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Overview of Latvian legal protection proceedings (1) 2/17/22

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The Covid-19 pandemic has thrown the global economy into recession. However, the warning issued by the industry experts and backed by the authors of a World Bank study that the economy will experience a rapid increase in the number of insolvency proceedings and legal protection proceedings (LPP) at the end of Covid-19, has not come true as yet. This is because the financial difficulties brought on by the pandemic were countered with an unprecedented government intervention in the market and a huge package of financial aid, including working capital grants and idleness benefits. The economic downturn is now being aggravated by Russia’s invasion of Ukraine, as the consequences of the war are pushing up energy prices and fuelling price rises in general, inevitably leading to debt crises. Latvia seems likely to face an inevitable wave of insolvencies and LPP, so this article aims to introduce companies to Latvian LPP and out-of-court workouts in simple terms in order to highlight the characteristics of these debt restructuring tools, as well as the role of the debtor, the creditors and the supervisor within these proceedings.

Initiating and approving LPP

LPP is a tool for restructuring debts under the Insolvency Act that helps the debtor restore its ability to settle his liabilities if he finds himself in or expects to run into financial distress. Yet this process will not restore the debtor to solvency unless he has a clear vision and a business plan for restructuring his business. It is important to note that initiating LPP is not mandatory – it is the debtor’s free choice. To begin with, the debtor has to make an application to court for opening an LPP case. This can be done by a company, a partnership, a sole trader, a foreign-registered person that carries on a permanent business in Latvia, and an agricultural producer.

Once the LPP case is open, the debtor starts enjoying protection from the creditors, including the following:

1. Any proceedings for enforcement of judgments against the debtor are suspended.
2. The secured creditors are prohibited from seeking the sale of the debtor’s charged, pledged or mortgaged assets unless this prohibition causes a significant damage to a particular creditor’s interests.
3. The creditors are prohibited from filing a petition for corporate insolvency proceedings against the debtor.
4. The debtor’s liquidation is prohibited.
5. Any contractual penalties, interest charges and late fees, including late fees on tax claims cease to accrue.

This protection from the creditors initially lasts two months with an option to extend it for another month if an extension is backed by the majority creditors and authorised by the court. During this period of moratorium, either the debtor himself, or with the help of an expert who cannot be the LPP supervisor, has to draw up an LPP step plan to be approved by the majority creditors and submitted to the court for authorisation. The content of an LPP plan is prescribed by section 40 of the Insolvency Act – the important thing is that the plan has to reflect the debtor's actual financial position, the proposed methods for restructuring his debts and gaining income, as well as cash flow forecasts for resolving the financial difficulties. If the LPP plan affects a tax authority's claim more than the law permits, or if approving the plan requires the tax authority's votes, the plan must be prepared and submitted to the tax authority within ten days after LPP was initiated, together with the operating balance sheet with a breakdown of its items and other information required by tax laws.

Once the LPP plan has been passed to the creditors for review, they have a right to vote for it, raise objections, or deny approval, and a creditor's silence, or failure to respond, will be taken as his refusal to approve it. The Insolvency Act details the procedure for considering creditor objections, with the possibility of calling in a certified auditor to issue an opinion on any ignored objections. It should be noted that the certified auditor is financed by the creditor whose objections have been ignored.

Once all the objections have been considered and the voting ends, the LPP plan will be treated as approved if it is approved by both creditor groups. Specifically, it is necessary to obtain approval from two-thirds of total principal claims of the secured creditors and more than a half of total principal claims of the unsecured creditors. Employees and certain related parties that have a decisive influence on the debtor, and any creditors that have obtained receivables from those parties, must not vote on the plan and their claims will not count towards the total basket of votes.

Approving the LPP plan

Once the plan is approved by the majority creditors in both groups, the debtor submits it to the court for authorisation, along with the certified auditor's opinion and the ignored objections. On receiving the application, the court will first decide to appoint a supervisor. For the court to decide on this appointment, the majority creditors have to agree on the supervisor candidate and the debtor, or if multiple candidates are nominated, the court will select one and appoint him as the debtor's supervisor. The court will also set a 15-day period for the supervisor to prepare an opinion on the LPP plan. On receiving his opinion, the court has 15 days to hear the LPP application in written proceedings, unless the court deems it necessary to adjudicate the case in a court hearing. Having considered the application, the court will examine the supervisor's opinion on the LPP plan, the certified auditor's opinion on creditor objections (if there is one) and the objections (if any). As a result, the court will assess two things: whether the plan has been approved by the majority creditors and whether it meets the Insolvency Act's requirements. If, based on the supervisor's opinion and other evidence, the court finds that the LPP plan contains any liabilities for which there is a dispute over rights and the amount of those liabilities significantly affects the plan's chances of being approved, the court will set the application aside. However, if the application is not approved or falls short of the Insolvency Act's requirements, it will be rejected and LPP terminated. If the debtor's LPP has been proposed for the second time in a year but its implementation has not been announced, the court will announce the debtor's insolvency proceedings. However, if the court finds that the LPP plan is approved and meets the statutory requirements, the court will authorise it and announce its implementation. It is important to know that a court-approved LPP plan is binding on all the creditors, including ones that have not approved it.

The LPP implementation period

The implementation period may last up to two years. This can be extended for up to another two years if an extension is backed by the majority creditors and authorised by the court. During the implementation, the debtor is subject to various restrictions, for instance, the debtor is prohibited from:

1. Entering into any transactions or carrying out any activities that may worsen his financial position or harm the interests of the creditors at large
2. Making loans unless that is his business activity
3. Issuing guarantees, making gifts or donations, or awarding bonuses or any other type of additional financial remuneration to the debtor’s board and council members
4. Disposing of or encumbering real estate with real rights unless the LPP plan provides for this
5. Distributing and paying profits in dividends
6. Settling any financial liabilities beyond the LPP plan or unauthorised by the supervisor, but in any case their aggregate amount must not exceed 2% of total creditor claims

During LPP, the debtor must carry out the plan, which includes applying all income towards implementing LPP and covering costs, inform the creditors and the supervisor about performance of the plan, answer the supervisor’s enquiries and allow him to check documents, as well as generally informing him of any essential circumstances likely to prevent the debtor from carrying out the plan. Throughout the implementation period, the supervisor is required to monitor performance of the plan and take action if the debtor breaches his restrictions or fails to carry out his obligations and the plan.

(to be completed in our next edition of Flash News)