the case No. 2005-19-01, Para 9*).

It follows from the opinion of the Saeima and those of the summoned persons that the legitimate aim of the Contested Norm is assurance of fast and effective recapitalization process of a failing credit institution though being systematically important for the State by including, into the process, the possibility to adopt a foreseeable decisions compliant with the requirements of the in the field of public support in increase of equity capital.

19.1. In the field of financial services, the State has undertaken a great responsibility for licenced credit institutions by introducing, among the rest, deposit guarantee mechanism. When solving of financial problems of a credit institutions, interests of depositors shall first be protected. The Constitutional Court has already concluded that "at the period of crisis, interference with the banking sector should be ensured as soon as possible to ensure stability of the financial sector and protection of the rights of depositors. Functioning of a credit institution shall always be assessed in conjunction with the possible impact on the entire financial sector and national economy of the State in general" (*see: Judgment of 30 March 2011 by the Constitutional Court in the case No. 2010-60-01, Para 22*).

It also follows from the case-law of the ECHR that in certain circumstances actions of the state, in the result of which participation share of the applicant in the bank is reduced, can be taken for the purpose of a legitimate aim, namely, protection of the interests of bank clients (*see: Judgment of 7 November 2002 by the ECHR in the case "Olczak against Poland", application No. 041/96, Para 84*).

By preventing all risks to financial stability of a credit institution, interests of depositors are protected, trust into domestic banking system is restored and general financial stability is assured.

19.2. In 16 February 2009 letter of the MF No. 7-4/127 addressed to the Budget Committee, wherein the MF asks to enshrine several norms, the Contested Norm included, into the Law as a suggestion of the responsible committee, states the following purpose: "Suggestions have been elaborated to improve the procedure for founding of a credit institution and increasing its equity capital in case if the Cabinet of Ministers has adopted a decision to materially increase participation share in the credit institution" (*see: Case materials, Vol. 2, pp. 46*).

In the MF letter of 24 February 2009 addressed to the Prime-Minister, the following has been indicated: for a potential investor to consider the possibility to participate in Parex banka capital, it is necessary to solve several issues, including the possibility to prevent the option that minority shareholders gain profit from investments into Parex banka. This can be ensured wither by executing full nationalization of Parex banka or reducing participation shares of the minority shareholders (*see: 24 February 2009 Letter No. 7/VK-74/540, case materials, Vol. 3, pp. 71*).

Reduction of participation share of shareholders if this ensures compliance of public support with the EU common market can be aimed at protection of the rights of other persons. Namely, in case if the State obtains or materially increases participation share in a credit institution, such participation shall be regarded as State aid. The Constitutional Court shares the opinions of the Saeima and the summoned persons that it is not admissible to provide support for a failing credit institution in a way that would permit former shareholders to gain ungrounded benefit from such aid. State aid impacts competition and in certain cases it can infringe the rights of shareholders of other credit institutions. Restrictions established in respect to State aid are aimed not only on fulfilment of liabilities of Latvia as a Member State of the EU but also to observance of the principle of justice and that of equality enshrined in the Satversme. A situation when shareholders of one bank would gain profit from increase in equity capital by means of State aid, though shareholders of other banks are denied such possibility cannot be admitted. Restrictions aimed at assurance of fair competition have been established for a legitimate aim, i.e. protection of the rights of other persons.

19.3. The Constitutional Court has already stipulated in its case-law that specific restrictions of fundamental rights were necessary in Latvia in 2009 to prevent consequences of the economic crisis. Under conditions of the economic crisis burden on members of the society should be allocated by taking into account the necessity to protect the weakest members of the society and observing solidarity between them. Under the conditions of economic crisis social solidarity means that every citizen

assumes a proportional responsibility for eliminating the harsh consequences of the crisis (*see, e.g.: Judgment of 18 January 2010 by the Constitutional Court in the case No. 2009-11-01, Para 10.3*).

If the State gets involved in rescuing of a credit institution that would become insolvent without the State aid and as a result the credit institution can successfully continue its work, the situation when the shareholders would gain benefit from the State aid invested into the credit institution without them participating in rescue measures of the credit institution would be regarded as unethical and non-compliant with the principle of justice. The restrictions that are aimed at shareholders of a credit institution to undertake a proportional burden if compared with that undertaken by tax payers in case if the credit institution is provided State aid have a legitimate aim, which is assurance of welfare of the society.

Consequently, the legitimate aim of the Contested Norm is assurance of welfare of the society and protection of the rights of other persons.

20. To assess proportionality of the restriction of the fundamental rights, the following should be investigated: 1) whether the measures selected are appropriate for reaching of the legitimate aim; 2) whether there exist other more lenient measures that would restrict the fundamental rights of persons at a lesser extent; 3) whether the benefit gained by the society is greater than the detriment done to rights and legal interests of a person (*see, e.g.: Judgment of 30 March 2011 in the case No. 2010-60-01, Para 23*).

21. When investigating whether the Contested Norm reaches the legitimate aim, several aspects shall be taken into account.

21.1. Insofar as the aim of the Contested Norm is rapid increase in equity capital, the aim is reached. Namely, increase in equity capital of a joint-stock company according to the general procedure, as regulated in the Commercial Law, is being executed in several stages, each of them having its own term; though the Contested Norm reduces the term of the procedure.

Pursuant to Section 249 (1) of the Commercial Law, the equity capital may be increased or reduced only on the basis of a decision of a meeting of stockholders, in which the regulations for an increase or reduction of the equity capital shall be approved, and amendments to the articles of association of the company made, except the case referred to in Paragraph four of this Section. Pursuant to Section 273 (1) indent 1 of the same law, a notice regarding the convening of a meeting of

stockholders shall be announced not later than 30 days prior to the planned meeting of stockholders. However, the Contested Norm establishes that no summoning of shareholders' meeting is necessary to perform increase in equity capital, and therefore no such term is required.

Pursuant to Section 252 of the Commercial Law, a notice regarding a priority right of stockholders to the newly issued stock shall be published in the newspaper *Latvijas Vēstnesis* and the company shall send a notice regarding their priority to the newly issued stock to all stockholders registered in the register of stockholders. The notice shall indicate the time period during which the stockholders must exercise their priority right, and which may not be less than one month from the date when the notice is published, or in the case of registered stock – from the date when the notice was sent. The Contested Norm provides no fundamental rights to the present shareholders; therefore no such term is necessary.

Moreover, if increase in equity capital takes place according to the procedure established in the Commercial Law and any of the shareholders fail to exercise his or her priority right, the term is extended even more, though no such situation occurs in case of application of the procedure established in the Contested Norm.

21.2. Insofar as the purpose of the Contested Norm is to effectively increase equity capital by reducing participation share of present shareholders, the purpose can be considered as reached because the Contested Norm does not establish the right of present shareholders to purchase shares of new issuance. Amongst the rest, conclusions included into EC 15 September 2010 decision testify that in the resent case the Contested Norm has most probably reached its aim. The EC held that measures already implemented and those that Latvia undertook implementing ensure a broad use of resources and the fact that private shareholders of Parex banka provide appropriate contribution into restructuration of the bank. Burden of former majority shareholders of the bank is testified by the fact that Latvia took over all their shares for a symbolic price – two lats. Consequently, it can be concluded that they have undertook consequences of insolvency of Parex banka. Along with the change of majority shareholders and as a result of recapitalization of the bank by the ERDB, impact of minority shareholders has been considerably reduced. The property right of the latter have reduced from 15.2 per cent previously owned to 3.7 per cent currently owned [*see: EC 15 September 2010 decision on the State aid C 26/09 (ex N 289/09) to be implemented by Latvia to restructure JSC Parex banka, Para 146 – 147, Official Journal of the EU, L 163, 23 June 2011, pp. 48*].

However, to reach the above mentioned aim, it is not necessary to refuse summoning shareholders' meeting. At the hearing, when replying to a question of the Applicant, Ms. D. Lagzdiņa indicated that, in the light of the right of the State to provide aid, it is of no importance whether a particular decision is adopted by the board or the council (*see: Transcript of Constitutional Court hearing of 6 September 2011, case materials, Vol. 7, pp. 83*).

None of notices by the EC relating to State aid necessary to overcome the financial crisis indicate that refusal to summon shareholders' meeting in such a case would be necessary to ensure fair competition. The Saeima representative could not prove that any of EC decisions on the State aid to Parex banka would accept that equity capital can be increased without a respective decision by the shareholders' meeting.

It can also be concluded from case-law of the EC regarding assessment of public support to credit institutions of other Member States of the EU that in case if equity capital is increased based on a decision of shareholder's meeting, it is rather likely that state aid would not comply with the EU common market. For instance, in the EC decision on state aid provided to a German bank "Commerzbank", it is indicated that this is the shareholders' meeting deciding on increase in equity capital (*see: EC 7 May 2009 judgment in the case State Aid N 244/2009 – Commerzbank – Germany" Para 32, http://ec.europa.eu /competition/state_aid/cases/231053/231053_959312_23_1.pdf)*, though the EC decision in the above mentioned case is positive.

Consequently, insofar as the aim of the Contested Norm is to effectively increase equity capital by also reducing participation share of present shareholders, no refusal from summoning shareholders' meeting is necessary to reach it.

21.3. The EC indicated one of the criteria in respect to public support measures in crisis situation already in October 2009, which is restriction of state support to the minimum. It is established in the EC notice that state aid for increase in equity capital should be restricted to the minimum and it may not permit the recipient to participate in aggressive commercial strategies or extend its activity, or to participate in reaching of other aims including excessive hampering of competition. The recipients shall make largest investments possible using their own resources, as well as ensure participation of the private sector (*see: Communication from the Commission on the application of State aid rules to support measures in favour of banks in the context of the financial crisis", Para 38, Official Journal of the EU, 25 October 2008, No. I*).

The regulatory framework that at all times denies shareholder's priority right to purchase shares of new issuance prohibit them making his or her own contribution into equity capital of the company and thus improve financial status of the company. Such solution has not been aimed at increase of financial status of the company by using private resources as far as possible. This might cause a situation when private capital is rejected, thought tax payers' funds are invested.

Insofar as the aim of the Contested Norm is to effective increase equity capital, the Contested Norm fails to reach the particular aim because it prohibits attracting private funds as far as possible to rescue the bank.

22. When assessing whether legitimate aim can be reached otherwise, the Constitutional Court has concluded in its case-law that a more lenient means are not any means, but only such by which the aim may be reached in the same quality (*see: Judgment of 13 May 2005 by the Constitutional Court in the case No. 2004-18-0106, Para 19 of the Concluding Part*). In the above mentioned case, several alternative measures for reaching of the legitimate aim are mentioned.

22.1. The Applicants indicate that one of the means restricting the fundamental rights at a lesser extent and ensuring reaching of the legitimate aim is action of the State in accordance with the procedure established in the Bank Overtaking Law. The State can obtain a considerable participation share in equity capital by first overtaking shares pertaining to shareholders of a credit institution, those of minority shareholders included, and them making investments into equity capital of the credit institution.

One of the economic policy pre-conditions for further disbursement of financial aid set for Latvia by the EU council in the 20 January 2009 decision providing medium-term financial assistance to Latvia is as follows: "[..] ensuring that the remaining minority shareholders of Parex banka do not benefit from the resolution of the bank and measures to enhance financial stability, by means of fully nationalising Parex banka (*see:* EU council in the 20 January 2009 decision 2009/290/EC providing medium-term financial assistance to Latvia, Article 3 (5) indent "i", Official Journal of the EU, 25 March 2009; or *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:079:0039:0041:LV:PDF).* Also Para 30 of EC 11 February 2009 decision NN 3/2009 Modification of public support measures to JSC Parex banka deals with a fair compensation to minority shareholders and conditions thereof (*see: EC 11 February 2009 decision NN 3/2009 Modification of public support measures to JSC Parex banka, Para 30, Official*

Journal of the EU, 27 June 2009, No. C 147, or http://ec.europa.eu/eu_law/state_aids/comp-2009/nn003-09-en.pdf).

It is not possible to agree with the opinions expressed by the summoned persons during the hearing that the Bank Overtaking Law could not be applied in respect to the Applicants. Such statement contradicts with the opinion of the Latvian state submitted to the EC: "[..] it is not excluded that LHZB will fully nationalise Parex banka through acquisition of its remaining shares from the minority shareholders. In this regard, the Latvian authorities confirmed that the compensation that would be paid to these shareholders in such event would be set according to the Bank Overtaking Law" (*see: EC 11 February 2009 decision NN 3/2009 Modification of public support measures to JSC Parex banka, Para 9, or http://ec.europa.eu/eu_law/state_aids/comp-2009/nn003-09-en.pdf).*

When reporting on the Contested Nom at the Saeima meeting of 26 February 2009, Mr. K. Leiškalns, Head of the Budget Committee indicated the following: "By applying the particular norm, interests of present shareholders are restricted at a lesser extent if compared to the case if the State would decide on performing compulsory takeover of the bank pursuant to the Bank Overtaking Law" (*see: Transcript of the Saeima meeting of 26 February 2009, http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/9E0A71FA0FC099A6C225756E0047 D780?OpenDocument).* It is not possible to agree with the opinion of the Mr. K. Leiškalns expressed at the court hearing, namely, that the Contested Norm is necessary because the Bank Overtaking Law could not be applied.

The following has been indicated in the annotation to the Bank Overtaking Law: "[..] if no agreement on voluntary takeover is reached, the draft law establishes that a separate law shall be adopted for each case of compulsory takeover. Such approach ensured that the legislator verifies in each particular case that an extraordinary situation has occurred and it is necessary to overtake shares or property, rights and obligations of a particular company to preserve stability of the national banking system, assure food functioning of financial transaction system, as well as to ensure interests of the society" (*see: Annotation to the draft Law "Bank Overtaking Law", http://titania.saeima.lv/ LIVS/SaeimaLIVS.nsf/0/4BFD4A715FA0A04BC225752100522558?OpenDocument).*

The Constitutional Court has indicated in its case-law that "real protection of the property of a person is not guaranteed only by a fair compensation (its amount), but also by the process of coercive expropriation itself" (*see: Judgment of 16 December 2005 by the Constitutional Court in the case No. 2005-12-0103, Para 22.3*).

It is possible to agree that the Bank Overtaking Law is more favourable in respect to the Applicants insofar as it provides that issues regarding expropriation of shares shall be assessed by the Saeima in the frameworks of legislative procedure, thought disputes regarding the amount of a fair compensations hall be settled at the court. The Contested Norm does not establish any of the above mentioned procedures.

The Cabinet of Ministers holds that that the fundamental rights would be restricted at a greater extent in case if the State would have fully overtaken Parex banka. As to compulsory expropriation of shares for an appropriate remuneration, Section 8 (1) of the Bank Overtaking Law provides: If the overtook bank has received state aid or the BL has granted funding to it before the suggestion on bank takeover has been made or simultaneously with it, then the granted state and BL funding shall be excluded from calculations without stating its amount whatsoever. 10 February 2009 Cabinet of Ministers Regulations No. 112 "Procedure for Calculation, Proposing and Payment of a Fair Compensation Amount to be Disbursed to the Bank Shareholders or the Bank" requires establishing the value of the object to be overtaken by taking into account the amount of bank capital and reserves presented as difference between the value of bank assets balance and liquidation value by assuming that the bank would receive state aid and BL funding in the future and taking into account any information on commercial activities of the State, actual ability of the State to continue commercial activities in the future, bank capital sufficiency indices and solvency status as on the date when a suggestion on bank takeover is submitted, as well as bank liquidity indices.

At the hearing, the Saeima representative and several summoned persons held that a fair compensation to the Applicants in case of application of the Bank Overtaking Law would be close to zero. Such opinion differs from the written opinion of the Association, namely, takeover of shares of shareholders of the credit institution and subsequent increase in equity capital would cause several negative consequences to the State and the credit institution. Financial means that the State would invest into the credit institution to improve its financial situation could be transferred to the shareholders.

It can be concluded form the case materials that in December 2009 the Applicant estimated their assets in the following way: two or more lats per share.
In the interview with the newspaper "Dienas Bizness", one of the minority shareholders who is not the Applicant maintained that "Parex banka has a large credit portfolio. [..] A lot of its property – symbolically a half of Latvia is bound at Parex

banka" (*see: Mārtiņa I. Nav gatavi tāpat atdot akcijas. Dienas Bizness, 19 December 2009, http://www.db.lv).*

At the moment of adoption of the Contested Norm, the MF held: if the issue of minority shareholders of Parex banka was solved by applying the Bank Overtaking Law, considerable negative consequences would occur in the form of litigation costs in case if the minority shareholders would not be satisfied with the amount of compensation disbursed (*see: FM letter of 24 February 2009 No. 7/VK-74/540, Case materials, Vol. 3, pp. 71 – 72*). Consequently, at the time of adoption of the Contested Norm, the MF was not sure about the exact amount of a fair compensation and it had certain concert about the risk of litigation.

The EC indicates in respect to assessment of assets and establishment of prices complying with rescue measures of financial institutions that, at the first stage, assets should be assessed, if possible, based on the present market value. "In fact, any transfer of assets included in a rescue scheme and exceeding market value shall be regarded ad State aid. However, present market value can considerably differ from the book value of assets, though in case of absence of the market, assets may have no value at all (certain assets may, in fact, have the value of zero)" (*see: Communication from the Commission on the treatment of impaired assets in the Community banking sector, Official Journal of the EU, 26 March 2009, or http://eur-lex.europa.eu/LexUriServ/Lex UriServ.do?uri=OJ:C:2009:072:0001:0022:LV:PDF).*

In the frameworks of the present case, it is not possible and even necessary to investigate whether a fair compensation and at what amount would be due to the Applicants in case if the State would decide to perform full nationalization of Parex banka.

Action of the State, in the result of which financial status of a credit institution was improved, permits shareholders to preserve their status of owner and exercise the rights that follow from shares. Consequently, application of the Bank Overtaking Law cannot be regarded as means restricting the rights of the Applicants at a lesser extent.

22.2. As to the legitimate aim is to reduce time necessary to summon shareholders' meeting, there exist an alternative means to reach the aim, namely, reduction of the stipulated term for summoning shareholders' meeting. The legislator had the possibility to reduce the term of 30 days established in the Commercial Law in a general manner and in respect to cases when a failing credit institution undergoing financial difficulties is to be rescued.

Likewise, it was possible to establish a very short term, in which a shareholder had to decide on implementation of its priority right and pay the subscribed capital.

22.3. The Contested Norm is related with State aid; therefore increase in equity capital pursuant to the procedure established therein is possible only after receipt of consent of the EC. This is illustrated by the situation in March 2009 when the first decisions of Parex banka council regarding increase in equity capital was not implemented because the EC did not confirm the amount of State aid requested. It was necessary for the CM to issue another decision and for the Council of Parex banka to adopt another decision (*see: Para 1.6. of the present judgment*).

Although it is probable that in an urgent case a EC decision is adopted on urgent basis, the EC decision of 11 May 2009 regarding Parex banka was received after a longer time period than that established by the Commercial Law for summoning shareholders' meeting. At this period, it was possible to timely summon shareholders' meeting. For instance, in May 2009, the EC adopted an individual decision regarding compliance of State aid with the common market also in relation to the German bank "Comerzbank", wherein Germany obtained 25 per cent of shares plus one share. The above mentioned bank decided on increase in equity capital at shareholders' meeting that was summoned at the time when the EC had not yet reviewed the particular issue. The shareholders' meeting took place shortly after the EC decision was adopted (*see: https://www.commerzbank.de/de/hauptnavigation/presse/pressemitteilungen/archiv1/2009/quartal_09_02/presse_archiv_detail_09_02_5417.html).*

As to State aid to Parex banka in the frameworks of restructuration stage, the procedure for adopting the EC decision lasted for more than one year. Namely, Latvia submitted the first wording of restructuring plan already on 11 May 2009, though the positive decision was taken only on 15 September 2010 (*see: Para 1.6 of the present judgment*). Norms of the Commercial Law does not prohibit summoning shareholders' meeting before a EC decision is adopted. Likewise, it is also possible to establish such regulatory framework that would permit the shareholders' meeting to relate increase in equity capital with the condition that the increase in equity capital takes place only based on a positive decision of the EC.

22.4. Unlike practice of other Member States of the EU, the regulatory framework of the Commercial Law prohibits shareholders' meeting to decide on refusal from the priority right of shareholders. The first sentence of Section 253 (1) of the Commercial Law provides that "the priority right of stockholders may not be revoked or restricted by the memorandum of association, the articles of association or by a decision of a meeting of stockholders". The second sentence of Section 253 (1) of the Commercial Law provides that "in the cases of increasing equity capital provided

for in Section 254, Paragraph two of this Law, stockholders shall not have priority rights". However, Section 254 of the same Law regulates inrease in equity capital for a special purpose. Purposes referred to in the second paragraph of the above mentioned section do not apply to the situation regulated by the Contested Norm.

Nonetheless, such regulatory framework is a result of a free choice of the legislator of Latvia. EU legal acts do not prohibit the legislator to develop such norm into the Commercial Law that would permit the shareholders, after having independently assessed the situation and their capacities, to decide on refusal from the priority right if it is necessary for rescuing of the bank.

Insofar as the legitimate aim of the Contested Norm is to increase equity capital in a way excluding all possibilities of the shareholders to exercise their priority right, it is possible to reach the above mentioned aim by applying more lenient means.

Consequently, the legislator had the possibility to reach the legitimate aim by alternative measures that would infringe the fundamental rights of persons at a lesser extent.

23. When assessing proportionality of the contested restriction, several aspects should be taken into account.

23.1. On the one hand, the Contested Norm has been adopted in the context of the situation of Parex banka, though, on the other hand, the possibilities to apply the Contested Norm are not limited with the particular subject-matter or the situation in spring 2009 when equity capital of Parex banka was increased when rescuing it.

23.2. At the court hearing, Mr. K. Leiškalns maintained that, when adopting the Contested Norm, the opinion of the EC and that of the International Monetary Fund was obvious: in case if minority shareholders proportionally participate in increase in equity capital, the EC would not accept such State aid. However, the case materials contain no documents stating such opinion of the EC before the Contested Norm was adopted. On 24 February 2009, namely, when the Contested Norm was included into the Draft Law No. 963 as a suggestion of the Budget Committee, though not yet confirmed, the MF indicated: in order to prevent the possibility of minority shareholders of Parex banka to gain profit from ERDB investments into Parex banka, possible solutions were discussed, "dilution of share value" included (*Letter of 24 February 2009 by the MF No. 7/VK-74/540, case materials, Vol. 3, pp. 71*). Consequently, reduction of participation share of shareholders, in fact, was aimed on fulfilment of requirements of the investor rather than at reaching of the aims referred to during the court hearing. However, as it follows from the above mentioned FM

letter, the ERDB did not even ask to debar shareholders from the priority right, though it drew attention to a possible solution, "in the frameworks of which minority shareholders preserve the amount of assets, though their participation share being reduced in case if they are not capable of investing their private funds into increase of equity capital of Parex banka (*see: Letter of 24 February 2009 by the MF No. 7/VK-74/540, case materials, Vol. 3, pp. 72*).

23.3. At the judicial debate, the Saeima representative emphasized the complex nature of the State aid granted to Parex banka as an important aspect of constitutionality of the Contested Norm. Namely, the State provided its support by not only increasing equity capital of the bank but also providing guarantees and warranting syndicated credits. The CM representative also emphasized the historical context for adoption of the Contested Norm and asked to assess the situation in conjunction with the events of November 2009 when the State purchases shares of Parex banka. Likewise, it follows from transcripts of CM meetings, in which the Cabinet decided on increase in equity capital of Parex banka, that the CM has also decided on other financial instruments necessary for ensuring of functioning of Parex banka.

However, the Contested Norm *expressis verbis* contains only two pre-conditions for its application: a request of the board and a decision of the Cabinet of Ministers. The norm provides no other conditions that would restrict its application in extraordinary conditions; it does not establish that it is applicable only in respect to banks that have certain systematic importance in the national economy of the State or in case if it is indispensible to ensure compliance of State aid with the common European market. The Contested Norm neither refer to other specific circumstances that the Saeima representative and the summoned persons have established in the case of Parex banka.

In the EC notices (communications), wherein it explains its policy for overcoming financial crisis in the field of planned State aid, the EC draws attention to several measures preventing hampering of competition to be executed to ensure that banks undergoing financial difficulties and their shareholders would bear a fair burden. However, it is not always the case that reduction of participation share of shareholders should be established at the burden. In February 2011, the EC has indicated in its notice (communication): "Until redemption of the State, behavioural safeguards for distressed banks in the rescue and restructuring phases should, in principle, include: a restrictive policy on dividends (including a ban on dividends at least during the restructuring period), limitation of executive remuneration or the distribution of bonuses, an obligation to restore and maintain an increased level of the solvency ratio

compatible with the objective of financial stability, and a timetable for redemption of State participation" (*see: Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, Para 45, http://eur-lex.europa.eu).*

Not in every case whenever a credit institution is granted restructuring aid contradicts the common European market just due to the fact that present shareholders of the credit institution have the possibility to exercise their priority right.

23.4. Two months after adoption of the Contested Norm, Mr. K. Leiškalns indicated when reporting on the draft Bank Overtaking Law: "This Law permits also minority shareholders to solitarily participate in recovery of the bank and therefore their shares can no way be expropriated since they do participate on solitary basis" (*see: Transcript of the Saeima meeting of 18 December 2009, http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/C212D7807418F5A6C22575370053DBFD?OpenDocument).*

It follows from the information presented by Mr. K. Leiškalns at the hearing that the Budget Committee, when considering the Contested Norm, assumed that at least in the case of Parex banka minority shareholders would not even want to participate in increase of equity capital.

The FCMC representative indicated that the Contested Norm shall be applicable when further functioning of the Credit institution without receiving additional capital in the form of investments is impossible, though present shareholders do not have the necessary capital, which was the case of Parex banka. The FCMC had no information at its disposal regarding the fact that minority shareholders also wanted to participate in increase of equity capital (*see: Transcript of the Constitutional Court hearing of 20 September 20011, case materials, Vol. 7, pp. 89 and 91*).

At the court hearing of 6 September 2011, the CM representative indicated that the MF has not received a concrete offer of minority shareholders to get involved in assuring liquidity of Parex banka, to perform payments into its equity capital or solve issues related with syndicated credits (*see: Transcript of the Constitutional Court hearing, case materials, Vol. 7, pp. 67*). However, in the letter of 24 February 2009, the MF expressed the following point of view: "[..] it is not possible to exclude the possibility that minority shareholders may also participate in increase of equity capital, for instance, the Swedish fund "East Capital"" (*see: MF 24 February 2009 letter No. 7/VK-74/540, case materials, Vol. 3, pp. 71*).

On 19 December 2009, several Applicants publicly confirmed their readiness to purchase shares of the bank in proportion to their owned shared (*see: Mārtiņa I. Nav gatavi tāpat atdot akcijas. Dienas Bizness, 19 December 2008)*. On 4 February 2009, two Applicants sent a letter to Mr. M. Bičevskis, State Secretary of the MF, and Mr. N. Melngailis, Head of the Board of Parex banka, wherein they confirmed their readiness to participate in recapitalization of Parex banka (*see: Case materials, Vol. 5, pp. 49 – 50*).

23.5. Application of the Contested Norm is not limited only to cases similar to that of the Applicants wherein proportion of shares owned by them in respect to administration of a joint-stock company permits implementing only certain rights of a shareholder.

A condition for application of the Contested Norm is a decision of the Cabinet of Ministers to obtain or materially increase participation share of the State in a credit institution. Pursuant to Section 1 (15) of the Credit Institutions Law, the term "participation" means directly or indirectly acquired participation by one or several persons acting in a co-ordinated manner based on an agreement that encompasses 10 and more per cent of equity capital of a company or number of voting stock, or give the possibility to considerably influence establishment of financial or action policy of the commercial society.

Consequently, the Contested Norm permits that it is applied in cases when a shareholder or a body of shareholders lose their majority right to the so-called "golden share" as the result of increase in equity capital, and therefore it also loses the possibility to impact economic activities of the credit institution.

In such cases, it is possible that a situation when share market value decreases in the result of application of the Contested Norm occurs.

23.6. Article 105 of the Satversme prohibits the State to perform measures, without sufficient grounds to do so, in the result of which negative consequences occur to property of a person, including decrease of property value or the amount of profit to be gained from property. However, when assessing compliance of certain regulatory framework with the Article 105 of the Satversme, it is necessary to establish causal relationship between the Contested Norms and the negative property consequences caused to a person. The fundamental right to own property established in Article 105 of the Satversme does not guarantee the right to be protected against business risks. Shareholders and subordinated creditors may gain profit as the result of successful functioning of a credit institution; though they are also subject to a substantial risk. "The State does not have the duty to prevent loss of [property] value resulting from

market factors" (*see: Judgment of 30 March 2011 by the Constitutional Court in the case No. 2010-60-01, Para 17.3*).

It follows from the documents that the representatives of the Applicants asked to include into the court file, as well as from their explanations at the hearing, the infringement referred to by the Applicants could be partially related to the fact that, under circumstances of economic crisis before 2008, the Board of Parex banka has failed to ensure successful functioning of the bank, the FCMC has failed to perform effective monitoring of Parex banka and prevent outflow of financial resources from the bank. Likewise, the State has failed to timely adopt a legal norm on the procedure of bank takeover. The former majority shareholders have decided to sell shares of Parex banka owned by them to the State without having found out the possibilities of rescuing the bank that could be assured by the Applicants. In December 2008, before the Contested Norm was adopted, the Board of Parex banka has failed to show its interest in the possibility to use free assets at the disposal of the Applicants. The above mentioned circumstances would have served as the reason why the Applicants could not timely get involved into rescuing of Parex banka, though their asset market value has reduced considerably.

In the frameworks of the case under consideration, the task of the Constitutional Court is not to assess the above mentioned circumstances because they do not influence constitutionality of the Contested Norm.

23.7. At the Saeima meeting of 26 February 2009, Mr. K. Leiškalns, Head of the Budget Committee indicated that the Contested Norm would be applied only in case if the bank and the shareholders "would sink"" (*see: Transcript of the Saeima meeting of 26 February 2009, http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/9E0A71FA0FC099A6C225756E0047D780?OpenDocument*).

However, the FCMC representative expressed the following opinion in respect to the fact when the Bank Overtaking Law and when – the Contested Norm should be applied: "The regulatory framework is clear enough id we look at these laws. Section 3 of the Bank Overtaking Law provides that bank takeover shall be permitted only in exceptional cases. [..] If banks were not overtaken, then the bank would no more be able to observe requirements regulating functioning of a bank. The Credit Institutions Law sets forth no conditions for a credit institution to be entitled to receive support" (*see: Transcript of the Constitutional Court hearing of 20 September 2011, case materials, Vol. 7, pp. 88*). Consequently, according to the FCMC, the Contested Norm could be applied not only in case if urgent threat of insolvency of a credit institution

exists that must be immediately prevented, but also in other cases whenever it is asked by the board and admissible from the point of view of norms regulating State aid.

It also follows from the EC decision of 11 May 2009 and EC decision of 15 September 2010 that the Contested Norm is applicable to increase in equity capital of Parex banka not only at the stage of rescuing of the bank, but also at that of restructuration.

The Contested Norm contains no restrictive criteria establishing that the norm can be applied only in case if no other means ensure rescuing of the bank.

23.8. The second part of the Contested Norm *expressis verbis* prohibits the present shareholders of the bank to participate in increase of equity capital of the bank. It follow from the literal sense of the norm that in case if the State already is a shareholder of the bank, it cannot participate in increase of equity capital of the bank. At the hearing of 6 September, the CM representative indicated that the second part of the Contested Norm shall be considered in conjunction with the first part thereof. If the second part of the norm would provide a hypothetical restriction in respect to the State, then the first part thereof could not be applied at all.

The Constitutional Court has already indicated in its case-law that laws and normative acts should not only be freely accessible to every person but also clear and comprehensive enough (*see: Judgment of 20 December 2006 by the Constitutional Court in the case No. 2006-12-01, Para 16*). "A norm shall be recognized as unclear in case if it is not possible to find out its real meaning by applying the method of interpretation" *see: Judgment of 20 March 2010 by the Constitutional Court in the case No. 2010-60-01, Para 15.2*).

It follows from the case materials that, when applying the Contested Norm, the CM as able to determine its real meaning. Consequently, there is no reason consider the Contested Norm as unclear. However, the Constitutional Court draws attention of the Saeima to the fact that, from the viewpoint of legal technique, the Contested Norm has an abortive wording.

23.9. The Contested Norm has been adopted at the time when the State had to adopt many decisions restricting the fundamental rights of persons to prevent consequences of the economic crisis. Often, an integral part of such regulatory framework is its short-term character, which is precisely established in the respective normative cat. The Constitutional Court has concluded in its case-law: the gravity of the infringement of rights is reduced by the fact that the restriction has been established only for a definite period of time (*see, e.g.: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 22.1*).

However, no term of validity has been established in respect to the particular Contested Norm.

23.10. The Contested Norm ensures, to a State administration institution, namely, the Cabinet of Ministers, broad possibilities to interfere with private legal relations and to select the way of increase in equity capital – either in accordance with the Contested Norm or the procedure established in the Commercial Law. However, the Contested Norm fails to enable a person to verify, by way of litigation, whether, in each particular case, the restriction established to the rights is proportional.

It is necessary to indicate that several CM decisions regarding Parex banka still was restricted information when the case was prepared for adjudication by the Constitutional Court. The Contested Norm does not commission the CM or council of a particular bank to notify shareholders on planned or executed increase in equity capital and provide substantiation of necessity thereof.

The State had the possibility to elaborate the Contested Norm in a way to prevent occurrence of the above described situation.

23.11. In the opinion of the State Chancellery regarding the Cabinet of Ministers decision on increase in equity capital of Parex banka in October 2009, it has been indicated that denial of the fundamental rights of minority shareholders of Parex banka infringes the principle of fair and just attitude established in treaties on protection of international investments (*see: Opinion of 13 October 2009 by the State Chancellery No. 18/TA-3670-DV on the informative notice and report decision, case materials, Vol. 3, pp. 189*).

In the frameworks of the present case, compliance of the Contested Norm with any particular international agreement on protection of investments is not protected. Therefore, the Constitutional Court shall not assess the above mentioned statement. However, it should be taken into account that benefit gained by the society from the Contested Norm is related with successful rescue of one or several systematically important credit institutions assuring welfare of the society and protection of the rights of person in the long-term; however, restrictions of the fundamental rights of shareholders that infringe the internationally agreed minimum of rights not only influence the fundamental rights of the Applicants but also may raise doubt among international investors regarding Latvia as a state favourable for investments. As a result, investment flow could reduce, whilst present investments would flow away. All the aforesaid could have a negative impact on welfare of the society in the long term.

When assessing the above mentioned circumstances in conjunction with one another, it can be concluded that the extent of the restriction established in the

Contested Norm is greater than it is necessary to reach the legitimate aim; moreover, there are other means that would ensure reaching of the legitimate aim and restriction the fundamental rights of persons at a lesser extent. Benefit gained by the society does not compensate the restrictions imposed.

Consequently, the regulatory framework of the Contested Norm restricts the fundamental right to property in a non-proportional way and therefore fails to comply with Article 105 of the Satversme.

24. It has already been indicated that Article 105 of the Satversme shall be interpreted in conjunction with liabilities of Latvia as a Member State of the EU and particularly with Directive 77/91/EEC.

The Constitutional Court has already concluded that judgments of the Constitutional Court cannot be appealed against; therefore the Constitutional Court will verify whether Court of Justice has already interpreted the above mentioned issue, whether what has been established in this Directive is clear enough not to cause any reasonable suspicion, and whether it is necessary to request a preliminary ruling from the CJEU (*see: Judgment of 28 May 2009 by the Constitutional Court in the case No. 2008-47-01, Para 15.2*).

In the Communication of 8 February 2010, the European Central Bank indicates that, in an emergency situation related with interests of a credit institutions, it should be necessary to establish the right to deviate from the property right and fundamental rights of shareholders established in Directive 77/91/EEC, adherence to which hinders recapitalization or restructuring of a failing bank, though the present case-law does not provide any exception in a crisis situation (*see: Communication by the European Central Bank " "Communication on "An EU Framework for Crossborder Crisis Management in the Banking Sektor": Eurosystem's Reply to the Public Consultation" Para 3.6, http://www.ecb.int/pub/pdf/other/euframeworkcrisismanagementbankingsector201002en.pdf).*

The CJEU has indicated that the purpose of the Directive 77/91/EEC is to assure to ensure a minimum level of protection for shareholders in all the Member States. That objective would be seriously frustrated if the Member States were entitled to derogate from the provisions of the Directive77/91/EEC by maintaining in force rules ─ even rules categorized as special or exceptional ─ under which it is possible to decide by administrative measure, separately from any decision by the general meeting of shareholders, to effect an increase in the company's capital (*see: Judgment of 12*

March 1996 by the CJEU in the case No. C-441/93 "Panagis Pafitis and others v Trapeza Kentrikis Ellados A.E. and others", Para 24, 38 and 39).

Expert Ms. E.Balode-Buraka is of the opinion that the Contested Norm fails to comply with Article 25 (1) and Article 29 (1) of the Directive 77/91/EEC.

However, it cannot be concluded in the present case that the result of litigation depends on interpretation of the above mentioned directive. International norms do not prohibit the Member States to establish a higher level of protection of rights in their constitutions.

Consequently, the Constitutional Court does not have the duty to address the CJEU to render preliminary ruling.

25. Having established non-compliance of the Contested Norm with Article 105 of the Satversme, it is not necessary to assess compliance of it with Article 1 of the Satversme.

26. Pursuant to Article 31 (11) of the Constitutional Court Law, in case if the Constitutional Court recognizes a norm as non-constitutional, a Constitutional Court judgment shall indicate in relation to the disputed legal norm (act) in force – the moment with which it shall cease to be in force, if the Constitutional Court has judged that this norm (act) does not comply with the norm of a higher legal force. In the present case, the Applicants have asked to recognize the Contested Norm as null and void as from the date of adopting it, namely, 26 February 2009. Consequently, the Constitutional Court shall determine the date, as of which the Contested Norms hall lose effect.

It has occurred in case-law of the Constitutional Court that it is possible to eliminate or compensate infringement of fundamental rights an applicant only when recognizing a contested norm as null and void as from the date of adoption of the contested norm or application of it in respect to the applicant (*see, e.g. Judgment of 3 June 2009 by the Constitutional court in the case No. 2008-47-01, Para 17*). By recognizing the Contested Norm as null and void in respect to the Applicant of the present matter, if it not possible to undo changes leading to the present situation and to return to the time when increase in equity capital of Parex banka took place to ensure proper observance of the procedure of increase in equity capital by repeating it.

Moreover, when considering the date, as of which the Contested Norm would lose its force, it is necessary to take into account rights and interests of the Applicants and other persons, as well. Likewise, it is necessary to assess infringement of the rights

of the Applicants in case if the Contested Norm would not be recognized as null and void as from the date of adopting it, as well as possible infringement of rights of other persons in case if the Contested Norm would be recognized as null and void as from the date of adopting it; likewise, it is necessary to assess proportionality of the infringement.

During the period exceeding one year and a half from the date of coming into force of the Contested Norm when the Applicants addressed the Constitutional Court, Parex banka has continued its commercial activities, persons subject to private law have been granted their rights and undertaken duties that are not related with the increase in equity capital of Parex banka; a joint-stock company "Citadele banka" has also been founded. Recognition of the Contested Norm as null and void as from the date of adopting it would cause legal insecurity and negative reaction of the financial market, which might also affect financial stability and social security of the State. In such a case, not only other persons but also the Applicants acting as shareholders would suffer.

The following has been concluded in case-law of the Constitutional Court: "[..] the more the person tolerates violation of his/her rights, the less interested the person is in the protection of constitutional rights" (*see: Judgment of 26 November 2002 by the Constitutional Court in the case No. 2002-09-01, Para 1 of the Findings*). The Applicants have addressed the Constitutional Court after the Contested Norm was applied to them three times already.

In spring 2010, one of the Applicants indicated: "We understand that the government of Latvia has acted taking into consideration the emergency conditions caused by the crisis when solving the financial institution. [..] As minority shareholders of Parex banka, we have tolerated the compulsory "dilution", this being a part of the bank rescue plan, which resulted in reduction of the participation share from 4.2 per cent to 1 per cent" (*see: Letter of 30 April 2008 by Mr. A. Abromavicius, "East Capital" partner, to Mr. Grants, Head of the Board of Privatizācijas aģentūra, case materials, Vol. 6, pp. 125 – 133*). This manifests that the initial infringement caused to the Applicants by the Contested Norm did not seem that substantial if the subsequent activities with the bank is legal and just.

As it was reasonably indicated by the Saeima representative, the situation of the Applicants is based on two aspects. On the one hand, the Contested Norm as such does not comply with Article 105 of the Satversme. On the other hand, the CM has not interpreted the norm as imperative one. When deciding whether, in the particular case, increase of equity capital shall be performed pursuant to the procedure established by

the Contested Norm or that by the Commercial Law, the CM was committed to consider whether the fundamental rights of persons are restricted in a non-proportional manner. The Constitutional Court does not have the duty to assess such action by the CM that has resulted in application, by the CM, of the Contested Norm rather than the regulatory framework established in the Commercial Law.

Consequently, in the present matter, it would not be proportional to recognize the Contested Norm as null and void as from the date of adopting it.

The Constitutional Court

Based on Article 30 – 32 of the Constitutional Court Law,

h o l d s:

Section 59.[5] of the Credit Institutions Law does not comply with Article 105 of the Satversme of the Republic of Latvia and shall be null and void as from the fate of publishing of the present judgment.

The Judgment is final and not subject to appeal.

The Judgment shall come into force on the date of publishing it.

The Judgment is announced on 19 October 2011.

President of the Constitutional Court G. Kūtris

Translated by E. Labanovska, translator of the Constitutional Court