THE CONSTITUTIONAL COURT
OF THE REPUBLIC OF LATVIA

Riga, February 9, 2004

JUDGMENT
in the name of the Republic of Latvia

in case No. 2003-21-0306

The Republic of Latvia Constitutional Court in the body of the Chairman of the Court session Aivars Endziņš, justices Juris Jelāgins, Romāns Apsītis, Ilma Čepāne and Andrejs Lepse

on the basis of the constitutional claim by the insurance stock company ”If Latvia”

under Article 85 of the Republic of Latvia Satversme (Constitution), Articles 16 (Items 1 and 6), 17 (Item 11 of the first part), 19^2 and 28^1

holding the proceedings in writing

on January 27, 2004 at the Court session reviewed the case

”On the Compliance of Items 2 and 6 of the Cabinet of Ministers August 5, 2003 Regulations No. 438 ”Amendments to the Cabinet of Ministers May 13, 1997 Regulations No. 180 ”By-law of the Guarantee (Reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport” with Article 91 of the Republic of Latvia Satversme (Constitution) and Article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms””.

The establishing part

1. On March 13, 1997 the Saeima adoted the Law On Mandatory Civil Liability Insurance for Owners of Road Transport (hereinafter – LIOR Law), Article 44 of which envisages formation of the Guarantee

(reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport (hereinafter – the Guarantee Fund).

The sixth part of the above Article determines that the Cabinet of Ministers shall confirm the Statutes of the Guarantee Fund.

On May 13, 1997 the Cabinet of Ministers adopted Regulations No. 180 ”By-law of the Guarantee (Reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport” (henceforth – Regulations No. 180). Item 14 of it established that ”the amount of a single contribution is 5000 lats”.

On August 5, 2003 the Cabinet of Ministers passed Regulations No. 438 ”Amendments to the Cabinet of Ministers May 13, 1997 Regulations No. 180 ”By-law of the Guarantee (Reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport” (hereinafter – Regulations No.438). Item 2 of it determines ”to substitute in Item 14 figure ”5000” with the figure ”400 000”. Thus Item 14 of Regulations No. 180 was expressed in a new wording: ” The amount of a single contribution is 400 000 lats”.

Besides, Item 6 of Regulations No.438 supplements Regulations No. 180 with Items 36^1 and 36^2. From the contents of the claim it follows that only the first part of Item 6 of the Regulations No.438 is being challenged. It determines: ”By September 1, 2003 the calculation shall be performed determining the aggregate amount of deductions paid into the fund of each insurance company from the premiums of mandatory civil liability insurance for owners of road transport. If the aggregate amount is less than the amount of a contribution referred to in Paragraph 14 of these Regulations, within a year the insurance company shall pay the balance in the Fund making the relevant payments by the 15^{th}. date of the last month of each quarter”.

Regulations No. 438 took effect on August 9, 2003.

Article 45 of the LIOR Law envisages the formation of Fund of Mandatory Civil Liability Insurance for insurance holders - Owners of Road Transport (henceforth – The Fund for the Protection of the Interests of Insurance holders).

The sixth part of Article 45 of the Law determines that the Statutes of the above Fund shall be confirmed by the Cabinet of Ministers.

On May 13, 1997 the Cabinet of Ministers adopted Regulations No. 179 ” The Statutes of Mandatory Civil Liability Insurance for the Protection

of Interests of Insurance Holders - Owners of Road Transport (henceforth – Regulations No. 179)".

2. **The submitter of the constitutional claim –** the insurance stock company "If Latvia" (henceforth – the submitter) challenges the conformity of Items 2 and 6 of Regulations No. 438 (hereinafter – the challenged norms) with Article 91 of the Republic of Latvia Satversme (henceforth – the Satversme) and Article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms.

   On October 26, 2001 the submitter received license for rendering services of mandatory civil liability insurance for owners of road transport **(**henceforth – LIOR services). The submitter points out that at the moment of submission of the constitutional claim the deductions of the company to the Guarantee Fund were 18 420,69 lats and in accordance with the challenged norms in the time of one year the submitter shall have to make the additional payment of 381 579,31 lats into the Guarantee Fund from the funds of the stock holders (in its September 4, 2003 letter No. 07-31/207 to the insurance company "If Latvia" the Republic of Latvia Traffic Bureau has pointed out that on August 1, 2003 the aggregate amount of 14 594, 16 lats were paid into the Guarantee Fund and in a year's time, counting from September 1, payment of the aggregate amount of 385 405,84 lats, will have to be deposited).

   The submitter points out that the challenged norms create a differentiated attitude to insurance companies, who are rendering LIOR services, as the Cabinet of Ministers has groundlessly equated two entirely different payments – the single contribution of the insurance company and deductions from LIOR premiums. Deductions into the Guarantee Fund are made from the insurance premiums received from the insurance holders but single contributions are paid from the funds of the stock holders of the insurance company.

   The submitter holds that the challenged norms create unequal attitude to the insurance companies, which have rendered LIOR services for several years and those companies, which offer the above services comparatively recently. The challenged norms distort the LIOR service market by creating groundless advantages for the insurance companies, which have worked for a longer period. It makes competition of equal worth among the insurance companies improbable.

   The submitter points out that one cannot regard the potential shortage of assets in the Guarantee Fund as the legitimate aim of the challenged norms as there is surplus in the Fund and the capital is continuing to increase.

The submitter acknowledges that the legitimate objective of the challenged norms is to strengthen the supervision requirements of the insurance companies as well as to further the stability of the insurance market; however, the means chosen for reaching the aim are not proportionate.

The submitter is the only company rendering LIOR services, who has to make the payment envisaged in the challenged norms into the Guarantee Fund.

After getting acquainted with the materials in case the submitter expressed his viewpoint in a written form, upholding the claim, incorporated in the application.

3. The institution, which has passed the challenged act – **the Cabinet of Ministers –** does not agree with the viewpoint of the submitter because of several reasons. The Cabinet of Ministers stresses that when adopting the challenged norms, the necessity of approximating the Republic of Latvia normative acts with corresponding requirements of the European Union as well as the protection of property interests of the persons, who have suffered in accidents and the stability of the insurance market have been observed.

It was stressed in the written reply that Latvia has undertaken international liabilities as of July 1, 1998 when the state became the member of the so-called Green Card system. Insurance compensation in "Green Card" cases shall be paid in full amount. In accordance with Latvian normative acts, regulating the LIOR sector, insurance compensation shall be paid in full amount from the assets of the Guarantee Fund and after that – under the procedure of regress – the sum has to be collected from the particular insurance company. Up to the time of passing the challenged norms the amount of a single contribution of the insurance company was 5000 lats. The Cabinet of Ministers holds that the sum was insufficient for ensurance of the possibilities to meet the requirements of the "Green Card" system in case of insolvency of the stock company. The Cabinet of Ministers points out that increase of the amount of the single contribution to 400 000 lats was determined so as no shortage or deficit in the Guarantee Fund were felt.

It is stressed in the written reply that increase of the single contribution was necessary to ensure the stability of the LIOR service market and to protect the interests of the insurance holders, as well as to implement the Directives of the European Union, which envisage a greater limit for insurance compensations.

The Cabinet of Ministers holds that the challenged norms do not violate the principle of equality, enshrined in Article 91 of the Satversme. The principle of equality requires comparing two situations. Not the activity in the LIOR service market but the fact of how long the insurance company has been acting in it shall be regarded as the element, characterizing the situation. Insurance companies, who have been acting in the market for a longer time, have made greater payments into the Guarantee Fund and – in difference from the submitter or any other new company - have proved their stability.

The written reply includes the viewpoint that the submitter, who acts in the insurance market approximately for about two years and the other insurance companies, who act in the insurance service market for a long time do not find themselves in equal, but on the contrary – in different situations. The principle of legal equality establishes that in different circumstances the attitude shall be different. If the challenged norms envisaged increase of the single payment also for those insurance companies, which are in the market for a long time, without making corresponding recalculations, it would be discriminating with regard to the companies.

Besides, even if the submitter and the other insurance companies were in equal situations, a differentiated attitude to the participants of market would be justifiable as it has reasonable causes. The written reply stresses that the legitimate aim of the challenged norms is the protection of the interests of those insurance companies, which have been acting in the LIOR service market with great stability and for a long time. The Cabinet of Ministers points out that the single contribution of 400 000 lats of an insurance company, acting in the insurance market is not a big sum. To ensure that the payment of the contribution is not a burden, there is the possibility of paying the sum in the period of one year. Thus the legitimate aim of the challenged norms can be reached and the restriction to the submitter is proportionate. There is no possibility of reaching the aim with less restricting means.

After getting acquainted with the materials in case, the representative of the Cabinet expressed in a written form the viewpoint, upholding the arguments, included in the written reply.

4. **The Ministry of Justice,** when answering to questions, asked by the Constitutional Court, points out that the amount of the single compensation paid into the Guarantee Fund has been radically increased, first of all to avoid the situation, when the insurance company sells policies for low prices and as the result is not able to ensure compensation payments and goes bankrupt. Secondly, in order to increase the responsibility of the insurance company, so as to in case of

the bankruptcy the payments could be covered from the funds of the insurance company itself. The above decision was reached to favor the financial stability of insurance companies and guarantee accomplishment of liabilities in case of bankruptcy. The Ministry of Justice expresses concern that the above might create unequal attitude towards the participants who have just entered the market.

Additionally the Ministry of Finance explains that the payments made by the insurers into the Fund, formed by themselves, which is envisaged in Article 32 (the first part) of the Law on Insurance Companies and their Supervision guarantee secure accomplishment of the liabilities of the insurance companies. At the present moment the minimum amount of the Fund is 3 million euro. The Guarantee Fund mentioned in Regulations No.180 was formed and serves as an additional measure of precaution with regard to LIOR.

5. **The Commission of the Financial and Capital Market**, in its answer to the questions asked by the Constitutional Court, points out that Regulations No.180 envisage two essentially different down payments – insurer's single contribution (the amount of which is determined in Item 11.1. of the Regulations and which the insurer pays from his/her money (funds) regardless of the received amount of the insurance premiums) and deductions from LIOR premiums (the amount of which is determined in Item 11.2 of the Regulations and which depends from the amount of the premiums received).

   The Commission holds that by increasing the amount of the single contribution, it should be applied to all the insurance companies, rendering the above services, regardless of the time when rendering of the services has been commenced. The amount of the single contribution shall not depend on the sum which the particular insurer has paid into the Guarantee Fund in accordance with Item 11.2. of the Regulations. In such a way the objective of the challenged norms – to ensure the stability of LIOR service market would be reached, besides, equal attitude to the insurance companies, who have already rendered the services and their potential competitors, who have commenced their activities in the sector later.

   Besides, the Commission points out – Article 32 of the Law on the Insurance Companies and their Supervision establishes that the amount of Guarantee Fund, formed by the insurers themselves, shall be 3 million euro and not 500 000 lats as was determined in the Article earlier and it ensures implementation of the supervision requirements, established by the Directives of the European Union.

6. **The Competition Board,** in its answer to the questions asked by the Constitutional Court, expresses the viewpoint that increase of the amount of the single contribution in itself does not mean restriction of competition, if it is attributed to all the participants of the market. However, increase of the single contribution, which is envisaged in the challenged norms, essentially decreases the possibility of competitiveness of relatively new companies and creates a powerful administrative barrier for entrance of new participants into LIOR service market.

   The Board points out that there is no reason for equaling single contributions and deductions from LIOR premiums, as Item 11 of Regulations NO. 180 define them as being different down payments. Recalculation on the basis of Item 36 of the Regulations creates unequal requirements for the new participants of the market as they undertake equal responsibility (risk) with the other participants of the market, including also for the period of time when they had not commenced their activities in the LIOR service market.

The concluding part

7. LIOR is a specific kind of insurance, which serves for the protection of property interests of the victims of road accidents – owners of road transport. Legal relations between the owners of the road transport and the insurers as concerns rendering of LIOR services are regulated by the LIOR Law, regulations No. 179 and Regulations No. 180.

7.1. LIOR Law envisages formation of two Funds: 1.) The Guarantee Fund, the aim of which is to ensure compensation payment for the losses caused by road transport, which are determined by law (*see the first part of Article 44 of the LIOR Law)*; 2) the Fund for the Protection of the Interests of the Insurers, the objective of which is to ensure compensation payment in cases of insolvency of the insurance companies (*see the first part of Article 45 of the LIOR Law).*

Formation of the Guarantee Fund is envisaged also by EEC Directive No. 84/5 (Item 1, Sub-item 4), which determines that the Fund shall be formed from which to pay insurance compensation in cases, when an unknown motor vehicle or a motor vehicle, the owner of which has not been insured against civil liability, has caused damage to a property or a person (*see Second Council Directive 84/5/EEC of 30 December 1983 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles).*

Thus the Directives of the European Union determine the necessity of formation of the Guarantee Fund but do not determine the quantity (amount) of it.

7.2. The Directive 2000/26/EC of the European Parliament and of the Council of May 16, 2000 envisages several requirements for ensuring the stability of the insurance market, inter alia also the stability of the LIOR market. Thus, Item 16 of the Directive determines that each insurance company shall form the Guarantee Fund of its own. The minimum amount of the capital of the Guarantee Fund shall be from two to three million euro (*see Directive 2000/26/EC of the European Parliament and of the Council of 16 May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEc and 88/357/EEC).*

Initially Article 32 of the Law on the Insurance Companies and their Supervision determined that the amount of the capital of the Guarantee Fund, formed by the insurance companies themselves, shall be 500 000 lats. However, when implementing the requirement of the above Directive, the Saeima passed Amendments to the Article on March 27, 2003. The Amendments determine that the minimum amount of the capital of the Guarantee Fund of the commercial companies, which render LIOR services shall be three million euro. The insurance companies, with the amount of less than the above sum shall increase it up to July 1, 2004. The Guarantee Fund ensures implementation of the liabilities of the insurance companies not only as regards the LIOR services but also as regards all the other kinds of insurance undertaken by the insurance company.

The Guarantee Fund, in difference from the Fund for the Protection of the Interests of the Insurance Holders and the Fund of the Insurance Company itself is formed mainly to ensure the protection of property interests of the victims of motor transport but not to ensure payment of compensation in case of insolvency of the insurance company.

8. The third part of Article 44 of the LIOR Law determines that several down payments, inter alia also the single contributions and deductions from the LIOR premiums shall create the capital of the Guarantee Fund.

Initially (in 1997) the Cabinet of Ministers determined that deductions from LIOR premiums shall be in the amount of 12%, later the amount

was gradually decreased to 4%. A greater amount of deduction was determined from the premiums of ”Green Cards”.

Up to August 8, 2003 the amount of the single contribution into the Guarantee Fund was 5000 lats. After the Amendments were made to Item 14 of Regulations No.180, it was determined that the amount of the single contribution shall be 400 000 lats, i.e. – the amount of the single contribution was increased 80 times.

In compliance with Item 11.1 of Regulations No. 180, the companies pay the above contribution in order to receive the special permit (license) for rendering LIOR services. The summary section of the draft Resolution of the Cabinet of Ministers, which gives explanation on the essence of the 400 000 lats contribution, establishes that the contribution ” shall be paid by an insurance company, which lays claim to receiving a license for rendering LIOR services” (*see p. 13 of the materials in the case).*

The submitter received the license for rendering LIOR services on October 26, 2001 and at the moment of the Amendments taking effect the company had been the member of the LIOR market already for two years. To receive the license the submitter paid the single contribution in the amount of 5000 lats.

The new single contribution in the amount of 400 000 lats shall be paid by the potential companies, who want to render LIOR services. Therefore the norm shall not be applied to insurance companies, which have already received the license.

Thus the challenged norm, which determines the single contribution does not concern the fundamental rights of the submitter, therefore there is no necessity to assess the conformity of the amount of the single contribution, which is determined in Item 2 of Regulations No. 438 with the legal norms of higher legal force.

9. Article 91 of the Satversme determines that ”all human beings in Latvia shall be equal before the law and the courts. Human rights shall be realized without discrimination of any kind”. Article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms anticipates that ” the enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, color, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status”.
The Constitutional Court, when interpreting Article 91 of the Satversme has declared that the principle of equality forbids the State institutions to

pass norms, which without a reasonable ground permits a differentiated attitude to persons, who are in equal and comparable circumstances. The principle of equality allows and even demands a differentiated attitude towards persons, who find themselves in equal circumstances if there is an objective and reasonable motivation for it (*see Item 1 of the concluding part of the Constitutional Court April 3, 2001 Judgment in case No. 2000 -07-0409).*

To assess whether the second challenged norm – the first part of Item 6 of Regulations No.438 complies with Article 91 of the Satversme, one has to establish:

- whether the challenged norm has a legitimate aim;
- whether the insurance companies, which render LIOR services are in equal and comparable circumstances;
- whether the challenged norm envisages a differentiated attitude and whether it has an objective and reasonable ground.

9.1. One cannot agree with the viewpoint expressed in the written reply, namely, that the legitimate aim of the challenged norms is the protection of the interests of those companies, which have been acting in the LIOR service market for a longer time and have proved their stability. The State, when regulating the performance of insurance companies in the LIOR service market, shall protect the interests of all the companies, functioning in the above market, regardless of the period of time for which the companies have been rendering LIOR services.

The summary of the Cabinet of Ministers draft Resolution establishes that the aim of the Amendments to Resolution No. 180 is securing of the stability of LIOR market and preclusion of shortage of the Guarantee Fund in case of insolvency of the insurance company.

For securing payment of insurance compensations in case of the insolvency of the insurance company another Fund – the Fund for the Protection of the Interests of Insurance Holders has been formed. On July 1, 2003 the balance (remaining sum) of the above Fund was 1 227 029,97 lats. In its turn the Guarantee Fund, the direct aim of which is not to secure payment of insurance compensation in case of insolvency, on May 1, 2003 had 10 961 410,82 lats (*see pp.5-6 of the materials in case).*

Besides, general terms of the Law on Insurance Companies and their Supervision envisage sufficiently severe requirements, which secure the guarantees of the insurance holders in case of insolvency of the insurance company (*see pp.27-28 of the case materials).*

Thus securing of the stability of LIOR market shall be acknowledged as the legitimate aim of the first part of Item 6 of Regulations No. 438.

9.2. To find out whether insurance companies, which are rendering LIOR services, are in equal and comparable by definite criteria circumstances, concrete situations shall be assessed.

The submitter holds that insurance companies, which render LIOR services shall be comparable ”as companies, acting in one and the same market”. In accordance with this criterion all the insurance companies as the participants of one and the same market are in equal circumstances.

In its turn the Cabinet of Ministers in its written reply points out that the reality of the LIOR market demands using ”another criterion, not as evident than the above, which clearly characterizes both comparable situations – namely – how long the companies are acting in the particular sector”. Therefore – to the mind of the Cabinet the insurance companies, which have been acting in the market for a longer time are not in equal and comparable circumstances with the companies, who are acting for a shorter period of time.

The insurance companies, which render LIOR services, realize their activities in compliance with the LIOR Law. The objective of the LIOR Law is to regulate the legal relations between the owners of the road transport and the insurers with an aim of protecting the property interests of the victims of road accidents (*see Article 2 of the LIOR Law).* Maintenance of the free entrepreneur activity environment demands comparing of the insurance companies as the participants competing in one market and not by taking into consideration the fact how long this or that particular company acts in the LIOR market.

Thus all the insurance companies, which render LIOR services, are in equal and comparable circumstances.

9.3. If the insurance companies, which render LIOR services, are in equal and comparable circumstances, then it is necessary to find out whether the challenged norm establishes a differentiated attitude and whether the differentiated attitude is justifiable. The challenged norm envisages that a recalculation for every insurance company is being made, determining the total amount of the deductions to be paid into the Guarantee Fund from the mandatory civil liability insurance premiums received from the owners of the road transport. Those insurance companies, the down payment of which does not reach 400 000 lats have to pay the difference into the Guarantee Fund.

The Guarantee Funds shall be formed of two kinds of payments – the single contributions, which the insurance companies cover from their funds in order to receive the LIOR license and the deductions from the premiums paid by the insurance holders. The amount of the sum paid by the insurance companies, which are the participants of the LIOR market for a longer time was formed gradually and is greater than the sum paid by the companies, which are acting in the market for a comparatively shorter time.

The aim of the Guarantee Fund is to protect the property interests of the victims of the road accidents. The Constitutional Court agrees that to protect the interests of all the victims of road accidents, the Guarantee Fund shall have a great accruals. However, in accordance with the challenged norm, the insurance companies, the contributions of which does not reach 400 000 lats, shall pay be difference from the funds of their shareholders and not from the received premiums as was done by the other members of the market.

Both – Article 44 of the LIOR Law and Item 11 of Regulations No. 180 define the above payments as two different kinds of contributions. Thus there is basis for the conclusion that the Cabinet of Ministers, when adopting the challenged norm has equaled the two essentially different contributions. Also the Commission of the Finance and Capital Market and the Competition Board in their answers to the Constitutional Court have pointed out that there is no ground for equaling both types of contributions.

The submitter, when receiving the license for rendering LIOR services, has realized all the requirements, which were in the normative acts in effect at that time. Among other things he has paid the single contribution, which at that time was 5000 lats.

When passing the challenged norm the Cabinet of Ministers has changed the provisions of granting the license to one of the participants of the market.

Amendments to Regulations No. 180, by envisaging advantages to the companies, who are in the market for a longer time, essentially decreases the competitiveness of the relatively new insurance companies (*see materials in case, p . 181).*

The contributions to be made by the submitter cannot be equaled with the contributions of the other members of the LIOR market, therefore a differentiated attitude towards one of the participants of the market is ungrounded and the principle of legal equality has been violated.

The principle of legal equality would be observed if the single contribution into the Guarantee Fund would have been envisaged for all the participants of the market.

Thus the differentiated attitude to the participants of LIOR market is not objective, has no reasonable ground and shall be declared as unlawful.

The substantive part

On the basis of Articles 30-32 of the Constitutional Court Law the Constitutional Court

hereby rules:

1. **To declare the first part of Item 6 of the Cabinet of Ministers Regulations No. 438 of August 5, 2003 ”Amendments to the Cabinet of Ministers May 13, 1997 Regulations No. 180 ”By-law of the Guarantee (Reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport”” as unconformable with Article 91 of the Republic of Latvia Satversme and null and void as of the moment of its adoption.**

2. **To terminate proceedings in the case on the compliance of Item 2 of the Cabinet of Ministers August 5, 2003 Regulations No. 438 ”Amendments to the Cabinet of ministers May 13, 1997 Regulations No.180 ”By-law of the Guarantee (Reserve) Fund of Mandatory Civil Liability Insurance for Owners of Road Transport”” with Article 91 of the Republic of Latvia Satversme.**

The Judgment is final and allowing of no appeal.

The Judgment takes effect as of the day of its publishing.

The Chairman of the Court session A.Endziņš