FOREIGN INVESTORS' COUNCIL IN LATVIA

POSITION PAPER ON INVESTMENT PROTECTION

Position Paper No. 6

FICIL

26.09.2024

EXECUTIVE SUMMARY

Investment protection is crucial in order to ensure long-term economic growth and to create a favourable business environment. FICIL has long emphasised the need for a transparent and reliable legal framework that protects both domestic and international investors. However, frequent changes in legislation and concerns about the quality of legislation create uncertainty among entrepreneurs. Data published by the European Commission shows that almost half of company directors in Latvia doubt whether the law and the courts will be able to protect their investments should problems arise.[1]

In order to address this situation and alleviate concerns, there is a need for not only incremental reforms, but also for a strategic approach to reforming the legislative process in order to promote stability, consistency and transparency. FICIL commends the progress achieved in implementing the recommendations made previously and particularly highlights the work initiated by the State Chancellery to introduce more consistent "ex post" assessments of legislative acts.[2] While progress can be observed on some issues, this year we continue to draw attention to a number of areas where we would like to see positive change. Investors expect predictable and well thought-out (data-driven) legislative changes, efficient courts and a more accessible and result-oriented public procurement process. FICIL would also like to remind that for foreign investors who have made their investments for the long term, the rules must remain unchanged.

Meeting the aforementioned challenges would create a predictable, transparent and investment-friendly environment. It is important to not only protect existing investments, but also to ensure that new investors feel reasonably assured that their investments shall be protected in the event of any problems.

1 European Commission (2024) "Perceived independence of the national justice systems among companies" (link)

2 The State Chancellery is currently working on the preparation of an "ex post" methodological assessment and is actively providing comments on the TAP regarding the relevant draft laws (during the harmonisation process), so that "ex post" assessments can be prepared for those. One example is the Climate Law (pending adoption), where an "ex post" assessment, with a deadline of end of 2028, is included in the annotation. There is a dedicated person in the analytics department of the State Chancellery who is working directly on the methodology for the "ex post" assessment

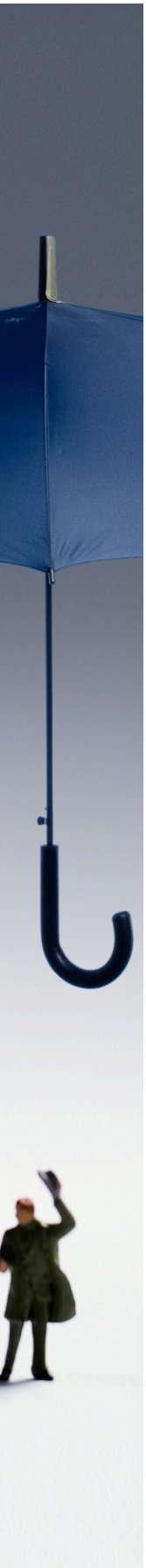

TABLE OF CONTENTS

RECOMMENDATIONS

IMPROVING THE QUALITY OF LEGISLATION

- Use data more effectively in policy-making, including by informing stakeholders.
- Strengthen the legislative process by giving stakeholders sufficient time to provide comments.
- Set a new amount for legal land use fees and develop a specific framework for critical infrastructure.

IMPROVING THE CAPACITY AND EFFICIENCY OF THE JUDICIARY

- Establish an appellate court for the Economic Affairs Court.
- Continue the digitalisation of the courts.
- Strengthen the competence of judges, in particular in the matters concerning the private sector and business.
- State administration should become engaged in the development of an appropriate investment protection model at the EU level.

REGARDING STATE-OWNED ENTERPRISES

- Review and extend the scope of Article 88 of the State Administration Structure Law.

IMPROVING THE PUBLIC PROCUREMENT PROCESS

- Work towards building a results-oriented public procurement policy.
- Promote cost-efficient public procurement. Implement the recommendations which were outlined by FICIL to improve the public procurement process in order to involve more foreign businesses in tenders.
- Improve the management of procurement contracts and make it more balanced.

RATIONALE FOR RECOMMENDATIONS

QUALITY OF LEGISLATION

Use data more effectively in policy-making, including by informing stakeholders

For many years, FICIL has been emphasising the need for data-driven decision-making in the public sector. In order to achieve this, one must ensure the availability of data and the opportunity to use it in a targeted way. FICIL therefore recommends strengthening data governance, including through ensuring the standardisation of data across the public sector. When a greater volume of data is used in the decision-making process, the decisions are generally more informed, and likewise the transparency is increased and the legislation is of higher quality overall, which in turn leads to greater trust in public administration.[3] The use of technology and data in decision-making can also offer a broader and deeper perspective, helping to quantify or show the risks, understand the context, and identify opportunities and potential outcomes.[4]

The government has already recognised the need to improve data-driven decision-making in various sectors.[5] Immediate steps can be taken in order to facilitate such evidence-based policy-making.

FICIL recommends that an additional section be introduced in the amendment or annotation part of legislative acts which are published on the Single Portal for Development and Harmonisation of Draft Legal Acts (TAP portal). In this section, the ministry which is responsible for the legislative act should indicate whether there is data available to support the proposed legislation or amendment, and whether this data supports the proposed motion. This would ensure that decisions are based on the specific data available and would inform the stakeholders in a more adequate way. All stakeholders would have the opportunity to find out whether data is available at all and whether it is used in the draft legislation. It shall also show the public sector what data might be needed in the future for making more informed decisions and shall improve the transparency of proposals.

Strengthen the legislative process by giving stakeholders sufficient time to provide comments

Firstly, there is a need to prevent belated submission of laws or amendments thereof, new proposals, as well as changes, to the Saeima, especially before the third reading. The case of the amendment of Article 49 of the Energy Law, for instance, has shown that substantial changes without proper consultation with the stakeholders may lead to chaos and negative consequences.[6] **In order to prevent this, mandatory requirements should be introduced for the submission of proposals to the Saeima for the third reading, ensuring their compliance with the Satversme of Latvia. Each proposal should be accompanied by a written justification which should include both its objectives and a description of the consultations carried out during its preparation.**

Secondly, the legislative process would be significantly improved by the introduction of new introductory texts (preambles) to the laws. Preambles would clearly define the objectives of the legislation, boost public confidence in the judicial system and provide improved leadership opportunities for the law enforcement authorities. It would contribute to more precise and coherent drafting of legal texts, thus making legislation more transparent and substantiated.

---

3 OECD working paper (2019): "A data-driven public sector: Enabling the strategic use of data for productive, inclusive and trustworthy governance" (link) and European Commission (2023) "Better Regulation Toolbox" (link)
4 Deloitte (2023) "The human touch: The 'invisible' force behind data-driven decision-making" (link)
5 Mentioned several times in the government action plan (link)
6 Article 49 of the Energy Law was substantially amended following the proposals from several parliamentarians. In the third reading, important amendments regarding which the industry association had not reached an agreement became known, but they were nevertheless approved by the MPs. The process became even more chaotic when the Ministry of Climate and Energy made further last-minute changes (link to the amendments)

Thirdly, the time limits set for the stakeholders to review and comment on legislative acts should be increased and consistently respected. Currently, for example, only four working days are given to comment on the updated draft of the National Energy and Climate Plan 2021-2030,[7] and less than five working days to comment on the report "On the Development of the Economy of Latvia".[8] This kind of practice is not appropriate. Routinely, a standard type of procedure should allow a minimum of 10 working days for the preparation and submission of stakeholder comments, especially when a draft law is being revised anew.[9] This is important in order for the stakeholders to fully understand and assess the changes, and to react to them accordingly.

Finally, the review process itself needs to be improved. The current system of compiling stakeholder comments or statements **should be complemented by detailed explanations of the changes that have been made and how they are to be applied to the different versions of the draft law. Technical improvements should also be sought, which would facilitate the comparison of different iterations of the legislation and help to clearly highlight and explain the most relevant changes based on the comments.**

Improving the quality of legislation is a continuous process that demands increased transparency. By introducing improvements, Latvia can substantially increase the quality of legislation, strengthen investment protection and foster a more stable and transparent business environment.

Set a new amount for legal land use fees and develop a specific framework for critical infrastructure

In order to attract foreign investment and ensure economic growth, it is crucial to provide for a transparent mode of determination for the legal land use fees for such critical infrastructure facilities as ports, airfields and other facilities, the true value of which is determined not by their cadastral value but by their strategic importance for national security and economic growth.

It has been almost three years since the introduction of the legal land use rights, but there are still a number of legal challenges that encumber business activity and discourage foreign investors from developing investment projects, especially in port areas, which are subject to strict regulatory requirements and specific use permissions. Although the law stipulates a legal land use fee of 4% of its cadastral value, the Constitutional Court has recognised that such amount of the legal land use fee is unconstitutional, and since 1 July 2024 this legal rule is no longer in force. The legislator has still not determined a different amount of the legal land use fee, thus, **at present, there is a *de facto* a lack of legal regulation, which in turn creates uncertainties in the legal relations between the parties.**

Currently, there are still ongoing discussions on the applicability of legal land use rights in port areas and whether the amount of legal land use fees poses a risk of unequal treatment towards the commercial operators who can agree with the port authorities on any other amount of land rent fees. **FICIL stresses the need to ensure the protection of foreign investments in order to strengthen the position of Latvia as an important logistics centre.** Therefore, a clear legal framework and a set amount of legal land use fees that can ensure fair conditions of competition are necessary.

FICIL recommends the adoption of a new amount of the legal land use fee, as well as a special regulation concerning the legal land use rights for critical infrastructure objects. This would make it possible to agree on a different amount of the legal land use fee, taking into account such factors as the necessary investments in infrastructure objects, the specifics of economic activity and the scope of its implementation, the economic situation and other criteria that would allow to objectively determine a reasonable amount of the legal land use fee.

7 The updated draft of the National Energy and Climate Plan 2021-2030 and the submission of its summary to the European Commission for evaluation (23-TA-1961)
8 On the Development of the Economy of Latvia (24-TA-1057)
9 Rules of Procedures of the Cabinet of Ministers Article 55

STATE-OWNED ENTERPRISES

Review and extend the scope of Article 88 of the State Administration Structure Law (SASL)

In Latvia, state-owned companies are relatively less developed than in the neighbouring countries. There is a current positive trend towards strengthening corporate governance in line with best practices, and the new generation of managers are keen to drive innovation and exports. Therefore, **it is important to address the issue of Article 88 of the SASL[10] and allow commercial state-owned enterprises to operate in a free market environment, as well as to promote the development of their activities outside of Latvia.** Good examples already exist in the Baltic states. A recommended solution to achieve this is to list a part stake in the state-owned enterprises on the stock exchange, without losing control. Minority shareholders can provide new challenges for the managers (of these companies), extend their fiduciary duties and allow them to increase the value of the company in more efficient ways.

The participation criteria listed in Article 88 (1) of the SASL are merely the result of a political resolution as to what, in a given legal and economic situation, are the most reasonable criteria for State participation in capital enterprises. Although the necessity of the criteria in Article 88 (1) of the SASL is often being justified on the grounds of ensuring the functioning of a free and fair competitive market, these criteria are not directly related to the prevention of practices that distort competition. In the current legal situation, even if a particular activity of a state-owned enterprise does not conform to the legal criteria of Article 88 (1) of the SASL, there is no reason to apply an automatic presumption that the service in question distorts free and fair competition.

On a global scale, the governance module for the enterprises controlled by public entities differs significantly from the intensive supervision module which is implemented in Latvia. In other countries, the state's participation in enterprises is likewise permissible in order to achieve such objectives as: promoting the employment of skilled professionals within the country (Norway); ensuring a special link with the state, diversifying the economy, generating innovation and supporting sustainable structural change (Finland); preserving cultural values, fostering science and innovation, promoting employment for specific social groups (Sweden).

Since the regulation on competition neutrality came into force in early 2020, the Competition Council has not adopted any decisions where infringements of Article 14.1 of the Competition Law would be found. **On the other hand, when it comes to potential infringements in the last four years, there have been only 14 cases, and therein competition neutrality was ensured as a result of a negotiation procedure. One of the main factors contributing to the low number of infringements of competition neutrality is the overly restrictive regulation of Article 88 (1) of the SASL.**

In order to promote the economic growth and development of Latvia, one should **assess the possibility of abandoning the legal supervision of the criteria of Article 88 (1) of the SASL, seeing as free and fair competition can be achieved through a much less restrictive mechanism: supervision of competition neutrality under Article 14.1 of the Competition Law.** With the amendments to the Competition Law, the significance of the criteria of Article 88 (1) of the SASL (restricting the activities of a public entity in the private sector in order to ensure free and fair competition) has been substantially reduced, thus warranting a reassessment of the current operational structure of Article 88 of the SASL and of the related regulatory framework.

FICIL believes that an extension of the scope of Article 88 of the SASL should be considered. Aware of the current political stance and of the sharply diverging views of the institutions and organisations involved, it should be recommended to choose the most conservative module possible when it comes to the changes to the module of supervision of the enterprises controlled by public entities: a module which achieves the objective with as little

10 https://likumi.lv/ta/id/63545-valsts-parvaldes-iekartas-likums

amendments as possible (e.g. by introducing an additional basis for the scope of applicability of the Article 88 of the SASL, including rational use of resources, achievement of the strategic objective of state-owned enterprises, and innovation).

IMPROVING THE CAPACITY AND EFFICIENCY OF THE COURTS

Establish an appellate court for the Economic Affairs Court (EAC).

Currently, the EAC is the only specialised court in Latvia that hears certain categories of civil and criminal cases and that has lived up to the expectations placed on it to improve the quality and efficiency of case handling. The EAC's rulings are based on an assessment of the circumstances and facts of commercial activity, and they reflect the judges' understanding of the specific area of commercial activity. This ensures confidence business have in the EAC. Entrepreneurs appreciate the assessments of the facts and the law which are included in the EAC's judgments; it is visible, for example, when they choose to accept even partially favourable judgments and avoid submitting an appeal, because the judgments are clearly substantiated, with understandable reasoning.

Taking into account previous FICIL suggestions, we recommend the creation of an appellate court for the EAC to ensure consistent review of judgements with a focus on the commercial perspective and to promote the development of coherent case law in the categories under the jurisdiction (competence) of the EAC. Additionally, we recommend expanding the range of cases to be heard and, in the future, assigning the arbitration support functions within the competence of the EAC. This would position the court as a specialised institution for resolving commercial disputes, encouraging parties to turn to arbitration, relieving the burden on general jurisdiction courts, and building greater trust in arbitration as a whole.

Continue the digitalisation of the courts

The digitalisation of the court system of Latvia has advanced considerably, so it is of particular importance that the *E-file* (*e-lieta*) is fully implemented and becomes usable, and that court staff are properly trained.

When assessing the practice of other European countries, one has to conclude that Latvian courts lack consistency in the use of digital solutions, which affects the rights of litigants and procedural equality. The organisation and necessity of remote hearings should also be assessed, and the cases in which remote hearings are organised should be determined in order to ensure that all the principles of the administration of justice, including openness, are respected.

Strengthen the competence of judges, in particular in the matters concerning the private sector and business

The use of digital solutions and the organisation of remote hearings raises many issues that each formation of court deals with differently. This affects the rights and obligations of the parties and, in relation to the time limits set for the parties or the procedural steps taken, creates an unequal situation for the parties during or before the hearing. These differences are in part due to the skills or habits of the composition of the court. However, the law must be applied equally to all participants, and deviations or inconsistencies that provide advantages to one party are not acceptable.

It has also been noted that in **complex cases, judges find an opportunity to refuse to initiate proceedings because they do not understand the merits of the case or because of other circumstances.** Such cases are evidenced by a repeated submission of the claim and a decision by another judge to open the case.

It has been observed that administrative courts in particular are composed of a relatively large number of judges who have previously worked in public administration and who examine cases through the prism of state or municipal institutions, tolerating the

inaction (or shortcomings) of these institutions during case examination.

In this context, the upcoming launch of the Judicial Academy at the beginning of the next year is crucial. It will provide essential training for all judges and court staff, helping to ensure that cases are handled fairly and efficiently, and that judgments are prepared in accordance with the law.

State administration should become engaged in the development of an appropriate investment protection model at the EU level

Most EU countries have decided to terminate bilateral investment treaties (BITs). This means that there is currently no single and clear EU framework for resolving investment disputes. In recent years, discussions have emerged within the EU about creating a unified model and court for resolving investment disputes. However, these discussions have remained at a preliminary stage without any concrete proposals. FICIL calls upon the Ministry of Justice to actively engage in the development of an appropriate investment protection model at the EU level and to use the available opportunities to articulate its position in order to promote the establishment of a foreign investment protection mechanism for investors from EU Member States and, consequently, to strengthen the investment environment in Latvia.

One of the key criteria for investors when making decisions is the ability to protect their investments and, in the event of an infringement of their rights, to seek a fair resolution and settlement. Countries that have a strong investment protection mechanism are positioned at an advantage when it comes to attracting new investors. In the EU, it is a common practice for investors to structure their investments in such a way that the latter are covered by investment protection treaties and, in critical cases, to have the possibility of recourse to a non-national arbitration institution as a neutral body to protect their (the investor's) rights. As a result, investors choose non-EU countries for their investments, and such decisions are not to the benefit of the EU Member States, including Latvia.

Additionally, more and more Latvian companies are starting or expanding their business activities within the EU, and for them as well, a reliable and functional dispute resolution mechanism for investment-related matters is crucial. This applies to both employment and tax revenue, and is also closely linked to the contribution to the national economy as a whole.

The current Civil Procedure Law of Latvia provides for the competence of the EAC to hear "claims of investors from the Member States of the European Union against the State of Latvia regarding the protection of investments". The EAC hears cases as a court of first instance, while appeals are heard by the Riga Regional Court, which is not a specialised court. **Accordingly, one may conclude that the law provides for the investment disputes between EU Member States to be heard by courts of general jurisdiction in Latvia, and, in order to file a claim, one has to pay a hefty state fee, for which there is no maximum limit. Under these circumstances, EU investors have only formal access to court protection for their investments, and there are no known cases where an investor has used this option and the case has proceeded to a final court judgment.**

To promote investment protection in Latvia, particularly from EU member states, we urge the Ministry of Justice to actively engage at the EU level in the creation of an appropriate foreign investment protection model and court institution.

IMPROVING THE PUBLIC PROCUREMENT PROCESS

Work towards building a results-oriented public procurement policy

Transactions conducted within the public procurement system constitute a significant part of Latvia's national economy. When a country makes international commitments and pledges to comply with those commitments, for example in the environmental, human rights or social areas, it often seeks to achieve the objectives of those commitments through its procurement policies. As Latvia currently has a decentralised procurement

system, the cascading of the country's procurement objectives is extended to more than 1 000 different procurers or contracting authorities.

Without changes to the approach and management of procurement by these contracting authorities, it is extremely challenging to introduce the necessary improvements and adopt best practices that would help achieve national objectives, particularly in the implementation of strategic procurement. The procurement policy of each contracting authority must be focused on deliverable results which are within its remit. Compliance with the laws and regulations governing procurement is not an end in itself, but rather a starting point and a means to achieve a goal. **As long as there is no clear role or responsibility assigned to each leading official within the contracting authorities for the efficiency of their procurement functions, these functions will continue to evolve based solely on individual initiative.**

So far, the state administration has not provided investors with clear reassurances concerning the specific long-term objectives of the contracting authorities and the milestones by which these environmental, social or innovation objectives are to be achieved. Without certainty about the specific outcomes that each contracting authority aims to achieve in the coming years, investments in areas requiring public procurement are expected to be limited to satisfying private sector demand.

FICIL continues to receive reports of artificial barriers created by contracting authorities that hinder fair competition and the organisation of the most economically advantageous procurements. It is crucial for contracting authorities to recognize early on whether the services or goods being procured can vary in quality and how important this quality is relative to the price they are willing to pay. Unjustified quality requirements in the qualification or evaluation criteria of procurements not only restrict competition and reduce the benefits gained but also undermine trust in contracting authorities as responsible stewards of public funds.

Additionally, concerns have been raised by oversight bodies about the lack of comprehensive evaluations of public procurement efficiency. FICIL believes that efficiency assessments should be carried out, analysing both specific sectors and the procurement system as a whole, to avoid situations where contracting authorities are primarily focused on spending money rather than achieving the most effective (best) outcomes.

Promote cost-efficient public procurement. Implement the recommendations which were outlined by FICIL to improve the public procurement process in order to involve more foreign businesses in tenders

To date, no additional requirements imposed on either the contracting authorities or bidders in procurement procedures have been evaluated in terms of costs. Consequently, this has resulted in administratively heavy and resource-intensive activities.

In Latvia, participation of foreign bidders in public procurement is hampered by disproportionate verification requirements, in particular in matters regarding beneficial ownership and tax debts. Instead of encouraging foreign bidders to participate in procurement, they are subjected to formal requirements which are difficult to comply with due to different regulatory frameworks in their home countries. These formal requirements, once fulfilled to avoid exclusion from the procurement process, are no longer monitored after the contract is awarded, indicating that they are only relevant at a specific moment but not when public funds are actually transferred to a potentially non-compliant company.

Therefore, **FICIL has urged the public sector to simplify and streamline the process for bidder verification by**:[11]

1) replacing certificates with self-declaration wherever possible;

2) reviewing the tax debt threshold and providing an option for bidders to settle the debts;

3) reducing the need for translations, FICIL proposes that translations should only be required

11 FICIL letter sent to the Ministry of Finance on July 24 of this year

when necessary, and documents in foreign languages should be accepted, which would require the State Language Centre and the Procurement Monitoring Bureau (PMB) to get involved in establishing a common position;

4) ensuring that exclusion criteria are relevant and applied even after the contract is awarded;

5) strengthening the capacity of PMB to provide clearer guidance to promote consistent practices among contracting authorities.

The costs for bidders to participate in procurements should be proportional to the value of the procurement, and contracting authorities should avoid dedicating excessive resources to the procurement process if it diminishes the return on investment for each euro spent.

Until the public sector conducts a **detailed assessment of the costs and benefits associated with the current procurement procedures (under the existing procedural requirements)**, a constructive discussion on procurement system reform is not possible. The last attempt of substantive review of the procurement system occurred in 2022 through the Procurement Centralisation Information Report,[12] which contained several proposed actions, the status of which remains unknown.

FICIL calls for **more comprehensive collection and publication of data related to public procurement.** For example, regarding procurement centralisation, how many ministries and municipalities have initiated procurement centralisation in recent years, and how many have actually implemented it? FICIL believes it is essential to reflect on past achievements by providing concrete examples. This would also allow to assess the qualitative benefits of possible proposals.

FICIL remains of the opinion that cooperation between state institutions is still weak, except where it is defined by detailed rules of conduct. This also relates to the area of public procurement. Any state official involved in organising procurement must act in accordance with the law, but they cannot be expected to act as an expert in every area of procurement. While FICIL is aware of the importance of following legal procedures, the importance of economic and business acumen cannot be ignored. Often, it is the latter that is key when it comes to securing the best economic outcome. Repeated participation in procurement procedures improves the officials' understanding of specific or complex procurements, which is why close cooperation with experienced procurement professionals is important.

State authorities should be encouraged to help and seek help from each other in the planning, design and monitoring of complicated procurements. Cooperation should start with, but should not be limited to, institutions in the same policy planning area. The suggested (closer) cooperation does not require increased resources from the state. Although the potential reallocation of resources may affect the budgets of individual institutions, but the savings made in the general state budget would significantly outweigh this.

Improve the management of procurement contracts and make it more balanced

The most important part of the public procurement process is not the process itself, but the conditions under which the services or goods are procured. This determines the degree of competition in the procurement as well as the cost and quality of the subject of procurement. The current focus is on preserving previously used contract terms and minimising risks for the contracting authority, rather than improving the procurement contract conditions to enhance competition and maximize benefits for the authority.

According to FICIL, the interests of the parties in procurement contracts are not balanced. There are unequal terms, with the contracting authority having the right to unilaterally withdraw in minor cases, while the contractor is not granted such an option. Additionally, contracts often lack provisions for predictable modifications or impose contractor liability without reasonable limits. As a result, costs can increase, or foreign bidders may choose not to participate due to disproportionate risks, as the

12 Informative Report (2022) "On the Centralisation of Public Procurement"

terms of procurement contracts do not align with standard business practices. In the worst-case scenario, contract execution can reach a deadlock, where the contractor must fulfil the contract despite delayed payments from the contracting authority, leading to the risk of insolvency for the contractor.

Contract management is not a matter of regulations but rather a reflection of the culture of each contracting authority and public administration. For years, the law has provided various tools for managing contract risks, but they are rarely used in practice. This is mainly due to a lack of experience and/or fear of scrutiny by the PMB, the State Audit Office, or the courts, which often stems from significant knowledge gaps. When the need arises during contract execution to consider amendments and their permissibility or significance, the quality of the contract is often insufficient to allow these tools to be properly applied in the contracting authority's interest. This applies to changes in deadlines, price adjustments, and other risk management mechanisms that could have been incorporated into the contract from the start or at least mentioned. **Unfortunately, even Latvia's largest public infrastructure projects are currently facing these issues, which has hindered finding solutions and continues to erode foreign investors' trust in the country's public procurement processes.**

FICIL

FOREIGN INVESTORS' COUNCIL IN LATVIA

POSITION PAPER ON INVESTMENT PROTECTION

Position Paper No. 6
26.09.2024

www.ficil.lv