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Global Legal Group

The International Comparative Legal Guide to:

Corporate Governance 2008

A practical insight to cross-border corporate governance

Published by Global Legal Group with contributions from:

Anderson Mori & Tomotsune
Andreas Sofocleous & Co.
Arnold Bloch Leibler
Ashurst LLP
Bahas, Gramatidis & Partners
BCM Hanby Wallace
Bernotas & Dominas Glimstedt
Blake, Cassels & Graydon LLP
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Zhong Lun Law Firm

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Latvia

Gencs Valters Law Firm

Valters Gencs

1 Setting the Scene - Sources and Overview

1.1 What are the main corporate entities to be discussed?

The corporate entity covered in the below answers is a ***public stock company*** (*publiska akciju sabiedriba*), which is entitled to offer to the public its tradable shares (stocks) by the permission of ***The Financial and Capital Market Commission*** (*Finansu un kapitala tirgus komisija*) on the market of the ***Riga Stock Exchange*** (*Rigas Fondu birza*). Only this type of corporate entity shall be incorporated in the jurisdiction of Latvia in order to offer the tradable shares (stocks) to public. For example such quite common type of corporate entity incorporated in Latvia as a ***limited liability company*** (*sabiedriba ar ierobezotu atbildibu*) is not entitled to offer such securities.

1.2 What are the main legislative, regulatory and other corporate governance sources?

There are two main legislative tools to govern the public stock company. First, the ***Commercial Code*** (*Komerclikums*), which provides the general rules of incorporation, organisation and operation of the public stock company. Second, the ***Financial Instrument Market Act*** (*Finanšu instrumentu tirgus likums*), which provides the legal regulation for the trade of stocks of the stock company to the public. The scope of authority to control the trade of stocks to the ***Financial and Capital Market Commission*** is provided by the mentioned ***Financial Instrument Market Act*** and ***The Financial and Capital Market Commission Act*** (*Finansu un kapitala tirgus komisijas likums*).

A company is entitled to provide its own regulation rules in its Articles of Association as far those do not contradict the requirements of the Law, particularly those provided in the *Commercial Code*.

There are no general Codes of Conduct for the corporate governance. The ***Riga Stock Exchange*** (*Rigas Fondu birza*) has provided ***Corporate Governance Principles and Recommendation on Their Implementation***, which the companies emitting their stock are free to apply in their activity and to what extent.

1.3 What are the current topical issues and trends in corporate governance?

The current and main trend in respect to the corporate governance in Latvia is to facilitate the procedures of registration and the granting of permissions. In general it concerns the simplifying of formalities, reducing the procedural time-frames and providing the possibility to submit the electronic documents to the state authorities.

2 Shareholders

2.1 What rights and powers do shareholders have in the operation and management of the corporate entity/entities?

The shareholders execute their operation and management powers thorough the Shareholders' (Stockholders') Meeting, which is the prime governing body of the company. The Commercial Code of Latvia provides, that only the Shareholders' (Stockholders') Meeting is entitled to take decisions in respect to:

- the annual report;
- the use of profit;
- the election or recalling of the member of the Council, auditor, controller or liquidator;
- the bringing or recalling of action against the member of the Board and Council or Auditor; as well in respect to the appointment of the representative in actions against the member of the Council;
- the amendments in the Articles of Association;
- the increase or reduction of the equity capital of the company;
- the emission and conversion of the company's securities;
- the remuneration of the member of the Council and auditor;
- the termination or continuation if the activities of the company; and
- reorganisation of the company.

2.2 Do indirect shareholders (e.g. beneficial shareholders who hold through nominees), have direct rights in relation to the corporate entity/entities?

Just direct shareholders, whose names appear on the Register of Members, have direct rights deriving from the shares (stocks) of the company. In general an indirect shareholder (stockholder) has no direct rights in relation to the company. Such indirect shareholder (stockholder) can obtain the rights to receive the information, attend meetings, vote and such like, if acting as representative of the direct shareholder. In this case the Power of Attorney in writing shall be provided by the direct shareholder (stockholder).

2.3 Are there any limitations on, and disclosures required, in relation to interests in securities by shareholders?

In respect to the corporate governance there are no limitations on the number of securities a shareholder (stockholder) can hold, or the speed with which he can build a stake in a company. However the statutory requirements of the Latvian Competition Law or Group of Companies Law may apply, but those are beyond the scope of this publication.

As regards to the disclosure a shareholder (stockholder) might be required to notify the company and the *Financial and Capital Market Commission* within 4 trading days of the event or knowledge of it. The requirement to notify might take place if the percentage of voting rights held either directly or indirectly reaches, exceeds or falls below the 5 per cent threshold (for some instances such threshold might be higher). If no statutory requirements to notify are observed, the shareholder (stockholder) is not entitled to execute its voting rights and a decision made in contradiction to this shall be considered as invalid.

2.4 What shareholder meetings are commonly held?

The regular annual shareholders' (stockholders') meetings are commonly held, which shall take decisions in respect to the Annual Report and usage of the profit; any other decisions can be made if included in the agenda as well. The annual shareholders' (stockholders') meeting shall be called by the Board of the company at least 30 days prior to such meeting taking place. The shareholders' (stockholders') meeting shall be notified to any shareholder (stockholder) recorded at the Register of Members; and announced to the official newspaper "*Latvijas Vestnesis*" and at least one more newspaper. The shareholders' (stockholders') meeting is entitled to take valid decisions irrespective of the percentage of votes represented except otherwise provided by the Articles of Association. In general the decision is made by the majority of the votes presented at the meeting. Some decisions (for example in respect to amendments to the Articles of Association) shall be made only by a majority of at least ¾ of the votes presented at the meeting.

2.5 Can shareholders call shareholder meetings or put resolutions?

Shareholders (stockholders) representing at least 1/20 of the total votes are entitled to request the Board to call the general meeting and put resolutions on an agenda. If so provided by the Articles of Association, the lesser proportion of shareholders (stockholders) are entitled for such actions. The Board shall call the meeting within 2 weeks after the request is made. If such request is ignored by the Board, the calling can be done either by the Council of the Company or the Commercial Register Authority.

2.6 Is electronic communication to or by shareholders possible?

For the moment no possibility is provided to communicate the official information to shareholders (stockholders) by electronic means. It is a legal requirement that the announcements for the shareholders' (stockholders') meeting shall be made in writing.

2.7 Can shareholders be liable for acts or omissions of the corporate entity/entities?

The shareholders (stockholders) shall not be liable neither for acts nor omissions of the stock company. Their liability is limited to the amount of their capital contribution on the shares (stocks) for which they have subscribed.

2.8 Can shareholders be disenfranchised?

Shareholders (stockholders) might be disenfranchised for some limited instances. For example, the voting rights attached to their shares (stocks) can be removed if some requirements of disclosure or offer to redeem the shares (stocks) are not observed. The shareholders (stockholders), who are the members of the Board, are not entitled to execute their voting rights regarding decisions in respect to their status and actions. Upon takeover of the company, where 95 per cent of the shares (stocks) have been acquired by a bidder, the remaining 5 per cent might be compulsorily purchased by that bidder.

2.9 Can shareholders seek enforcement action against members of the management body?

The shareholders (stockholders) are entitled to seek enforcement action against members of the management. The members of the Board and Council are jointly liable for the damages made to the company. Such members can escape such liability by proving they have acted as reasonably prudent and careful managers - that means the members of the management body, but not the shareholders, have *onus probandi* in this respect In general the action is initiated by the majority of the general meeting of the shareholders (stockholders); the minority of the shareholders (stockholders) are able to execute the action rights if representing 1/20 of the capital of the company or amount of such capital is at least LVL 50,000.00 (approximately EUR 71,000.00).

3 Management Body and Management

3.1 Who manages the corporate entity/entities and how?

All public stock companies shall be managed by two-level managing body, which consists of the ***Council*** (*Padome*) and the ***Board*** (*Valde*). The Council presents supervisory power, but the Board - the executive power. The Council represents the interests of shareholders (stockholders) during the time periods between the shareholders' (stockholders') meetings and supervises the Board. The Board manages and represents the company, and is responsible for the commercial activities of the company. A company shall be managed by all the members of the Board jointly. In respect to the third persons each members of the Board have representation rights. If separate representation is not provided in the Articles of Association, all the members represent the company jointly.

3.2 How are members of the management body appointed and removed?

The company shall have at least 5 but no more than 20 members of the Council (supervisory management body); and at least 3 members of the Board (executive management body) in order to offer tradable shares (stocks) to the public. The number of members in management bodies shall be specified in the Articles of Association.

The Council shall be elected by the Shareholders' (Stockholders') Meeting for the period not exceeding 3 years. Every shareholder (stockholder) or group of them is entitled to appoint its nominee for

the Council election considering that at least 5% of votes shall be delivered to him at the moment of the general meeting. Such nominees are included on the election list. Voting takes place once for all the nominees included on the list. Those nominees are elected as members of the Council, who gain the most votes considering the maximal number of members provided in the Articles of the Association. Member of the Council can be removed at any time by the decision of Shareholders' (Stockholders') Meeting. In case the member resigns or is removed, the Council elections shall take place for all member positions again.

The members of the Board are elected by the Council for a period not exceeding 3 years. A member of the Board can be removed by the Council because of important reasons, which in any case shall be considered as gross violations of authority, failure to perform duties, an inability to manage the company, or the cause of harm to the company, as well as loss of confidence expressed at a Shareholders' (Stockholders') Meeting.

3.3 What are the main legislative, regulatory and other sources impacting on directors' contracts and remuneration?

The *Commercial Code* of the Latvia provides that the remuneration of the members of the Council (supervisory management body) shall be determined by the Shareholders' (Stockholders') Meeting, but the remuneration of the members of the Board (executive management body) shall be determined by the Council. No legal provisions are provided in respect to the director's contracts. In practice either employment or authorisation agreement is concluded between the company and the member of the management body.

3.4 What are the limitations on, and what disclosure is required in relation to, interests in securities held by members of the management body?

Members of the management bodies neither have limitations to own shares (stocks) nor any limits on the number or proportion of them. General requirements of the disclosure (see question 2.3) apply to the members of the management bodies as well.

3.5 What is the process for meetings of members of the management body?

Meetings of the Council (supervisory management body) can be held as necessary, however not less than once pre quarter. Such meeting can be called by the chairperson of the Council. By providing reasons, any member of the Council or the Board is entitled to make a request to the chairperson to call the meeting. The Council is entitled to make decisions if more than one half of the members of the Council take part in the meeting. Decisions are made by the majority of votes of members participating at the meeting, except otherwise provided by Articles of Association.

Decisions are entitled to be made at the meeting of the Board (executive management body) if more than one half of the members of the Board participate. Decisions are made by the majority of votes of members participating at the meeting, except otherwise provided by Articles of Association.

3.6 What are the principal general legal duties and liabilities of members of the management body?

The principal general duty stipulated by the *Commercial Code* is that a member of the management body shall perform his/her duties as a reasonably prudent and careful manager (*krietns un rupigs saimnieks*). In the light of *Civil Code* that means the members of the management body are liable not only for malicious intent and gross negligence, but for ordinary negligence as well. The standard of a reasonably prudent and careful manager might include reasonable commercial risks the members of the management bodies can meet.

3.7 What are the main specific corporate governance responsibilities/functions of members of the management body?

The standard of a reasonably prudent and careful manager (see question 3.6) *inter alia* includes the responsibilities of the members of the management body:

- to observe the requirements or the legal enactments and regulations;
- to observe the Articles of Association of the company;
- to observe the decisions of the Shareholders' (Stockholders') Meeting;
- to perform fiduciary duties to the company; and
- to perform fiduciary duties to the Shareholders (Stockholders).

The Council (supervisory management body) is entitled to dismiss a member of the Board (executive management body) at any time, if such representative of the company made gross violations of authority, failed to perform or perform appropriately his/her duties, is not able to manage the company, or is causing harm to the interests of the company, as well loss of confidence expressed at a Shareholders' (Stockholders') meeting.

3.8 What public disclosures concerning management body practices are required?

There is a legal requirement to disclose information in the Annual Report concerning management body practices in respect to:

- identification of the members of the management;
- the representative authorities of the members of the Board, including the entitlement for emission and redemption of the shares (stocks); and
- all the agreements between the company and the member the Board, which provide compensation in case of resignation or the discharge.

3.9 Are indemnities, or insurance, permitted in relation to members of the management body and others?

There are no limitations in respect of indemnities or insurance in relation to the members of the management body and others.

4 Corporate Social Responsibility

4.1 What, if any, is the law, regulation and practice concerning corporate social responsibility?

For the moment there is neither a law, regulation nor practice in Latvia concerning corporate social responsibility.

4.2 What, if any, is the role of employees in corporate governance?

There is no considerable role of employees in corporate

governance. The employees can affect the corporate decisions through the labour unions. The Latvian *Commercial Code* provides a possibility for the company to provide to its employees the Employee Stocks, however such stocks shall not provide any voting rights.

5 Transparency

5.1 Who is responsible for disclosure and transparency?

The Board (executive management body) as a whole is responsible for the legal disclosure and transparency requirements of the company. The Board is responsible for the preparation, signing, provision of other necessary procedural steps required, and submission of Annual, Quarterly and Semi-Annual Reports.

5.2 What corporate governance related disclosures are required?

In respect to the general financial information the company shall prepare and submit the Annual Report to the Commercial Register Authority of Latvia, which by this will be accessible to the public. In respect to the offering of the shares (stocks) to the public the company shall prepare the Annual Report and the Quarterly and Semi-Annual Reports, which shall be submitted to the ***Central Storage of Regulated Information*** (*Oficala obligatas informacijas centralizeta sistema*) and published on other mass media.

5.3 What is the role of audit and auditors in such disclosures?

In general, Annual Reports of the companies shall be audited, except for small companies and where performance of the auditor is not provided in the Articles of Association. If a company exceeds certain criteria, such audit shall be made by a sworn auditor. Auditors shall prepare reports to accompany the Annual Reports. An auditor shall be liable to the company and third persons for any damages caused due to the auditor's fault. An auditor shall not be liable for damages resulting from violations of the members of the management, except if such auditor knew or should have known about such violation, but failed to indicate this in his/her audit report.

5.4 What corporate governance information should be published on websites?

The specific information, required by the *Financial Instrument Market Act* to be included in the Annual, Quarterly and Semi-Annual Reports shall be submitted and published on the website of the ***Central Storage of Regulated Information*** (*Oficala obligatas informacijas centralizeta sistema*). This is the information system with easy and free of charge access for the public on www.oricgs.lv supervised by the ***Financial and Capital Market Commission***. Such information includes financial data of the company, description of the shares (stocks), persons with the significant influence *et cetera*. The information in respect to the shares (stocks) might be required to be published on the company's own website.

Valters Gencs

Gencs Valters Law Firm
Valdemara Center, 3rd Floor
21 Kr.Valdemara Street
LV-1010, Riga
Latvia

Tel: +371 6724 0090
Fax: +371 6724 0091
Email: valters.gencs@gencs.lv
URL: www.gencs.eu

Founding partner of the GENCS VALTERS LAW FIRM. **Education:** Law School of the University of Latvia (LL.B., - 1993); Institute of International Affairs (International Business Studies, 1994); Recipient of the U.S. Senator Edmund F. Muskie scholarship, 1994; John Marshall Law School, Chicago, IL, USA; (LL.M., 1995). **Work Experience:** Legal Counsel for Ministry of Foreign Affairs of Latvia (1994); Welsh & Katz, Ltd., Chicago (1995); Member of the Working Group on Tax Law appointed by the Prime Minister (1997); Member of the Working Group on Intellectual Property Protection and Enforcement Issues appointed by Prime Minister (1999); Head of Tax & Legal department of Ernst & Young Latvia, Head of Tax ad hoc group of the Foreign Investors Council in Latvia (1998-2002). **Publications:** On editorial Board of Tax Analysts (USA) Member: Latvian Bar Association; IBA, AIPLA; FICPI, ECTA; AIPPI; LES USA & CANADA; ITMA; INTA; MARQUES, GRUR, European Patent and Trademark Attorney. **Practice areas:** Tax; Competition, Finance; Litigation; Intellectual Property. **Languages:** English, Latvian, Russian.