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Arbitration in Latvia: Urgent Need for Statutory Reform

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(*) (**)

The Saeima (Parliament) of the Republic of Latvia passed a new Civil Procedure Law ("CPL") on October 14, 1998, which became effective on March 1, 1999. The CPL contains a chapter dealing with arbitration and thus Latvia now has a comparatively new statutory regulation pertaining to arbitration, which attempts to incorporate new developments in international arbitration. Nevertheless, there has been criticism of the new law from Latvian politicians, governmental officials, and the business community, who plead for expeditious reform.

To understand the problems inherent in the current statutory regulation in Latvia, we must first briefly examine the historical development of the Latvian State and in particular its arbitration legislation.

Latvia declared itself an independent state on November 18, 1918, and the international community recognized Latvia's independence in 1921. In 1929, Latvia joined the League of Nations and in 1940 Latvia was incorporated into the Soviet Union, although it regained independence in 1991.

Until 1940, the Russian Civil Procedure Law of 1864 (as amended between 1920 and 1940) governed domestic arbitrations in Latvia. During this time two permanent arbitration institutes were established; one at the Latvian Chamber of Commerce and Industry, and another at the Latvian Craftsmen Chamber. However, only a few domestic arbitrations took place, and no international arbitration cases were reported during this time in Latvia.

Until 1991, all commercial disputes were settled either by the State courts or by the State Arbitration Court, a type of commercial court still known in Russia as *arbitrazhnyi sud*. There were no permanent arbitral institutions in Latvia where domestic and international commercial disputes could be settled. Private arbitration to resolve a dispute between two physical persons was allowed by the Soviet Procedural Law.

The Latvian judiciary has been reformed in accordance with the 1993 Law on the Judiciary. Pursuant to this legislation, the Commercial Court (the former State Arbitration Court) was dissolved in 1995, and the courts became the only forum for commercial disputes. However, the courts were in practice inefficient in dealing with commercial disputes. Their caseloads increased dramatically due to the substantial number of cases and the length of time taken in reaching final rulings on the merits of disputes.

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In the meantime, several laws (e.g., the Civil Procedure Code and the Law on Foreign Investments) provided that commercial disputes could also be settled by means of arbitration. The first permanent international arbitral institution in Latvia was established in March 1992, when the Latvian Chamber of Commerce and Industry approved the Charter of the International Arbitration Court. After the closure of the Commercial Court, both domestic and new international arbitral institutions emerged and their number is constantly increasing. According to the Ministry of Justice there are now more than eighty registered permanent arbitration courts in Latvia.

In short, Latvia's existing 1998 arbitral statutory regulations (as part of the new CPL) were adopted at a time when Latvia did not have a strong tradition of settling disputes by arbitration, the judiciary did not want to deal with arbitral matters and supporters of former State arbitration were lobbying for minimal court control and interference.

I The Current Legal Framework for Arbitration

Chapter D of the CPL, which deals with arbitration, was initially based on the UNCITRAL Model Law on Commercial Arbitration. (1) However, draft provisions with respect to court assistance in formation of the arbitral tribunal and during the arbitration process, as well as regarding the setting aside of the arbitral award, were struck out before the CPL was enacted. Article 488 of the CPL provides that only procedural provisions of Chapter D of the CPL are binding on an arbitration. Since there is no legal distinction made between international and domestic arbitration, the procedural provisions of Chapter D of the CPL are applicable to both.

The CPL does not directly define the term "arbitration" but in accordance with the CPL's Commentary "arbitration is a non-governmental entity reviewing and adjudicating cases falling within its jurisdiction." (2)

Until 1996, the Civil Procedure Code provided that an arbitral tribunal should be established following the agreement of all parties engaged in the dispute (3) but today, in accordance with international standards, the CPL states that the parties shall be free to submit their disputes

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to a permanent arbitral institution and to an ad hoc arbitral procedure. (4)

A Arbitrable matters

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All disputes relating to civil matters are arbitrable, except disputes:

(1) connected to changes in the registration of civil status deeds; (5)

(2) connected to the rights of persons under trusteeship or guardianship, or with the rights of persons found insolvent or with their interests protected by law;

(3) amending or terminating legal interest in real estate, if one of the parties to the dispute is limited by law from acquiring real estate;

(4) the adjudication of which may infringe the rights or the interests protected by law of such a person as is not a party to the arbitration agreement;

(5) in which at least one party is a state or local government institution. (6)

Article 487 of the CPL is considerably different from the former Civil Procedure Code, which prohibited the arbitration of disputes relating to family and employment matters. The CPL now permits the arbitration of employment disputes and there are only two exceptions concerning disputes arising from family matters.

This law also prohibits the state and municipal institutions from taking part in domestic arbitration. However, most agreements (investment and other) to which Latvia is a party contain arbitration clauses and the CPL does not apply to international arbitrations to which the Latvian Government is a party. Article 25 of the Latvian Civil Law states that the Law's provisions are applicable insofar as it is not prescribed otherwise in international agreements and Conventions to which Latvia is a party. In addition, according to the statutory hierarchy of laws, international agreements prevail over national laws.

However, Latvia recently ratified the European Convention on International Commercial Arbitration (7) with a reservation to the effect that legal persons considered by the applicable law as “legal persons of public law” will not have the right to conclude valid arbitration agreements. (8) We presume that this reservation was made to prevent Latvia being involved in lengthy and costly international arbitration proceedings, in which Latvia has so far been unsuccessful. Due to a lack of legal resources, many investment agreements concluded between Latvia and foreign investors were drafted to favour the foreign party, leading to Latvia losing several international arbitrations.

As information about arbitral proceedings involving Latvia are made known to the public due to statutory principles of freedom of information, including information about public funds awarded to foreign investors, the proceedings are discussed in the media and the general attitude of the Latvian public to such proceedings has become increasingly negative.

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With the latest amendments to the CPL, which came into force on January 1, 2003, a new provision was added to this article stating that arbitration is not permitted where one of the parties is insolvent. This is a logical amendment based upon the fact that persons found insolvent partly lose their legal capacity and status as a legal person. (9)

B Arbitration agreement

An “ ‘Arbitration agreement’ is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.” (10) The CPL does not provide any direct rules for dispute resolution arising from non-contractual relationships, leaving space for wide interpretation. For instance, Article 487 of the CPL provides a list of non-arbitrable matters but does not mention non-contractual disputes. On the other hand, Article 514 of the CPL provides that to initiate arbitral proceedings, the claimant must submit a Statement of Claim and attach to it the contract in connection with which the dispute has arisen.

The CPL requires that arbitration agreements be in writing (11) and this provision is harmonized with Article 7.2 of the UNCITRAL Model Law, with the exception that the Latvian statute does not provide that the arbitration agreement can be made by an “exchange of statements of claim not denied by another.” It will be considered that the parties have entered into an arbitration agreement if in their contract or other written document they have referred to certain rules or documents providing for dispute resolution by means of arbitration.

A declaration or ruling that the contract containing the arbitration clause is invalid does not invalidate the arbitration agreement. At the same time, the CPL provides that parties have the right unilaterally to withdraw from the arbitration agreement if the arbitral tribunal is not formed; if no procedural activities take place for more than four months from the commencement of arbitral proceedings, or if the final award on the merits of the dispute is not rendered within one year from the commencement of arbitral proceedings. (12) This provision primarily ensures swift arbitral proceedings, yet parties may use it deliberately to delay proceedings. The law gives parties to an arbitration the possibility to agree on different time limits. In practice, the arbitration rules of permanent arbitral institutions provide that the arbitral tribunal may prolong the time limit for rendering an award or other procedural time limits upon the request of a party.

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If parties have concluded the arbitration agreement, the court is obliged to return the Statement of Claim to the claimant as provided by Article 132 of the CPL. Equally, the court must terminate pending proceedings based on Article 223 of the CPL if the parties have entered into an arbitration agreement after court proceedings have commenced.

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C The arbitral process

Article 506 of the CPL provides that parties can freely agree on the arbitration proceedings. If there is a reference to a specific arbitral institution in the arbitration agreement, the arbitration is to be carried out in accordance with the rules of that arbitral institution. According to Article 495 of the CPL, the arbitral tribunal decides on its own jurisdiction over the dispute brought before it.

An arbitrator can be any legally capable person regardless of his/her citizenship or place of residence and should be independent and impartial. (13) The old Civil Procedure Code placed certain restrictions on arbitrators, including precluding persons who had lost the right to be judges or prosecutors, and those who had criminal convictions, from serving as arbitrators. (14)

The Law on the Prevention of Conflicts of Interest in Activities of Public Officials (15) limits the scope of activities of public persons, stating that judges, notaries, prosecutors, and public officials cannot be appointed as arbitrators. Otherwise, the CPL leaves the parties and arbitral tribunals to establish additional restrictions or requirements concerning the qualifications of arbitrators.

Nevertheless, the legal definition of impartiality and independence of judges and arbitrators is not clear and the possibility for corruption in this area cannot be excluded. Consequently, the Government has initiated a discussion with the legal community to determine whether arbitrators should have the same status as public officials. If an arbitrator is treated as a public official then (s)he will gain the same status as the State President, Members of Parliament, judges, and prosecutors. A special law has been adopted to ensure that actions of public officials are in the public interest, and to prevent personal or financial conflicts of interest. (16)

However, the Ministry of Justice considers that expanding the concept of public official to include arbitrators in order to be able to bring them to trial for corrupt activities is not an appropriate way to regulate their behaviour. There is currently a discussion under way about changing the law to provide more specific requirements concerning arbitrator's qualifications and to introduce a special licensing system for arbitrators.

The rules of a permanent arbitral institution should set out the proceedings regarding the appointment of arbitrators. For ad hoc arbitration with a three-member tribunal, each party appoints one arbitrator and they in turn appoint the chairman. (17) Article 493 paragraph 4.1 provides that if the parties cannot agree on an arbitrator for a period of four months from the date of commencement of proceedings, and this term is not extended, then one party can unilaterally withdraw from the arbitral proceedings. This situation is very likely in ad hoc arbitrations because if a party fails to appoint an arbitrator the law does not provide for the possibility of applying to the courts to appoint an arbitrator instead of the party in default.

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Article 501 (Grounds for Challenge) is almost identical to the UNCITRAL Model Law. However, the CPL does not provide for a solution in cases where one party has not appointed an arbitrator or if the appointed arbitrators cannot agree on the chairman of the tribunal. The law provides that if the arbitration agreement does not set forth another authority, the arbitral tribunal has to decide on a challenge to one of the arbitrators. The law does not empower the courts to review such challenges and therefore a party cannot obtain court assistance in this respect.

Interim measures of protection may be ordered by the court, but only before the arbitral proceedings have been initiated. (18) Article 138 of the CPL provides that:

a potential plaintiff can request the securing of a claim prior to its filing in the court and even prior to the setting in of a commitment term if the debtor, in order to avoid fulfilling the commitment, is withdrawing or alienating his own property, leaving his place of residence without informing the creditor, or performing other activities which certify that he is dishonest.

The application must be submitted to the court that has jurisdiction over the debtor or his property.

As for the arbitration process itself, the CPL leaves it to the parties to decide this in the arbitral agreement or in accordance with the Rules of the Arbitration Court. (19) While the arbitration law was still in development, the UNCITRAL Arbitration Rules were widely used in Latvia as the basis for determining the arbitral proceedings.

The parties must use the State language (Latvian) in the proceedings unless agreed otherwise. This provision has its roots in the post-Soviet era, when the issue of the official language was of high priority on the pro-independence agenda, amidst continuing protest against Russification.

Questions regarding the arbitration costs are regulated by the Rules of the Arbitration Court. (20) In accordance with the law, arbitration costs include costs related to arbitration and the arbitrator's fee. Arbitration-related costs include not only the arbitration fees but also other

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expenses such as travel and expert witnesses. These expenses, including lawyer's fees, are determined after the real and factual expenditure has been calculated, but arbitration institutions often follow the State Court practice in civil trials and collect no more than 5 percent of the satisfied part of the claim as provided in CPL Article 44. There is no additional State duty, except for activities outside of the proceedings, i.e., interim measures of protection and issuing the enforcement act in the courts. Arbitration and legal fees are subject to VAT.

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The same CPL provision provides that in ad hoc arbitrations, the fee is determined after the appointment of arbitrators unless the parties have decided otherwise. (21) Latvian lawyers consider that this can raise many problems, such as the arbitrator asking for a fee that the parties are not able or willing to pay. In addition, the CPL does not state what happens when parties begin settlement proceedings. Therefore, we find that in some of the CPL Articles, provisions dealing with ad hoc and institutional arbitration do not distinguish between the two. For example, Article 515 provides that "the Respondent shall submit a reply to the claim in the time limit established by parties or by the court of arbitration, indicating objections, if there are any, and evidence supporting the objections," and one can presume that this refers only to institutional and not to ad hoc arbitration.

Detailed requirements for the Statement of Claim are regulated by Article 514, which generally complies with, for example, the UNCITRAL Arbitration Rules. The CPL does not require the law on which the claim is based to be stated. If the Statement of Claim does not correspond to the statutory requirements, the CPL does not stipulate the possible causes of action. The respondent can submit either the response to the claim or the counterclaim with the difference that a response to the claim will not be considered as an independent claim. The counterclaim can be submitted no later than by the expiration of the time limit set for submitting the response to the claim. (22)

Amendments to the claim or defense are "allowed by any party during the entire process, until the resolution of a dispute has begun." (23) In our opinion this provision is controversial, the first part allows parties to submit amendments during the entire process but the second limits this term. Moreover, the provision does not leave any room for the arbitrator to decide on this matter.

Oral hearings are mandatory unless the parties agree otherwise. (24) In practice, written proceedings are rarely conducted in Latvia. Written proceedings are provided for in the Small Claim Arbitration Rules of the Chamber of Commerce and Industry of Latvia – the only place where these Rules are adopted. As we will discuss further, the process of arbitration is simplified in this Small Claim Arbitration Rules, as the amount of the claim is small. In the twenty-two cases arbitrated until June 2003 under the Small Claim Arbitration Rules, only in one case did a party ask to hold oral hearings. (25)

If the CPL articles on confidentiality, correspondence, and default (26) are very similar to international standards, then some uncertain questions arise in connection with provisions regarding evidence. For example, the CPL does not provide that the witnesses, including expert witnesses, can be cross-examined during arbitral proceedings (although this was provided for under former State arbitration). The CPL defines evidence as the explanations of parties, evidence in writing, material evidence, and the opinion of experts. (27)

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The arbitral tribunal may appoint an expert (28) if a party requests this but this provision is narrower than that of the UNCITRAL Model Law. (29) Moreover, an expert can only be called upon if a party had paid the arbitral tribunal for the services of experts before the appointment of the expert. Since the cost of engaging experts can only be known after the experts have been employed, parties may encounter difficulties in obtaining an expert opinion during arbitral proceedings.

It is important to note that the CPL does not provide for any court assistance in connection with discovery in arbitration proceedings. It also obliges parties to notify the courts immediately of any possible violations of the arbitration rules, otherwise they will not have the right to refer to them in enforcement proceedings.

D Awards

The CPL distinguishes between procedural decisions and awards. (30) The award and the arbitration decision approving the settlement have the same effect as State Court decisions. However, if a settlement is concluded outside the arbitration, it does not have this capacity. The law stipulates that the arbitral award is to be kept in the archives of a permanent arbitral court as the court will often require this during enforcement proceedings.

The award cannot be appealed. (31) This provision has created a dangerous situation because the law does not provide any way to have the arbitral award set aside. Thus, even if enforcement is not granted by the court, the arbitral award remains in force and can serve as *res judicata* in other proceedings.

The court can refuse to enforce an arbitral award if the losing party provides evidence that:

(1) the arbitration agreement was concluded by an incapable person or is not in force in accordance with the law to be applied to it;

(2) the party was not properly informed about the appointment of the arbitrator or the

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arbitral proceedings, and this had substantially affected or could affect the arbitral proceedings;

(3) the arbitral tribunal was not properly composed or the arbitral proceedings did not take place in accordance with the provisions of the arbitration agreement or Part D of the CPL;

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(4) the award deals with a dispute not contemplated by, not falling within, or falling beyond the terms of the arbitration agreement. In this case, the court can issue an order to enforce the award in respect of the matter covered by the arbitration agreement but only if it is possible to separate it from the questions which are not included in the arbitration agreement. (32)

A judge can also refuse to issue a court order if it is established that in accordance with this law only the court could resolve a particular dispute. If the court refuses to enforce the arbitral award, because it is established that the arbitration is invalid or it was rendered by an incapable person, or the arbitral tribunal has exceeded its authority by deciding on matters out of the scope of the arbitration agreement, the dispute may be settled by the court of general jurisdiction. If the enforcement of an arbitral award is refused on the grounds of a lack of notice to the respondent concerning arbitral proceedings or of improper arbitral proceedings, new arbitral proceedings can be held.

E Applicable international law

On March 11, 1992 Latvia adopted the Law on Accession to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"). (33) There is no exact data on how many arbitral awards have been enforced in Latvia: neither the Ministry of Justice nor the courts keep these statistics.

On January 23, 2003, the Law on Accession to the European Convention on International Commercial Arbitration was adopted. It holds that the Chamber of Commerce and Industry is the main arbitral institution in Latvia. In accordance with this Convention the President of the Chamber of Commerce and Industry is entitled to appoint a sole arbitrator and to determine the place of arbitration. (34)

II Institutional Arbitrations

Article 486 of the CPL provides that any new arbitral institution must notify the Ministry of Justice, which maintains a registry of arbitral institutions. No other limitations are set forth and therefore almost anyone can establish an arbitral institution. As we have noted above, there is no control or supervision concerning the quality of the institution's work. The legal consequences of this registration are not clear, since non-registration is not a ground for refusing the enforcement of an arbitral award.

Most arbitration institutions in Latvia are established as companies with limited liability, and several have been established within other organizations, such as the Arbitration of Latvian Chamber of Commerce and Industry.

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According to the Ministry of Justice, as of October 13, 2003, there are eighty-six registered arbitration institutions (35) that can also hear international cases. The situation is paradoxical: any company can establish its own arbitration institution where all disputes in connection with goods or services provided by that company are settled. One cannot expect a fair process in such an arbitration. For example, according to one widely reported case, (36) an arbitration agreement provided that disputes were to be settled by the arbitration court established by one party's lawyer, who happened to be the chairman of this arbitral institution. This lawyer, as the representative of the claimant, submitted the statement of claim to the arbitration court, and as chairman of the arbitration court appointed himself as the sole arbitrator. Of course, the arbitral award was rendered in favor of his client. The losing party could only complain to the General Prosecutor about the unfair proceedings and the unfair award, because no other legal remedy to set aside an arbitral award is available. There have also been reports about fictitious arbitration proceedings taking place for illegal or sometimes criminal purposes.

III Conclusion

The statutory regulation of both international and domestic arbitration in Latvia generally corresponds to the international requirements embodied in the UNCITRAL Model Law on International Commercial Arbitration, the New York Convention, and the European Convention on Commercial Arbitration. However, the law does not contain important provisions concerning court assistance in forming the arbitral tribunal, in applying interim and protection measures, in discovery, and in possible deadlock cases. As a result of the Latvian judiciary's desire to stay away from arbitral proceedings and the government's policy of not spending money to exert control over arbitration in order to ensure a fair process, distrust of arbitration as a means of settling commercial disputes is rapidly growing. Accordingly, only speedy and substantial changes in the statutory regulation of arbitration can rectify this situation in Latvia.

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16) *Id.*
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18) *Id.* art. 496.
19) *Id.* art. 506, ¶ 1.
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28) *Id.* art. 522.
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