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# THE CORPORATE GOVERNANCE REVIEW

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EDITOR  
WILLEM J L CALKOEN

LAW BUSINESS RESEARCH

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WILLEM J L CALKOEN

LAW BUSINESS RESEARCH LTD

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# LATVIA

*Girts Lejins and Janis Bogdasarovs\**

### I OVERVIEW OF GOVERNANCE REGIME

There are two main sources of law governing listed companies in Latvia – the Commercial Law deals with company law issues and the Law on the Financial Instruments Market<sup>1</sup> deals with financial instruments (*inter alia*, transferable securities), which are publicly offered and traded.

The Commercial Law provides the general company law rules for capital companies, such as incorporation, management structure, reorganisation, liquidation, etc. There are two types of capital companies – a limited liability company whose shares cannot be publicly tradable objects; and a joint-stock company whose shares may be publicly tradable objects (transferable securities). The joint-stock company whose shares are listed on the stock exchange is a public joint-stock company.

The Law on the Financial Instruments Market governs the procedure whereby financial instruments are publicly offered and circulated, and whereby participants in the financial instruments market are licensed and supervised, and also establishes the rights and obligations of participants of the financial instruments market and liability for infringements of the requirements set out in this particular Law.

There are no general codes of conduct for corporate governance in Latvia. The Law on the Financial Instrument Market defines corporate governance as a set of measures aimed at achieving the operating goals of a company and controlling its performance, as well as assessing and managing the operational risks of a company. The joint-stock company whose shares are traded on the regulated market has an obligation to prepare a corporate governance report annually. According to the Law on the Financial

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\* Girts Lejins is a founder and managing partner and Janis Bogdasarovs is an associate at Raidla Lejins & Norcous.

<sup>1</sup> English version of the Law on the Financial Instruments Market available at: [www.fktk.lv/texts\\_files/Law\\_on\\_FIM.pdf](http://www.fktk.lv/texts_files/Law_on_FIM.pdf) (accessed on 14 March 2011).

Instrument Market, the company is free to choose which corporate governance code to apply. The stock exchange NASDAQ OMX Riga has issued Principles of Corporate Governance and Recommendations on Their Implementation.<sup>2</sup> These Principles of Corporate Governance and Recommendations on their Implementation ('the Principles of Corporate Governance') have been prepared taking into account the requirements for capital companies laid down in the legal acts of the Republic of Latvia as well as the recommendations of the European Union and the OECD on the governance of capital companies. It covers a broad range of areas, such as management of the company, relations with shareholders, disclosure of information, internal control and risk management and remuneration policy. These rules follow the principle 'comply or explain'. The application of these particular Principles of Corporate Governance is mandatory for companies, whose shares are listed in NASDAQ OMX Riga.

The listed company regime is enforced by NASDAQ OMX Riga, which is the only regulated secondary securities market in Latvia.<sup>3</sup> The securities market is regulated and supervised by the Financial and Capital Market Commission.<sup>4</sup> The scope of authority and the competence of the Commission are defined by the Law on the Financial Instruments Market and the Law on Financial and Capital Market Commission.<sup>5</sup> The Commission conducts supervision of the securities market on behalf of the state in order to enhance the stability and reliability of the entire financial sector. The objective of the legal regulation is to ensure regular and lawful operation of the market. The main functions of the regulatory framework are:

- a* to protect interests of investors;
- b* to ensure lawfulness, reliability, efficiency and transparency of the market;
- c* to reduce systemic risks.

NASDAQ OMX Riga performs market supervision over market participants and issuers of securities traded on the market, with respect to the price formation of the securities traded on the market, conclusion and execution of transactions and fulfilment of provisions of the Rules and Regulations adopted by the NASDAQ OMX Riga.

## II CORPORATE LEADERSHIP

### i Board structure and practices

A public joint-stock company is managed by a two-tier management structure consisting of a management board and supervisory board. The management board is the executive

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2 Available at [www.nasdaqomxbaltic.com/files/riga/corp\\_gov\\_May\\_2010\\_final\\_EN.pdf](http://www.nasdaqomxbaltic.com/files/riga/corp_gov_May_2010_final_EN.pdf) (accessed on 14 March 2011).

3 See the website of the NASDAQ OMX Riga at [www.nasdaqomxbaltic.com/market/?lang=en](http://www.nasdaqomxbaltic.com/market/?lang=en) (accessed on 14 March 2011).

4 See the website of the Financial and Capital Market Commission at [www.fktk.lv/en](http://www.fktk.lv/en) (accessed on 14 March 2011).

5 English version of the Law on the Financial and Capital Market Commission available at: [www.fktk.lv/en/law/general/laws/on\\_the\\_financial\\_and\\_capital\\_m/](http://www.fktk.lv/en/law/general/laws/on_the_financial_and_capital_m/) (accessed on 14 March 2011).

institution of a company, which manages and represents the company, for its turn, the supervisory board is the supervisory institution of a company, which represents the interests of shareholders during the time periods between the meetings of shareholders and supervises the activities of the management board. The two-tier management structure is mandatory for public joint-stock companies and no alternative management structures are permitted.

### *The management board*

The management and representation rights of the company are under the exclusive competence of the management board. The management board supervises and manages the affairs of the company and is responsible for the commercial activities of the company, as well as for accounting in compliance with the law. All members of the management board have representation rights and members represent the company jointly, if the articles of association do not specify otherwise. The exclusivity of the management board to manage and represent the company does not preclude the management board from delegating the adoption of certain internal decisions to other management institutions or officers. However, the management board will remain fully liable for all decisions taken, even if the adoption of those decisions were vested in other management institutions or officers.

The management boards of public joint-stock companies shall consist of at least three members. The members of the management board are elected to office by the supervisory board for five years, if the articles of association do not specify a shorter term. The chairman of the management board is appointed by the supervisory board from among the members of the management board. The Principles of Corporate Governance suggest not to re-elect the same management board members for more than four successive office terms.

### *The supervisory board*

The supervisory board is the supervisory institution of a company which represents the interests of shareholders during the periods between the shareholders' meetings and supervises the activities of the management board within the scope specified by the Commercial Law and the articles of association of the company. The functions and rights of the supervisory board are the following:

- a* to elect and recall members of the management board and to continually supervise the activities of the board of directors;
- b* to monitor that the business of the company is conducted in accordance with law, the articles of association and the decisions of the shareholders' meetings;
- c* to examine the annual accounts of the company and the proposal of the management board for the use of the profits and draw up a report;
- d* to represent the company in court in all actions brought by the company against members of the management board, as well as in actions brought by the management board against the company and to represent the company in other legal relations with members of the management board;
- e* to approve the concluding of transactions between the company and members of the management board or the auditor;

- f* to examine in advance all issues which are within the competence of the meeting of shareholders or which, pursuant to the proposal of members of the management board or the supervisory board, have been proposed for discussions at the meeting, and to provide its opinion on such issues;
- g* to give consent to decisions of the management board to increase the equity capital;
- h* to request that the management board reports on the circumstances of the company and to become acquainted with all of the activities of the management board;
- i* to examine the company's registers and documents, as well as the cashier's office and all of the property of the company.

The supervisory board does not have the right to decide on issues which are within the competence of the management board. However, it may be specified in the articles of association that the management board shall acquire consent from the supervisory board to decide on issues of major importance, such as acquiring participation in other companies, acquisition or alienation of undertakings, opening or closing branches, etc.

The supervisory board of a public joint-stock company shall consist of at least five members but not more than 20 members. The members of the supervisory board are elected to office by a general meeting of shareholders for a period of five years, if the articles of association do not specify a shorter term. Members of the supervisory board elect from among themselves a chairman of the supervisory board and at least one deputy chairman. The deputy chairman performs the duties of the chairman only if the chairman is absent or has assigned such task.

### ***Remuneration***

In accordance with the Commercial Law, members of the management board have the right to receive remuneration according to the scope of their duties and the financial circumstances of the company. The amount of remuneration determines the supervisory board. In turn, shareholders' meetings determine remuneration for members of the supervisory board. The Principles of Corporate Governance suggest that the company should develop a clear remuneration policy, specifying general principles, types and criteria the remuneration of the management and supervisory board members.

### ***Audit committee***

The public joint-stock company has an obligation under the Law on the Financial Instruments Market to establish the audit committee. Members of the audit committee are elected for a three-year period by a shareholders' meeting, if the articles of association do not provide for a shorter term. At least one member of the audit committee shall be independent, having the necessary education and at least three years' experience in accounting or auditing. A sufficient number of members of the audit committee shall be elected to ensure the audit committee can duly perform its tasks. The audit committee has the following tasks:

- a* to monitor the drawing up of the financial statements of a company and, where a company draws up consolidated annual accounts, the consolidated financial statements;

- b* to monitor the effectiveness of the operation of the internal control and of the risk management systems of a company;
- c* to monitor the process of the statutory audit of the annual accounts and, where a company prepares consolidated annual accounts, also of the consolidated annual accounts and the rectification of the deficiencies detected by the audit;
- d* to propose an official auditor for carrying out audit services in the company;
- e* to review and monitor the independence of an official auditor in the meaning of the Law on Sworn Auditors.

Audit committees were established as a mandatory institution in public joint-stock companies by the Law on the Financial Instruments Market on 22 May 2008, with the respective amendments to the said law. In accordance with the Transitional Provisions, a company, whose shares are admitted to trading on the regulated market, has an obligation to elect members to their audit committee in the nearest shareholders' meeting. The joint-stock company Latvijas Gāze, listed in the Baltic Secondary List of NASDAQ OMX Riga, failed to comply with the legal requirements regarding the establishment of an audit committee and did not establish their audit committee until July 2010. As the result of such breach of law, the Financial and Capital Market Commission imposed a 5,000 lat penalty on the company.

#### *Company practice in takeovers*

The EC Directive 2004/25/EC<sup>6</sup> on takeover bids has been transposed into the Law on the Financial Instruments Market with the respective amendments. The Law on the Financial Instruments Market prescribes the neutrality rule for the management bodies of the company, in case of a takeover situation. The law prohibits members of the management and supervisory board from interfering with the takeover bid by taking action or refraining from any action, unless the management and supervisory board acquires prior authorisation of the shareholders' meeting for carrying out activities that may frustrate the success of the takeover bid.

#### **ii Directors**

##### *Requirements set for members of the management board*

The Commercial Law states relatively few restrictions for members of the management board. Any natural person with capacity may be a member of the management board, except members of the supervisory board and auditors of the same company, persons who by a court judgment have been deprived of the right to conduct the relevant type or all types of commercial activities and members of the supervisory board of the dominant company in a group of companies. The articles of association may provide stricter restrictions in respect of members of the management board. The Principles of Corporate Governance in respect of requirements for management board members suggest that it shall be observed that every board member has appropriate education and

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<sup>6</sup> Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:HTML> (accessed on 14 March 2011).

work experience. The company shall prepare a summary of requirements to be set for every board member, which specifies the skills, education, previous work experience and other selection criteria for every board member.

There is a prohibition of competition in respect of members of the management board. Members of the management board may not, without consent of the supervisory board or shareholders' meeting, be a general partner in a partnership or a shareholder in a company which is engaged in the same field of commercial activities as the original company, conclude transactions in the field of commercial activities of the company in his name or in the name of a third person, as well as be a member of the management board of another company which is engaged in the field of commercial activities of the original company, except in cases where the original company and the other company are part of the same group of companies. If there is a conflict of interest between the company and a member of the management board, his or her spouse, kin or in-laws (counting kinship up to the second degree and affinity up to the first degree), the issue shall be decided at a management board meeting, in which the interested member of the management board does not have voting rights, and this shall be noted in the minutes of the management board meeting. A member of the management board has a duty to notify such interests before the beginning of a management board meeting. A member of the management board who violates this requirement shall be liable for losses incurred by the company. The Principles of Corporate Governance recommend that it is the obligation of every management board member to avoid any, even only supposed, conflicts of interest in their work. In taking decisions, members of the management board shall be guided by the interests of the company and not use the cooperation offers proposed to the company to obtain a personal benefit.

#### *Requirements set for members of the supervisory board*

Any natural person with capacity may be a member of the supervisory board, except members of the management board, the auditor, agent or commercial representative of the company, as well as members of the management board of any dependant company of the company or any person with rights to represent the dependant company. These are the only restrictions for members of the supervisory board prescribed by law. According to the Principles of Corporate Governance, the supervisory board should be composed of individuals whose knowledge, opinions and experience is varied, which is required for the supervisory board to fulfil their tasks successfully. It is also recommended that at least half of the members of the supervisory board be independent. Also, every member of the supervisory board shall avoid any conflicts of interest in their work, be completely independent from any external circumstances, shall comply with the general ethical principles in adopting any decisions related to the business of the company and shall assume responsibility for any decisions taken.

#### *General duties and liabilities of members of the management bodies of the company*

The Commercial law stipulates that members of the management and the supervisory board shall perform their duties as a prudent and careful manager. The term 'careful and prudent manager', in the light of Commercial Law, contains the following duties for members of the management bodies:

- a to observe the law;

- b* to observe the articles of association of the company;
- c* to observe the decisions of the shareholders' meetings;
- d* to perform fiduciary duties to the company; and
- e* an inexplicit duty to perform fiduciary duties for the shareholders.

### III DISCLOSURE

The Law on the Financial Instruments Market and NASDAQ OMX Riga Rules On Listing and Trading of Financial Instruments in the Markets Regulated by the Exchange stipulate the mandatory disclosure requirements of public joint-stock companies. The management board of public joint-stock company is responsible for the disclosure requirements of the company. The company has an obligation to disclose, without delay, any information on material changes in its economic activity or other circumstances related to the company that has not been publicly disclosed and that may affect the price of its listed financial instruments or the ability of the company to fulfil the liabilities attached to the financial instruments. The disclosure requirement may be divided into two main pillars – disclosure of financial information (financial reporting) and disclosure of information about significant events which may affect the company.

In respect of financial reporting, a company listed on the stock exchange has an obligation to prepare and disclose an Annual Report, Quarterly and Semi-Annual Reports. The Annual Report shall be audited. The company also has an obligation to disclose information about significant events. 'Significant events' for the purpose of the relevant law shall mean, *inter alia*, changes to the management, attorneys and auditors, a change of the company's address, a court or arbitration process, insolvency or liquidation, forecasts and financial results, changes in the company's commercial activities, etc.

### IV CORPORATE RESPONSIBILITY

There is neither a legislative basis nor practice in Latvia regarding corporate responsibility, although the companies may introduce a policy of corporate responsibility on a voluntary basis. There are also no mandatory requirements in respect of employees' participation in the management institutions, therefore employees have a limited role in corporate governance in Latvia.

### V SHAREHOLDERS

#### i Shareholder rights and powers

In accordance with the Commercial Law, shareholders exercise their right to participate in the management of the company at shareholders' meetings. Decisions regarding the following are in the exclusive competence of shareholders' meetings:

- a* the annual accounts of a company;
- b* the use of profits from the previous year of activities;
- c* the election and recall of members of the supervisory board, the auditor, the company controller, and liquidator;

- d* the bringing of actions against members of the management board, the supervisory board and the auditor or withdrawing actions against them, as well as regarding the appointment of a representative of the company to maintain actions against members of the supervisory board;
- e* amending the articles of association of the company;
- f* increasing or reducing equity capital;
- g* the issuance and conversion of the company's securities;
- h* specifying remuneration for members of the supervisory board and the auditor;
- i* the termination or continuation of the activities of the company or regarding the reorganisation of the company;
- j* the general principles, types and criteria for determination of remuneration intended for members of the management and supervisory board.

## ii Shareholders' duties and responsibilities

The shareholders of the public joint-stock company have a duty to disclose information regarding their shareholding in the company. A shareholder who acquires (directly or indirectly) or disposes of shares with voting rights of a company shall notify the respective company and simultaneously the Financial and Capital Market Commission of the proportion of its voting rights as a result of the acquisition or disposal of shares, where that proportion reaches, exceeds or falls below the thresholds of 5, 10, 15, 20, 25, 30, 50 or 75 per cent. In addition, if the state of origin of a company is the Republic of Latvia, the shareholder of that public joint-stock company shall have to notify the respective company and simultaneously the Financial and Capital Market Commission of the proportion of their voting rights as a result of the share acquisition or disposal of shares, where that portion reaches, exceeds or falls below the thresholds of 90 and 95 per cent.

The shareholder or shareholders, who act in concert and who directly or indirectly acquire the voting rights attaching to shares in such number that the voting rights of those persons reach or exceed 50 per cent of the total shares with voting rights of a company, have the duty to make a mandatory buyout offer to other shareholders of the company.

In February 2007, the Financial and Capital Market Commission decided that a shareholder of joint-stock company 'Valmieras Stikla Šķiedra' had failed to comply with the regulation of the Law on the Financial Instruments Market in respect of a duty to notify the company or the authority regarding their shareholding which exceeded 50 per cent of company's share capital and the duty to make a mandatory buyout offer to other shareholders of the company. As the result of such violation of law, the Financial and Capital Market Commission imposed a 5,000 lat penalty on the shareholder. In the view of the Financial and Capital Market Commission, this decision would ease the opportunity for minority shareholders to claim for damages from the shareholder, who failed to comply with the law, if the minority shareholders consider that damages have been incurred.

### iii Shareholder activism

#### *Say on pay*

According to the Commercial Law and the Law on the Financial Instruments Market, it is part of the competence of a shareholders' meetings to determine the remuneration for members of the supervisory board, the auditor and audit committee, as well as to define the general principles, types and criteria for determination of remuneration intended for the members of the management and supervisory board. Thus, the shareholders may directly affect the remuneration of the supervisory board members and indirectly affect the remuneration for management board members, defining the general principles of remuneration policy for the company. In accordance with the law, the amount of remuneration for members of the management board is determined by the supervisory board. The Principles of Corporate Governance suggest that, without limiting the role and operations of the company's management bodies responsible for setting the remuneration for management and supervisory board members, the drafting of the remuneration policy should be made a responsibility of the management board, which during the preparation of draft policy should consult with the supervisory board of the company. To avoid conflicts of interest and to monitor management board remuneration policy, the company should appoint a responsible person having sufficient experience and knowledge in the field of remuneration for the development of remuneration policy.

#### *Derivative actions*

A company may bring an action against members of the management board or the supervisory board or the auditor, on the basis of a decision taken by a shareholders' meeting, which has been taken by a simple majority of votes of those present. The articles of association may not specify a larger majority for the bringing of an action. At the same time, a company has a duty to bring an action against members of the management board or the supervisory board or the auditor if requested by a minority of shareholders who jointly represent not less than one twentieth of the share capital or whose participation in the share capital of the company is not less than 50,000 lats. Such request by a minority of shareholders shall be submitted to that institution of the company which, in accordance with the law, has the right to bring an action, but if such institution does not bring a court action within one month, the minority of shareholders may commence a court action without the intermediation of this institution.

Actions by a company against the board of directors shall be brought and maintained by the supervisory board. However, action by a company against the supervisory board and the auditor shall be brought and maintained by the management board if a meeting of shareholders does not decide otherwise.

In respect of losses which a company incurs due to an unjustified action, those shareholders who voted for the bringing of the action or the minority of shareholders in the actions which were determined malicious or grossly negligent shall be jointly liable.

The recent considerable derivative action took place in January 2011. The shareholders' meeting of joint-stock company 'Latvijas kuģniecība', listed on the Baltic Official List of NASDAQ OMX Riga, decided to pursue a claim against the former members of the management board and former members of the supervisory board for

compensation for losses incurred by the company in 2009 and 2010, as well as for unjustified enrichment.

#### **iv Contact with shareholders**

The Law on the Financial Instruments Market provides that the management bodies shall ensure equal treatment of all owners of transferable securities (shares) that are of the same type and class. The rule of 'equal treatment' applies also to communications with shareholders. To enable shareholders to exercise their rights, the management board of a company shall ensure that all information is available to shareholders and that the data provided is truthful.

In accordance with the Commercial Law, a notice regarding the convening of a shareholders' meeting shall be announced not later than 30 days before the planned meeting. The Principles of Corporate Governance suggest that the company shall ensure that complete information on the course and time of the meeting, the voting on decisions to be adopted, as well as the agenda and draft decisions on which it is planned to vote at the meeting is available to the shareholders in due time. The company shall also inform the shareholders whom they can address to receive answers to any questions on the arrangements for the shareholders' meeting and the agenda issues and ensure that the required additional information is provided to the shareholders.

Shareholders have the right to receive copies of the draft decisions free of charge 14 days before the announced meeting. In addition, pursuant to the request of shareholders, the management board has a duty to submit information about the economic circumstances of the company to the meeting to such an extent as is necessary to examine the relevant issues on the agenda and to objectively make a decision.

## **VI OUTLOOK**

Currently, there are no substantial pending developments or trends regarding corporate governance of public joint-stock companies in Latvia. However, the wording of Principles of Corporate Governance and Recommendations on their Implementation, issued by the stock exchange NASDAQ OMX Riga have recently been amended. The revised and supplemented Principles of Corporate Governance were prepared following the trends prevailing in the European economy, taking into consideration the latest recommendations of the European Commission for the remuneration of management board members of listed companies. The new wording of Principles of Corporate Governance and Recommendations on their Implementation were effective as of 1 June 2010 meaning that, from 2011, listed companies will have to provide their corporate governance reports following the new version of Principles of Corporate Governance and Recommendations on their Implementation.

## Appendix 1

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# ABOUT THE AUTHORS

### **GIRTS LEJINS**

#### *Raidla Lejins & Norcouis*

Girts Lejins is the founder and managing partner of Raidla Lejins & Norcouis' Riga office. His main practice areas are corporate and commercial law issues, banking & project finance, privatisation and dispute resolution.

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In recent years, Lejins has headed significant M&A deals in telecommunications, banking and finance, retail, insurance, IT, securities exchange, media and other key industries. He is recognised as a leading lawyer in the fields of corporate/commercial, banking and finance and dispute resolution by the international law firm directories *Chambers Europe*, *Legal 500*, *Who's Who Legal* and *PLC Which lawyer?*

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Janis Bogdasarovis is an associate in Raidla Lejins & Norcouis' Riga office, specialising in M&A, corporate and general commercial law. He obtained an LLM degree from the University of Latvia and an LLM degree in Commercial Law from Erasmus University, Rotterdam. Before joining the Raidla Lejins & Norcouis team, Janis organised and conducted shareholders' meetings of public joint-stock companies and assisted companies in the preparation of corporate governance reports.

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