

# THE WORLD BANK

## GLOBAL JUDGES FORUM

### COMMERCIAL ENFORCEMENT AND INSOLVENCY SYSTEMS

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#### LATVIA

*By Inara Garda*

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## **1.0 Introduction and Overview**

Bankruptcy procedures in Latvia are governed by two laws: 1996 Law on the Insolvency of Undertakings and Companies and 1995 Credit Institution Law, which regulates bankruptcy procedures for banks and other financial sector companies.

Latvian legislation gives priority to the possibility to continue the company's operation. The law specifies that creditors must first review the possibility of a peaceful settlement, and failing such settlement, options for restoration of the company must be examined. Peaceful settlement is an agreement between the debtor and creditors. After the debtor fulfils the terms of settlement, the creditors may not raise further claims. Such settlements may be achieved at any stage of the insolvency process prior to the commencement of the auction of the debtor's property. Restoration is a collection of measures aimed at renewal of the debtor's solvency.

Bankruptcy and the recovery of value from the underlying business and assets is a solution of last resort only, if continuation of the company's operation is not possible by means of settlement or restoration.

Legislation regulating insolvency procedures provides for greater protection of the creditor interests. It specifies the rights of creditors over the debtor during the insolvency process, but provides less rights for the debtor itself. Several of the debtor's duties are specified in the law, for example, the duty to provide information and participate in the court proceedings. The law does not give the debtor rights to influence the insolvency process.

Although Latvian insolvency law is intended to encourage settlement and restoration, in practice, bankruptcy proceedings are the most common solution for insolvent enterprises. It is likely that the insolvent company will already be too far gone to allow a rescue by the time the insolvency proceedings are initiated, however this may not be a reflection of weakness of the insolvency legislation itself, but perhaps it is more indicative of shortcomings in other legislation.

In practice, problems in insolvency may arise due to insufficient legislative coverage, which results in gaps in certain important areas. Due to a lack of regulatory laws, specific problems relating to the attraction of new capital may arise, if the company is declared to be insolvent and no decision has been made regarding restoration. Only after a decision on restoration is taken, the administrator is authorised to borrow funds in the name of the debtor and to pledge the debtor's property. Prior to the commencement of restoration the law does not regulate these issues.

There are two important changes to the insolvency procedures recently - new law establishing State agency "Insolvency administration" came into force on 1 January 2003 and State agency "Insolvency administration" started to work on 1 July 2002. Law on Protection of Employees in case of Insolvency of Employer regulates general provisions for satisfaction of claims of employees in case of insolvency of the employer and procedures of formation and utilisation of the resources of the employee claims guarantee fund. The main functions of the state agency "Insolvency administration" are to train, to certificate, to suggest to the court and to supervise administrators.

The Law on Judicial Power states that an independent judicial power exists in the Republic of Latvia, alongside the legislative and the executive power. The independence

of the courts shall be guaranteed by the State; in adjudging trials, judges and lay judges shall be subject only to law.

#### A. Secured Claims and Enforcement

Mostly in Latvia loans to business are secured.

The following types of security exist under Latvian law:

possessory pledge – a pledge of moveable property transferred to the creditor’s possession;

usufructuary pledge – a pledge of moveable or real property which generates accretion and is transferred into the creditor’s possession. The creditor then has the right to gather accretion thereafter;

mortgage – a pledge of real property registered in a public register without the property being transferred to the creditor’s possession;

ship mortgage – a pledge of sea merchant ships, possession of which is not transferred to the creditor;

commercial pledge – a pledge of moveable property, the aggregation of such property are registered in a public register.

The enforcement of pledge and mortgage rights is performed in accordance with general practice pursuant to Latvian civil law or specific legal regulations regarding each separate type of pledge. Upon commencement of the insolvency procedure, there are certain restrictions on the enforcement of pledge and mortgage rights.

The secured creditor who has not been satisfied by the debtor within the time provided for, may resort to the pledged property for satisfaction and, for this purpose, take all the necessary steps for its sale.

The process of creating, registering and enforcing collateral are efficient.

#### B. Unsecured Claims and Enforcement

Creditors may achieve satisfaction of their claims pursuant to the Civil Procedure Law of Latvia by lodging a claim in court or, subject to certain preconditions, by transferring the dispute for settlement to arbitration. Settlements of disputes at court or arbitration tribunal are carried out based on the principle of contest – the plaintiff and the defendant are obligated to prove the actual and legal justification of their respective claims or objections. When a court reviews a dispute, it may be appealed to the first and second level appeal courts. Consequently, the amount of time a debt is settled through this process varies from case to case.

The creditor and the debtor can solve their dispute within the debates, sometimes this is an effective mechanism to encourage negotiated settlement in lieu of litigation.

The fee for bringing the dispute to court is paid by the plaintiff. The amount of the fee depends on the value of the claim. Whichever party wins the case can collect all court costs and up to 5 per cent of its legal fees (proportional to the amount of the claim) from the opposing side.

#### C Liquidation

The Law on Insolvency of Undertaking and Companies, Credit Institutional Law and Civil Procedures Law regulate liquidation.

The businesses can liquidated only by a judicial proceedings and it is commenced by the creditors’ meeting.

A decision regarding initiation of bankruptcy proceedings shall be taken by a vote of a creditors meeting, if possible settlement or restoration have not been proposed, or if a proposed possible settlement or restoration, or draft settlement or restoration plan have been rejected at the creditors meeting, or a restoration has been discontinued without another resolution of the state of insolvency being adopted.

The Liquidation process is controlled and supervised by the administrator who is appointed by a court. He or she is responsible for insuring that the insolvency proceeding proceeds lawfully and effectively.

#### D Reorganization

The Law on Insolvency of Undertakings and Companies, Credit Institution Law and Civil Procedures Law regulate Restoration process.

The insolvent businesses can be restored only by a judicial proceedings and it is commenced by the creditors' meeting.

A creditors meeting shall examine the possibility of restoration, if possible settlement is not proposed at the first creditors meeting, the possibility of settlement is rejected, a settlement has not been entered into or a settlement has been revoked.

The Restoration process is controlled and supervised by the administrator who is appointed by a court. He or she is responsible for managing the restoration of the debtor.

#### E Non-Bankruptcy Workouts and Restructurings

The law contains no specific provisions for informal restructurings of insolvent companies, but The Commercial Law says that the companies may be reorganized by way of merging, division or restructuring. Merging of companies may take the form of acquisition (the acquired company transfers all of its property to another (acquiring) company) or consolidation (the acquired companies transfers all of their property to a newly founded (acquiring) company). Division is a process in which a company transfers all of its property to one company or more other companies through splitting up or divestiture. Restructuring is a process in which one type of company is restructured into a different type of company. In these cases the restructured company ceases to exist without liquidation procedures.

## **2.0 Legal Framework For Creditor Rights**

### Creation and Enforcement of Security in Real Property

A mortgage gives a creditor a property right in regard to pledged immovable property only after registration in the Land Register. Registration of pledge rights in the Land Register can only be allowed with the consent of the pledger, which he or she has expressed either in establishing the pledge right or subsequently. This provision does not apply to those cases where the pledge right is registered on the basis of the judgement or decision of a court.

Pledged real property may be sold by the creditor only at an auction. If the parties have agreed that the pledged real property may be sold at price that is not set, it should be sold at a voluntary auction through the court. The court approves the auction regulations. If the parties fail to agree on selling the property at a price that is not set, an application for the compulsory enforcement of obligations on a no-contest basis must be filed with the court. The judge's decision on this matter has the force of an executive document and it is submitted to the executors for the sale of the pledged object.

If the real estate for sale is the joint property of several persons, then the concurrence of all the joint owners is required to declare voluntary auctioning of the real estate through the court.

#### Security in Personal Property

A possessory pledge is established by the delivery of movable property by a debtor into the possession of a pledgee, with the intent that it shall be security for his or her claim if, in addition, this intent has been expressly stated, or clearly manifested by implication. Property secured through a possessory pledge may be sold by the creditor acting on the debtor's behalf, if the pledge allows for the sale at a price that is not set. If there is no such permit, property secured by possessory pledges can be sold at an auction through the court. A notarised possessory pledge may be exercised through compulsory enforcement of the obligation on a no-contest basis.

The ship mortgage can be exercised either without court proceedings, if the debtor has granted such a right, or through court proceedings and a subsequent sale at an auction. A mortgaged ship owned by the state may only be sold pursuant to a court judgment.

The commercial pledge is established on the basis of contract and it has to be registered in the Register of Commercial pledges. Property secured by a commercial pledge may be sold at an auction if at least one month's prior notice has been given, if the debtor has granted such a right and it has been filed with the commercial pledge register. If the property is not in the creditor's possession, it will be necessary to enforce the security through the use of a no-contest compulsory enforcement procedure.

#### Unsecured Claims

If a creditor or a group of creditors, except secured creditors, intends to exercise rights specified in the Law on Insolvency of Undertaking and Companies, the creditor(s) may submit an insolvency petition to court if:

the debtor has not settled a debt with a creditor that has sent the debtor a letter of complaint about the outstanding debt (after which the debtor has two weeks to settle the debt) and a written notice of the creditor's intention to submit an insolvency petition (this can only be sent after the debtor's two week grace period elapses). If the debtor fails to settle the claim within one week after this, the creditor or group of creditors can submit an insolvency petition;

within three months it has not been possible to execute, fully or partly, a court judgment regarding recovery of a debt, because the assets of the debtor are insufficient for the settling of its debts;

the debtor has notified the creditors or given public notice regarding its actual insolvency.

If the petition is granted, the court will make a declaration of insolvency, which may then result in a settlement, rehabilitation, or bankruptcy. The court may also terminate the insolvency process, if the debtor has become solvent before the creditors decide upon an insolvency solution, or if no creditors have applied during the time period given for the submission of creditors' claims to the administrator.

If the debtor fails to voluntarily perform according to the judgment the plaintiff has the right to seek compulsory enforcement of the judgment. A compulsory enforcement of the judgment requires a judgment by the court or a decision from the arbitration tribunal to this effect and a writ of execution based on that judgment or decision. Based on such a writ of execution, compulsory enforcement is performed by executors:

through the sale of the debtor's property;

through the collection of the debtor's income, property placed with other people; through the withdrawal of objects owned by the debtor that are specified in the judgment. In cases where there is no dispute regarding the claim, it is also possible to conduct compulsory enforcement of the claim on a no-contest basis.

Upon insolvency proceedings being initiated, a creditor is prohibited from performing individual actions by which losses are inflicted upon the interests of the creditors as a whole.

### **3.0 Liquidation**

#### Principal Laws Governing Liquidation

The Law on Insolvency of Undertaking and Companies, Credit Institutional Law and Civil Procedures Law regulate liquidation proceeding. The Commercial Law regulates self-liquidation of a company.

#### Courts Which Administer Liquidation

A regional court in accordance with the legal address of the debtor examines a matter regarding insolvency of a debtor. This court shall also examine other issues related to the insolvency of the undertaking or company.

#### Commencement of a Liquidation

Subject to certain conditions, the right to initiate an insolvency procedure is enjoyed by both creditors and the debtor. The debtor may submit an insolvency petition, if it cannot duly settle its debt obligations. A creditor may also submit an insolvency petition requiring that the debtor be declared insolvent, if the debtor fails to settle its debt obligations.

Bankruptcy is one possible solution to insolvency. It is not the court that decides whether to initiate bankruptcy proceedings. Initiation of such proceedings is instead decided on at a creditors' meeting, where the creditors vote according to the size of their claims. A decision to initiate bankruptcy proceedings has to be taken, if:

proposals for a settlement or the debtor's rehabilitation have not been made;

a proposed possible settlement or rehabilitation, or draft settlement or rehabilitation plan have been rejected at the creditors' meeting;

a rehabilitation has been discontinued without adoption of another solution for the insolvency.

When the decision is taken to initiation of bankruptcy proceedings, the creditors meeting shall determine the day for commencement of the auction of the property of the debtor. If the creditors meeting does not vote for the initiation of bankruptcy proceedings or does not determine a day in regard to the auction, the administrator shall determine such. If it is not possible to commence the auction within the specified term, the administrator shall convene a creditors meeting that shall decide on the postponement of the commencement of the auction.

The principal purpose of bankruptcy proceedings is to discharge the claims of creditors to the fullest extent possible by obtaining maximum realizations from the sale of the debtor's property. Sale of the debtor's assets is made through public auctions, unless the law prescribes other procedures of alienation with respect to the particular property, or the creditors' meeting grants the administrator authority to apply other forms of alienation.

#### Parties to a Liquidation

The committee of creditors of the debtor, an administrator, and a debtor and its representatives are involved in the insolvency proceedings.

With some participation of the creditors' meeting, an administrator is responsible for case management control and administration during a corporate bankruptcy. The creditors' meeting appoints the date for the beginning of the auction of the company's property, and the administrator organizes the auction and drafts its regulations. In certain cases and with the consent of a creditors' meeting, the administrator may use other forms of sale of the company's property.

#### Liquidation Estate

Settlement and rehabilitation procedures do not involve the sale of the company's assets. Therefore, in order to sell the company's assets, the creditors must initiate bankruptcy proceedings. The creditors decide whether or not to initiate bankruptcy proceedings through a vote of the creditors' meeting.

A court judgment announcing the debtor's insolvency is ground for staying court proceedings against the debtor and terminating enforcement of judgments for amounts adjudicated, but not yet collected from the debtor.

In the auction has to be included all the property of the debtor, except monetary funds, as well as property, which are subject to pledges, in accordance with valid contracts concluded by the debtor, in favor of secured creditors. At the first auction, the bidding shall take place by ascending step. If the property is not sold at the first auction, the bidding at subsequent auctions shall take place by descending step. After the highest bidder has paid the specified price for immovable property, the administrator shall prepare and sign a sales contract on the basis of which an entry shall be made in the Land Register. In selling the property of the debtor by way of auction, the minimum term for announcing an auction shall be one month.

The rights of secured creditors to enforce security are restricted. There is an initial suspension of security rights until the moment that a decision has been made about a solution for the debtor's insolvent state. If bankruptcy proceedings are the chosen solution, creditors can exercise their security after commencement of bankruptcy proceedings. Once proceedings are initiated, the creditor is obligated to co-ordinate with the administrator in respect of the auction provisions and the opening price and the written contract of sale of the secured property. If no such co-ordination takes place, the contract of sale of the secured property is null and void. If the amount of money received for the pledged property of the debtor exceeds the secured claims and the auction expenditures, the surplus shall be paid into the current account of the debtor.

#### Administrative Powers

An administrator has to prepare a list of claims of secured creditors, unsecured creditors and of third persons, against which the debtor has a right to claim, indicating the amount of each claim. In the list of claims of unsecured creditors, the administrator has to indicate the number of votes, corresponding to the amount of claims, of each unsecured creditor in the first creditors meeting. The administrator also has to group the claims of creditors in the sequence regarding settlement of debts, examine them and take a decision regarding recognition or rejection of a debt, but the administrator does not have the right to reject creditors' claims accepted by a court judgment, which has come into effect. When the basis for the claims of secured creditors has been verified, the administrator has

to exclude property pledged for the security of such claims against which the claims of creditors may be brought.

After the debtor is declared insolvent, all the rights and authority of the corporate management, as specified in the debtor's articles of association, laws or agreements are passed to the administrator. The debtor loses its right to handle its property, and the operation of the debtor's management is stayed.

The administrator is responsible for submitting a notification regarding the initiation of bankruptcy proceedings and the day specified for commencement of the auction to the newspaper "Latvijas Vestnesis", within three days after the creditors meeting has taken the decision, and shall send the decision on the initiation of bankruptcy proceedings for registration in the Enterprise Register.

An administrator can assign the claims of the debtor against third persons, if the term for payment of the debt has not expired when the bankruptcy proceedings are taking place, or collection of the debt is not possible. Assignment contracts shall be made after the approval of the provisions of such contracts at a creditors meeting.

When the debtor is declared as insolvent, the administrator has all the rights and powers: to take possession of and administer all property of the debtor, as well as the property belonging to third persons, as is in the possession of or held by the debtor;

to liquidate branches or representation offices of the debtor;

to submit any claim of the debtor against third persons to a court for adjudication;

to appoint officials for the performance of the administrative work of the debtor and determine their competence, and to hire and dismiss from work employees, including those who were engaged to work before the initiation of the insolvency matter;

to cover administrative expenses from the funds of the debtor;

to lease (rent) out any property of the debtor, as well as to lease (rent) any property, if such is in the interests of the creditors as a whole;

to renounce, with the consent of the creditors meeting, any claim, or to enter into any settlement in the name of the debtor with respect to claims of the debtor against third persons;

to request the holders of capital shares of the debtor to fulfill their obligations with respect to the equity capital (statutory fund) or other property, or to bring action in court regarding enforced fulfillment of such obligations;

to submit a petition regarding the declaring as insolvent of any such third person as has debt obligations against the debtor, and to represent the claims of the debtor, if proceedings are initiated on the basis of such petition;

to change the registered legal address of the debtor;

to satisfy the claims of the employees of the debtor, except the members of administrative bodies and control institutions of the debtor, regarding salaries, for which a court judgment has entered into effect prior to the declaration of the insolvency, and the claims of such employees regarding compensation for injuries inflicted at work with respect to mutilation or occupational disease during the full time of the insolvency proceedings.

#### Creditors and Claims

The creditors should submit their claims against a debtor to the administrator within three months from the day notification is published in the newspaper "Latvijas Vestnesis" regarding the declaring of the debtor as insolvent if a court has not specified a shorter time period. All the creditors are entitled to become acquainted with the submitted claims

and can submit reasoned objections to the administrator regarding the validity of the claims of other creditors, except claims regarding which court adjudication has come into effect. In the first creditors meeting the administrator should submit for approval his or her decision regarding the approved claims of unsecured creditors, as well as the rejected claims of unsecured creditors.

Each creditor has the right to appeal to court parts of the decision of a creditors meeting regarding approval of claims of creditors or rejection of the claim of the creditor. The appeal may be submitted within two weeks from the day of the creditors meeting, but if the creditor has not participated in the meeting, from the day when the creditor is notified of the decision of the creditors meeting.

In the event of bankruptcy, creditors' claims are discharged in two groups. Firstly, priority creditors are to be satisfied. Priority creditors are divided into the following groups:

claims of employees;

mandatory contributions to state social security and the payments of personal income tax that are related to such claims of employees;

mandatory contributions to state social security to ensure receipt of unemployment benefits;

payments to farms, individual producers, co-operatives and incorporated companies for agricultural products supplied to processing undertakings;

payment of debts in respect of social security for one year prior to the initiation of the insolvency proceedings;

state claims regarding repayment of state-guaranteed credit; and

claims regarding repayment of debts of other taxes and fees, including the remaining social security debts, except deferred payments.

After satisfaction in full of the claims of the priority creditors as provided for above, the remaining funds shall be distributed for the satisfaction of claims of the remaining creditors in the following groups and sequence:

the claims of the remaining creditors, including claims relating to bank debts and of trade creditors, as well as the claims of those creditors who have acquired the status of a creditor after the initiation of the insolvency proceedings and to whom the general term for submission of claims by creditors does not apply;

deferred tax payments;

salary debts remaining after payments to priority creditors have been made and other payments resulting from lawful employment relationships;

the claims regarding payment of interest to priority creditors as well as to the remaining creditors; and

the claims of such creditors as have submitted their claims after the prescribed term.

The claims of each subsequent group of creditors shall be satisfied only after complete satisfaction of the claims of the prior group of creditors. If funds of the debtor are not sufficient to completely satisfy all the claims of one group of creditors, such claims has to be satisfied in proportion to the amount that is due to each creditor within such group.

Property, which is covered by security, shall be excluded from the bankruptcy estate available to settle the claims of other creditors. Secured creditors will be settled from the proceeds of realization of the assets subject to the security. Any shortfall in recovery will be treated as an unsecured claim.

### Officers, Directors, Affiliates

From the 1 January, 2003 in the insolvency proceedings as administrators may be appointed only individuals. As administrators cannot be appointed persons who would be found an interested party, persons who have been sentenced in regard to crimes with respect to property, economic, administration or entrepreneurship, regardless of whether or not the conviction is extinguished or set aside.

An administrator shall have security for cases where he or she by their actions inflicts losses upon creditors or other interested persons. The security may consist of civil legal liability insurance for the activities of an administrator or a security deposit, which has to be determined in an amount not less than ten per cent of the amount formed by the sum of the market value of the funds in the debtor's cash office and current accounts, and the fixed assets and current assets of the debtor. A creditors meeting may decide on a reduction in the amount of the security. If an administrator takes part in more than one insolvency proceedings, he or she shall have separate security for each proceeding in the amount specified by the creditors meeting.

When the insolvency matter has been initiated an administrator has to be suggested by the state agency "Insolvency administration", after that the court has to accept or reject the suggested administrator.

An administrator is responsible for ensuring that the insolvency proceeding proceeds lawfully and effectively. He or she has to administer the property of the debtor during the insolvency proceedings and ensure its maintenance until the termination of the insolvency proceedings and the payment of money intended to cover the costs of administration and debts, or the entering into of a settlement. Administrators shall ascertain the causes of actual insolvency and provide their opinion regarding them to the creditors meeting and the court, he also has to provide information as to how insolvency proceedings are proceeding to the creditors meeting, as well as send the settlement adopted by the creditors meeting to the court for approval and has a duty to provide necessary information to the Enterprise Register. Once in the month the administrator has to write a report on his activities in the insolvency proceedings and submit it to the state agency "Insolvency Administration".

An administrator shall receive remuneration for the performance of the duties of an administrator. He should agree, in writing, with the creditors meeting regarding the amount of the remuneration. If agreement is not reached, the administrator shall receive remuneration according to the rate specified in the Law:

fifteen per cent of the actually recovered amount, which does not exceed the first three thousand LVL recovered;

plus ten per cent of the actually recovered amount as exceeds three thousand LVL, but is not more than ten thousand LVL;

plus five per cent of the actually recovered amount as exceeds ten thousand LVL, but is not more than one hundred thousand LVL;

plus three per cent of the actually recovered amount as exceeds one hundred thousand LVL, but is not more than one million LVL;

plus one per cent of the actually recovered amount, as exceeds one million LVL.

An administrator shall receive remuneration according to the fixed rate in the following cases and in the following amount:

from the day of the appointment of the administrator until the day of the adjudication of the insolvency matter – a one-time remuneration in the amount of five times the minimum monthly salary;

until the termination of the bankruptcy procedure, if the assets of the debtor do not cover the administrative expenses – a one-time payment in the amount of five times the minimum monthly salary;

in the case of a settlement entered into at the first creditors meeting, a one-time payment in the amount of thirty times the minimum monthly salary;

in the case of restoration – a salary in the amount of fifteen times the minimum monthly salary.

An administrator is fully liable for losses caused to the creditors through his or her fault, but he is liable for the activity of the debtor or of former administrators, and transactions, which were concluded prior to his or her taking office.

An administrator could be removed by a court, on the basis of the decision of a creditors meeting regarding the expressing of a lack of confidence in the administrator, if the administrator does not comply with the provisions or the restrictions specified in the Law, he or she is incompetent regarding the performance of his or her duties or the administrator uses his or her powers in bad faith. If the court has removed the administrator then the state agency should suggest other administrator and the court should appoint the new one.

An administrator has the right to invite, with the consent of a creditors meeting, specialists (accountants, lawyers, economists and others), if this is necessary to ensure the effectiveness of the insolvency proceedings and can hire one or more assistant administrators.

Creditors or their lawful or contractual representatives have the right to participate in a creditors meeting regardless of the amount of claims. If the amount of creditors exceeds three hundred then in the creditors meeting participate those creditors who represent not less than one per cent of the whole amount of claims. In such case, one person is representing several creditors. Only unsecured creditors have voting rights at a creditors meeting, but secured creditors have voting rights to the amount of the unsecured portion of their debt.

A creditors meeting main responsibilities is to elect the committee of creditors, choose a resolution for the state of insolvency – a settlement, rehabilitation or a bankruptcy, also to accept or reject a draft settlement in case of settlement or the restoration plan in case of rehabilitation.

A creditors meeting takes a decisions by a simple majority of votes of the present creditors entitled to vote, proportionately to the amount of debts submitted by a creditor.

It is mandatory for the creditors meeting to elect a committee of creditors, which consists of 5 to 9 persons, if more than fifty creditors have submitted their claims in the insolvency proceedings. The committee of creditors has to represent all groups of creditors involved in the relevant insolvency proceedings. A committee of creditors can take decisions, if more than half of the elected members of the committee of creditors are present.

The administrator shall determine the debtor's representatives whose participation in the insolvency proceedings is mandatory; they must attend all creditors meeting and court sessions of which they are notified, as well as to provide necessary information. If

debtor's representatives fail to attend court, they may be brought to court by forced conveyance. The debtor's representatives shall submit the requested information in writing, certifying it by their signature. For the provision of false information, the debtor's representatives shall be liable in accordance with the Criminal Law of Latvia.

#### Non-Judicial Liquidation

Non-judicial liquidation can be performed if a meeting of shareholders decides so; it has to be performed by the members of the board of directors. A meeting of shareholders can appoint and remove one liquidator or several liquidators. A liquidator can be a natural person with the capacity to act and at least one of the liquidators shall be a person with a permanent place of residence in Latvia. When a decision has been taken on the liquidation of a company, the decision shall be submitted for recording in the Commercial Register within three days.

The liquidator is responsible for sending a notice regarding the commencement of the liquidation to all known creditors of the company, where they are invited to submit their claims within three months after the day of publication of the notice.

After the end of the time period for submission of creditor claims, the liquidator must compile a liquidation initial financial account. After the claims of creditors have been satisfied or the monies due them are deposited and the liquidation expenditures have been covered, the liquidator shall compile a liquidation closing financial account and a plan for the division of the remaining property, in which a liquidation quota shall be determined and which has to be examined by an auditor. A liquidator shall perform the necessary activities for the organization of the company documents and their transfer to the State archives.

The liquidator has to send the liquidation closing financial account and the plan for division of the remaining property to all shareholders. The notice to the holders of bearer stock has to be published in the newspaper "*Latvijas Vestnesis*", indicating the place where the liquidation closing financial account and the plan for division of the remaining property are accessible.

The remaining property of the company shall be divided among the shareholders in accordance with the plan for division of the remaining property prepared by the liquidator, in proportion to the shares owned by each shareholder, if the founding documents do not specify otherwise. After the division of the remaining property of the company, the liquidator shall submit an application for the completion of liquidation to the Commercial Register Office. The liquidation closing financial account and the plan for division of the remaining property, as well as the opinion of the auditor (if an audit examination was performed), shall be appended to the application.

If it is found during the course of the liquidation that the property of the company is not sufficient to satisfy all the legitimate claims of creditors, the liquidator has a duty to submit an insolvency petition in accordance with the procedures specified by law.

The company is liquidated when it is deleted from the Commercial Register.

#### **4.0 Rehabilitation/Compositions/Schemes**

Overview of schemes for rehabilitation

As restoration has to be considered as various kinds of lawful measures directed towards renewal of solvency of the debtor.

A creditors meeting can examine the possibility of restoration, if possible settlement is not proposed at the first creditors meeting, the possibility of settlement is rejected, a settlement has not been entered into or a settlement has been revoked.

A creditors meeting may discontinue a restoration, if the restoration measures are not taking place in accordance with the restoration plan, the debtor's solvency has not improved to the extent anticipated in the time period provided for in the restoration plan or it is determined that the restoration plan cannot be executed.

#### Courts Which Administer Reorganizations

A regional court in accordance with the legal address of the debtor examines a matter regarding reorganization of a debtor. This court shall also examine other issues related to the insolvency of the undertaking or company.

#### Commencement of a Reorganization

Rehabilitation and settlement result in the continuance of the company's operations. The debtor and its creditors have a right to initiate settlement. Although the law does not directly specify one party's right to initiate rehabilitation, a decision to initiate the rehabilitation of a debtor can be made by the creditors or the administrator.

Settlement is allowed in all stages of insolvency proceedings until the commencement of the auction of the debtor's property. The court does not make a proposal for a settlement. A settlement will be accepted if it is voted for by more than half of the creditors present at the creditors' meeting. Voting is determined in proportion to the monetary amount of claims.

Settlements may comprise:

the reduction in the amount of claims;

the renunciation or reduction of contractual penalties and/or interest, including late charges;

postponement of the term for fulfilment of obligations.

In the event of a settlement, the lawful rights and interests of secured and priority creditors may not be impinged upon without their express, written consent.

A settlement is subject to approval by the court. During the term of the settlement's validity, the rights of the creditors' meeting to adopt decisions regarding rehabilitation or commencement of bankruptcy proceedings are restricted.

The law states that if insolvency is not resolved through a settlement, a decision regarding the application of rehabilitation must be taken, but it does not specify who should formally initiate the voting on such an issue. Voting on the issue may be initiated through its inclusion in the agenda of the creditors' meeting, which may be prepared by the administrator or through an application of creditor(s) representing less than one quarter of the total debt amount that have requested that a creditors' meeting be convened. If the administrator finds that there is a basis for the issues stated in the application, he may include them in the creditors' meeting agenda.

#### Participants and their Roles

During the creditors' meetings, the creditors elect the creditors' committee, agree upon the type of insolvency procedure, require reports from the administrator, establish the amount of remuneration for an administrator and/or express a vote of no-confidence in an administrator.

Secured creditors have voting rights if the voting is on a rehabilitation plan. During a rehabilitation period, those secured creditors whose rights to sell the mortgage are restricted have voting rights at the creditors' meetings.

An administrator is appointed by a court immediately after initiating insolvency proceedings and is responsible for the proceedings.

The administrator has the right, with the consent of the creditors' meeting, to use specialists (accountants, lawyers, economists, etc), if it is necessary for ensuring the efficiency of the insolvency procedure.

State Agency "Insolvency Administration" is responsible for the certification of administrators (individuals only), training of administrators, supervision of insolvent company employee claims fund, etc.

#### Reorganization Estate

The estate in the rehabilitation process can be recovered. Recovered property is financial funds and other property, which have been included in the property of the debtor during the insolvency proceedings on the basis of rights to claim against third persons, have been recovered where transactions are declared invalid or have been recovered through repayment of debts.

#### Administrative Powers

The administrator is responsible for managing the restoration of the debtor. In this process he or she has additional powers:

to obtain or borrow monetary funds in the name of the debtor and to pledge the property of the debtor;

to establish branches or representative offices of the debtor;

to transfer the property of the debtor to branches or representative offices of the debtor and to assign to them the assuming, fully or partly, of the entrepreneurial activity of the debtor;

to lease out any property of the debtor, as well as to lease any property, if such is advantageous for the activity of the debtor.

If there has been a fundamental change of circumstances, which affects or may affect fulfilment of the restoration plan, the administrator has to propose that the creditors meeting make amendments to the restoration plan.

#### Creditors and Claims

Given that rehabilitation and settlement are components of insolvency proceedings, satisfaction of unsecured creditors is conducted in accordance with the restrictions following the judgment announcing insolvency. After settlement or rehabilitation is chosen, satisfaction of claims is conducted in accordance with the provisions of the settlement or the rehabilitation plan. In rehabilitations or settlements, enforcement of security by secured creditors is conducted subject to the same conditions as in liquidation proceedings, unless a debtor's property used as security for a claim is included in the rehabilitation plan and is necessary for the implementation of the plan. Then the rights of a secured creditor to enforce the security may only be conducted after rejection of the rehabilitation plan, or the end or cancellation of rehabilitation.

A secured creditor has the right to request and receive, after the approval of the restoration plan, compensation for the restriction of his or her rights. The amount of the compensation has to be determined as annual percentage of the relevant secured claim or

its secured part, and it may not be less than the refinancing rate specified by the Bank of Latvia in the day of the approval of the restoration plan.

If the pledged property is destroyed, or its value decreases during the restoration proceedings, the claim of the secured creditor has to be covered, according to the value of the pledged property or to the extent of its reduction, from the administrative expenses of the insolvency proceedings. The reduction of the value of the pledged property, as indicated herein, is not applicable to natural wear and tear of the property.

#### Officers, Directors, Affiliates

A creditors meeting shall take a decision regarding application of restoration by voting thereon. A decision regarding application of restoration shall be taken if more than half of the creditors' present vote for it according to the amount of claims. The administrator, a creditor or a group of creditors may request a court to revoke the decision of a creditors meeting regarding a restoration if the taking of such decision has been achieved through fraud or duress, or as a result of an error.

During rehabilitation proceedings the administrator manages the company in accordance with the approved rehabilitation plan. If a settlement is reached, the managerial rights are restored to management under the guidance of the administrator, but if it is cancelled, the administrator manages the corporate property. Commencement of insolvency proceedings, regardless of a resolution through settlement, rehabilitation or bankruptcy, restricts the rights of the debtor to handle its property; as such rights are transferred to the administrator.

If a creditors meeting approves a restoration plan, the committee of creditors shall be re-elected and shall include representatives of the secured and unsecured creditors proportionately to the represented amount of claims. In cases when a debtor's restoration is discontinued only the representatives of unsecured creditors have to continue their activity in the committee of creditors, electing, if necessary, additional members from among the unsecured creditors.

Discontinuation of a restoration may be requested by a secured creditor whose rights during the restoration are restricted if he or she is not paid the compensation specified in the restoration plan in due time. In this case the creditors meeting, upon taking a decision on discontinuation of the restoration has to decide on the determination of another resolution of the state of insolvency.

The administrator shall convene a meeting of creditors regarding completion of the restoration not later than a month after the expiration of the time period provided for in the restoration plan. The administrator shall present a report regarding the course and the results of the restoration. The creditors meeting shall vote on the approval of the report and on the recognition of complete fulfillment of the obligations of the debtor. If the creditors' meeting does not approve the report, it shall decide on entering into a settlement or the initiation of bankruptcy proceedings. The administrator shall send the decision of the creditors meeting to a court for approval.

#### Reorganization Plan and Process

The rehabilitation plan must be prepared within two months of the date that the creditors' meeting approved the application for rehabilitation. The creditors' meeting designates the drafter(s) of the plan, and they can include the administrator, a creditor or a group of creditors, as well as third parties contracted by the administrator. The plan must include specific measures to be taken for restoring the company's solvency and a time schedule,

necessary resources and milestones for the company's solvency, as well as the terms and procedure for the payments of creditors' claims. During the plan's preparation, the creditors will most likely have to cover the expenses of the accountants, lawyers and similar consultants (the administrator's expenses are covered by the insolvent company). The time period for restoration measures provided for in the plan, but it cannot exceed ten years.

The rehabilitation plan is adopted, if at least two groups of creditors (secured/priority/other creditors) have voted for the rehabilitation plan and one of them is an adversely affected group (a group of creditors whose claims would not be fully discharged in the plan). The votes of the members of each group are in accordance with the amount of their claims. After the expiration of the term for rehabilitation, the creditors' meeting must decide whether or not to approve the administrator's report (on the progress and result of rehabilitation), and on whether there has been complete fulfilment of the debtor's obligation.

A restoration plan must be registered in the Enterprise Register, everything, which is related to the restoration plan (amendments, extensions of the term) and is not registered with the Enterprise Register are not valid.

Fast-track/prepackaged reorganization procedures

Rehabilitation is not very widely used in Latvia that is why there are not any pre-packaged reorganization procedures.

Insolvency treatment of State-owned Enterprises

Only the Privatisation Agency, a city council, district council or parish council, or the Ministry of Agriculture respectively are entitled to submit an insolvency petition regarding a State or local government undertaking or company transferred for privatisation.

In regard to those State undertakings or companies to which the Law On Privatisation of Objects of State and Local Government Property is applicable, only the Privatisation Agency may perform the functions of administrators in insolvency proceedings provided for by this Law.

In regard to those local government undertakings or companies to which the Law On Privatization of Objects of State and Local Government Property is applicable, the functions of administrators in insolvency proceedings provided for by this Law may be performed only by a person who has been appointed by a court upon the recommendation of a city council, district or parish council.

In regard to those State undertakings or companies to which the Law On Privatization of Property in Agriculture Service Undertakings is applicable, the functions of administrators in insolvency proceedings provided for by this Law may be performed only by a person who has been appointed by the court upon the recommendation of the Ministry of Agriculture.

In insolvency proceedings in regard to State and local government undertakings or companies, such norms as provide for and regulate the convening and activities of a creditors meeting, as well as the formation of the committee of creditors are not applicable. In such case, the Privatization Agency or the local government shall perform the functions of the creditors meeting.

Insolvency treatment for banks and financial institutions

An insolvency petition of a credit institution can be submitted by the credit institution, the administrator in other insolvency proceeding, creditor or a group of creditors and the Finance and Capital Market Commission. The main supervisor in the insolvency of banks and financial institutions is the Finance and Capital Market Commission, who also appoints and controls an administrator.

The total amount of remuneration for the administrator and the assistant to the administrator shall be 15 per cent of the recovered assets (property), excluding money in the cashier's office and other obtained funds. If no assets (property) have been recovered, the total monthly remuneration of the administrator and the assistant to the administrator shall be 30 minimum monthly salaries.

Within three days after the credit institution is declared insolvent, the administrator shall send a notice and a copy of the court judgement to the Bank of Latvia, the Enterprise Register and the Land Registry Office according to the location of the immovable property.

If the restoration of solvency has started, the administrator has to restore the right of the credit institution to administrate and to control its property. The total time period for restoration may not exceed two years.

If the Finance and Capital Market Commission does not approve the restoration plan, or if restoration is revoked or discontinued, the administrator shall take a decision on the initiation of bankruptcy proceedings.

A decision on initiation of bankruptcy proceedings shall be taken, upon receipt of a petition, by a court. After the property is realised in the auction the claims have to be covered in the order of:

the costs of the insolvency proceedings or liquidation;

payments up to 500 (inclusive) LVL to depositors – natural persons;

claims of employees;

taxes and other payments (debts) to the State budget and the budgets of local governments;

such debts to creditors which have arisen from a credit institution accepting, but failing to fulfil, payment orders from a client regarding money transfer to accounts of the State or local government budgets;

State claims regarding repayment of credits guaranteed by the State;

the remaining legal claims of the creditors (principal sums without interest);

claims regarding interest payments to the creditors;

claims of such creditors who have submitted their claims after the specified time limit;

claims regarding the funds which creditors have loaned to the credit institution for a definite time period;

The claims of each subsequent group of creditors shall be satisfied only after complete satisfaction of the previous group of creditors. If one group cannot be fully satisfied then such claims have to be satisfied proportionately to the amount due to each creditor within such group.

When the liquidation proceedings have been completed, the administrator has to send the court adjudication regarding the completion of bankruptcy proceedings to the Enterprise Register, for the deletion of the credit institution in the Enterprise Register.

## **5.0 Institutional Framework for Insolvency**

### **Role of Governing Institutions/Judicial Authorities**

The organisational management of regional courts, district (city) courts is implementing the Ministry of Justice, which is responsible for selecting judges, supervising the work of these courts, organising the training for judges, performing the statistical accounting and other organisational matters.

### **Specialization among courts/judges and tribunals**

Judicial system of Latvia includes district (city) courts, regional courts and Supreme Court. Constitutional Court shall function as a separate court. Laws of the Republic of Latvia do not provide for the establishment of specialised courts, but in courts – taking in account the organisation of judicial review – the specialisation of judges in different categories of matters (employment, family, copyright protection, and insolvency matters, etc.) is the actual practice of judicial review.

District (city) courts, regional courts and the Supreme Court are interconnected only in functional (procedural) aspect, i. e., only by receiving from lower courts and reviewing the matters, that are appealed against, but those courts are not interconnected in organisational (administrative) aspect.

District (city) courts are the first (lowest) stage of the judicial system, the court of first instance for civil, criminal matters and matters arising from administrative legal relations, except of those matters that are within the jurisdiction of regional courts and the Supreme Court. Currently there are 34 district (city) courts in Latvia.

Regional courts are the second (medium) stage of the judicial system. Five regional courts are established in Latvia according to historical and actual regions of the state. A Regional Court is a court of appellate instance for civil, criminal and administrative matters, which have been adjudicated by a district (city) court as the first instance court. A Regional Court, sitting as a court of appellate instance, shall adjudicate by a panel comprising three regional court judges. A Regional Court shall have a Civil Matters Division, a Criminal Matters Division and an Administrative Matters Division. Furthermore, a regional court is the first instance court for the criminal and civil matters, which are within the jurisdiction of regional courts in accordance with the procedure law. Regional Court as the first instance court reviews following civil matters: matters entailing a dispute on property rights to real estate; matters arising from rights of obligations, if the sum of the claim exceeds 30 000 lats; matters on patent rights and protection of trademarks; matters on insolvency of enterprises and companies; and matters on insolvency and liquidation of credit institutions.

Furthermore, several special laws provide for the review of matters by regional court as the first instance court – claims relating to deprivation of citizenship, complaints against decisions of Competition Board.

The Supreme Court is the highest (last) stage of judicial system in Latvia, and the judgements thereof are final. The composition of the Supreme Court of the Republic of Latvia is divided into two parts the Senate and two judicial panels: the Civil Matters Panel and the Criminal Matters Panel. The Senate shall be composed of three departments: the Civil Matters Department, the Criminal matters Department and the Administrative Matters Department. The Senate shall be the court of cassation instance for all matters. A Panel of the Court is the court of appellate instance for matters, which have been adjudicated, by regional courts as courts of first instance.

## Organization of the Court

The insolvency proceedings are adjudicated by Regional Courts. The insolvency matters are adjudicated by a single judge of a Regional court.

In the insolvency matters also take part an assistant to a judge, who is responsible of receiving visitors and their submissions, take measures in connection with the preparation for matters for adjudication at a sitting of the court, as well as perform other tasks assigned by the judge, a court consultant, who is responsible for generalizing and analyzing court practice and statistics, as well as carry out other methodological work the clerk of court, who manages and organizes the work of the office of the clerk of court, a court recorder who takes the minutes of a court sitting, a process server who delivers court summonses, indictments and other documents to the addressees thereof, a court interpreter when necessary takes part in sittings of a court, as well as translate court documents and court administrator who ensures the provision of the material necessities of the court, the arrangement of suitable premises and order in the court.

## Court Operations

The court can accept an insolvency application only from a person in whose name the application is submitted, or a person who has been authorized to submit it, after that the application has to be registered. The judge has to make a decision, regarding initiation of insolvency proceedings in the next day after receipt of the application. When the proceeding is initiated the court has to impound the monetary funds of the debtor and if it is necessary also to impound the property of other debtors. A notice regarding the initiation of the insolvency proceedings has to be displayed on the court premises in a visible place immediately. The judge has to appoint an administrator, who is suggested by a state agency "Insolvency Administration".

The court has to adjudge an insolvency case within 15 days of the time the case was initiated. When the court declares the debtor insolvent, it has to state the day when the insolvency comes into effect. Based on the respective application, the court has to make a decision regarding confirmation or revocation of a settlement, completion of a bankruptcy proceeding, termination of an insolvency proceedings, resignation or dismissal of the administrator and appointment of another administrator, affirmation of the act of auction of the real property and deleting an insolvency mark from Land Register. The court also has to examine different complaints and make a decision regarding them.

## Judicial decision-making

A judge should find a debtor insolvent if a court determines at least one of the following elements:

the debtor is unable or, due to circumstances as can be proved, will be unable to adequately settle its debt obligations;

the debtor has ceased to settle debt obligations, payment of which has come due the debt obligations of the debtor exceed its assets.

The court has to confirm the settlement, revoke the decision of a creditors meeting regarding a restoration if the taking of such decision has been achieved through fraud or duress, or as a result of an error. The court can decide to complete a bankruptcy after the administrator has submitted a motivated application, where has to be report on administrators work, debtors liquidation balance sheet.

## Appellate process

The appeal process is acceptable only in the insolvency proceedings until the judgment is made. An administrator, creditor or a group of creditor can submit an appeal, regarding a decision of a creditors' meeting. The court can examine the appeal regarding the creditors' committee, which is submitted by an administrator only if it has already been examined at a creditors' meeting. The creditors' meeting and the debtor can submit a appeal regarding actions of administrator if it has already been submitted to him or her and has not received any response.

When a court has declared a debtor as insolvent, its judgment is final.

#### Institutional Integrity

In the insolvency proceedings are involved such institutions as the Regional court and Supreme court, the state agency "Insolvency Administration", the Commercial Register, the Land Register and other State institutional, which work in the integrity to solve the case.

### **6.0 Regulatory Framework for Insolvency**

#### Existence of System of Regulation

In order to improve the efficiency of the insolvency process in July 2002 was established the state agency "Insolvency Administration".

#### Role and Function of Regulatory Body

The state agency's main functions is to prepare qualifies administrators in the insolvency process, to examine and certify administrators, to satisfy employees claims of insolvent companies and carry out other essential duties. This agency is releasing the court from the function to evaluate administrators before appointing him or her by advising an administrator of definite insolvency case. This agency also supervise administrators enabling them to manage insolvent companies, take decisions on their future activities, sell the assets and then divide income between the creditors. The agency guarantee payments to the administrators where there are no assets to defray the costs.

One of the benefits of the Insolvency Administration is quick examination of employees' claims and meeting their rights. According to the law "On Protection of Employees in Case of Employer's insolvency" the Administration is the holder and manager of finances for the "Employees Claims Guarantee Fund".

#### Role and Function of Office Holders

The state agency "Insolvency Administration" is managed by a director, who is hired and fired by the Minister of Justice. The director is responsible for administrative work and finances. An order of a director can be appealed to the Minister of Justice. This agency is also managed by a director board (5 people), who is responsible for ensuring the rule of law and for taking decisions on the daily work of the agency.

To ensure the policy of the country the Minister of Justice forms an advisory council, who has rights to give advices to the agency about administrative work.

### **7.0 Cross-Border Insolvency**

#### Recognition of Foreign Cases, Representatives

The court accepts for consideration foreign cases, which are considered in accordance with Latvian laws and international contracts. If the law of a foreign state is in conflict

with the social or moral ideals of Latvia, or mandatory or prohibitory norms of Latvian law then this law is not applicable in Latvia.

#### Recognition of Foreign Creditors and Claims

An administrator has to examine also foreign creditor claims and make a decision are they legitimated or not. The process is the same as with Latvian creditor claims.

#### Recognition of Foreign Judgments or Orders

Since 1990, the Republic of Latvia is a member state of substantial international documents that regulate international civil process issues. They are: Hague Convention of 1 March 1954 relating to civil procedure (in force from 15.07.1993); United Nations (New York, 10 June 1958) Convention on the Recognition and Enforcement of Foreign Arbitral Awards (in force from 13.07.1992); Hague Convention of 5 October 1961 Abolishing the Requirement of Legalization for Foreign Public (in force from 30.01.1996); Hague Convention of 15 November 1965 on the Service Abroad of Judicial and Extra judicial Documents in Civil or Commercial Matters (in force from 01.11.1995).

At this time Latvia does not have a special law on International private law. At this time international private law, norms are to be found in the introductory division of the Civil Law. Even through these Sections are not many, I think that it is not necessary to concretise and add to them at this time. In any case, this will be proven by court practice.

Latvian Procedure Law Chapter 77 “Recognition and Enforcement of Foreign Court Adjudication” contains only four Sections (Sections 636-639), which are dedicated to the recognition and enforcement of foreign court adjudication. Three Sections (Sections 637-639) regulate procedural activities. In accordance with Sections 637 and 638 of the Latvian Procedure Law the document that initiates the recognition and enforcement of foreign court adjudication process is an “application”, which must be submitted for examination in the district (city) court in territory of which the adjudication is to be enforced. From Section 636, Paragraph one of the Latvian Procedure Law, it follows that in Latvia at this time only adjudication of those states with Latvia has concluded an international agreement may be submitted for recognition and enforcement. An adjudication of a foreign court shall be submitted for recognition and execution within three years from the date of coming into legal effect of the adjudication unless another time limit has been provided for by international treaties.

An application for recognition and execution of foreign court adjudication shall be examined at an open court sitting, notifying the parties of it beforehand. The failure of such persons to attend shall not impede the examination of the application. In examining an application regarding recognition of a court adjudication, the court takes: a decision regarding the recognition and enforcement of the court adjudication; or a decision regarding the rejection of the application.

#### Return of Assets to a Foreign Representative

#### Conflict of Law Issues

#### Bankruptcy Treaties and Conventions

Latvia has accented to The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958), which prescribes the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal.

The insolvency procedures started in another jurisdiction in respect of a corporation incorporated in our jurisdiction are not recognized. This is because of a lack of practice, precedent and national legislation in this area. Latvia is not a member of the Lugano Convention of 16 September 1988 on jurisdiction and the enforcement of judgments in civil and commercial matters.

### **8.0 Proposed or Pending Legislation**

In the nearest future there is pending amendments in the Law On the Insolvency of Undertaking and Companies, which will refer to the state agency “Insolvency Administration”. It is expected that new functions will be added as the right to participate in a creditors meeting, the right to participate in the meetings of a committee of creditors.

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