

Collection of Research Papers in Conjunction  
with the 6<sup>th</sup> International Scientific Conference  
of the Faculty of Law of the University of Latvia

# Constitutional Values in Contemporary Legal Space II

16–17 November, 2016

This publication presents the second collection of research papers in conjunction with the 6<sup>th</sup> International Scientific Conference of the Faculty of Law of the University of Latvia “Constitutional Values in Contemporary Legal Space”, Riga, 16–17 November, 2016, 294 pages.

Conference proceedings are supported by JSC “Latvijas Gāze”.



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All contributions have been double-blind peer reviewed.

Layout: Andra Liepina

English language editor: Andra Damberga

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ISBN 978-9934-18-230-3

**Inga Kacevska, Dr. iur**  
University of Latvia, MCI Arb, Latvia

## SCRUTINY OF THE ARBITRATION LAW'S RULES BY THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

### Summary

In 2004 and 2014, the Constitutional Court of the Republic of Latvia has rendered two very important judgments discussing the interrelation between the arbitration and the court of general jurisdiction. The aim of this article is to provide comparative analysis of those judgments and to suggest the necessary improvements for the arbitration law in Latvia as recommended also by the Constitutional Court, but disregarded by the legislator. For example, currently the assistance of the courts of the general jurisdiction in arbitration proceedings is not sufficient in Latvia.

**Keywords:** arbitration, courts assistance in arbitration procedure, Constitutional Court.

### Introduction

In 2014, there were around 214 registered arbitration courts in Latvia. In order to reduce the number of arbitral institutions and to facilitate the trust of arbitration in the society, the Latvian legislator has adopted a new Law on Arbitration Courts that came into force as of 1 January 2015.<sup>1</sup> As the previous arbitration acts, the Law is not based on UNCITRAL Model Law on International Commercial Arbitration (hereinafter – UNCITRAL Model Law),<sup>2</sup> thus, there is minimal assistance provided by the state courts in arbitration process. Namely, the state courts are not entitled to perform the functions referred to in Article 6 of the UNCITRAL Model Law, and *inter alia* set aside procedure is not available in Latvia.

Interaction between courts and arbitration, as well as the need for a wider scope of state courts' assistance in arbitration process have been an issue in practice and it is also reflected in the case law of the Constitutional Court (*Satversmes tiesa*) of Latvia. In order to better comprehend the notability of these judgments, firstly, author gives a short summary of the facts pertaining to the relevant Constitutional Court's cases, followed by the comparative analysis of the judgments and the impact of those judgments on the arbitration environment of Latvia.

<sup>1</sup> Law on Arbitration Courts: Law of the Republic of Latvia. Latvijas Vēstnesis, 1 October 2014, No. 194.

<sup>2</sup> UNCITRAL Model Law on International Commercial Arbitration with amendments 2006. U.N. Doc A/40/17, Annex I, 21 June 1985.

### 1. 2004 case of the Constitutional Court<sup>3</sup>

In the constitutional claim, Limited Liability Company “Asmers” argued that the dispute resolution in the arbitration court cannot be compared with a fair and open adjudication by an independent and impartial court of the general jurisdiction as guaranteed by the Constitution of the Republic of Latvia<sup>4</sup> and the European Convention for the Protection of Human Rights and Fundamental Freedoms.<sup>5</sup> Thus, an agreement, by which the party waives the right to settle the dispute outside the court, shall not be deemed valid. That is, in the view of “Asmers”, the norm providing that a judge shall refuse to accept a statement of a claim and shall terminate proceedings even if “the parties have, in accordance with law, agreed to settle the dispute in an arbitration court”<sup>6</sup> has to be acknowledged as unconstitutional.

In this 2004 case, the Constitutional Court advised that arbitration courts did not belong to the judicial system and could not be considered within the scope of the term “the court.”<sup>7</sup> This was argued in the context of the Article 92 of the Constitution stating that “everyone has the right to defend their rights and lawful interests in fair court”. Consequently, the rights to settle the dispute in the court of general jurisdiction are not absolute and the parties may waive this right by the signing the arbitration agreement. Basically, the Court confirmed a well-known fact that there were also other means of the dispute resolution than the litigation. Moreover, the courts shall respect the parties’ autonomy to choose to settle the disputes outside the courts of general jurisdiction. The arbitration agreement often restricts a party’s constitutional and human rights to a public hearing in a court of law.<sup>8</sup>

The constitutional complaint was rejected in the case at hand. However, despite the uncomplicatedness of the grounds of the constitutional complaint, the Constitutional Court gave a valuable contribution to the development of arbitration law in Latvia. For example, this judgment has been one of the most often cited,<sup>9</sup> especially as concerns the state court’s responsibility to assess the compliance

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<sup>3</sup> On the Compliance of Section 132 (Item 3 of the First Part) and Section 223 (Item 6) of the Civil Procedure Law with Article 92 of the Republic of Latvia *Satversme* (Constitution): Judgment of the Constitutional Court of the Republic of Latvia in Case No. 2004-10-01 dated 17 January 2005. *Latvijas Vēstnesis*, 18 January 2005, No. 9.

<sup>4</sup> The Constitution (*Satversme*) of the Republic of Latvia: Law of the Republic of Latvia. *Latvijas Vēstnesis*, 1 July 1993, No. 43.

<sup>5</sup> European Convention for the Protection of Human Rights and Fundamental Freedoms ETS 5, 213 U.N.T.S. 22.

<sup>6</sup> See: Art 132(3) and 223(6) of the Civil Procedure Law: Law of the Republic of Latvia. *Latvijas Vēstnesis*, 3 November 1998, No. 326/330.

<sup>7</sup> See: § 5 of the 2004 Judgment of the Constitutional Court.

<sup>8</sup> Kurkela M., Turunen S. *Due Process in International Commercial Arbitration*. Oxford University Press, 2010, p. 43.

<sup>9</sup> See *inter alia*: Judgment of Supreme Court of the Republic of Latvia in the Case No. SKC-143/2014, 2014; Judgment of Supreme Court of the Republic of Latvia in the Case No. SPC-38, 2012; Judgment of Supreme Court of the Republic of Latvia in the Case No.SPC-10/2008, 2008, etc.

with due process in arbitral proceedings during the award's execution process.<sup>10</sup> At that point of time, the average practitioners did not face very complicated problems arising out of arbitration law, thus, also the other possible assistance of the court in arbitration process was not as contemporary a topic in the judgment.

## 2. 2014 case of the Constitutional Court<sup>11</sup>

Ten years later, the Constitutional Court again returned to the issue of the competence of the court and arbitration. In the main proceedings, "Hiponia"<sup>12</sup> was the respondent in two arbitral procedures in one arbitral institution and the disputes raised from one commercial contract. "Hiponia" insisted that the claim in arbitral court is based on forged arbitration agreement, thus it was not valid. However, the arbitral institution denied the request posed by "Hiponia" for an expertise of the arbitration agreement. Latvian law does not provide for the court's assistance in taking evidence, thus "Hiponia" had no other procedural opportunity to prove this submission. Arbitration Institution made two awards against "Hiponia".

However, in parallel with the arbitral proceedings, "Hiponia" requested the court of general jurisdiction to decide upon the validity of the arbitration clause. However, in all three instances the courts decided that they had no competence to decide the matter, as the Article 495 (1) of the Civil Procedure Law clearly stated: "an arbitration court determines the jurisdiction regarding the dispute, even if one of the parties contests the existence or the validity of this agreement."<sup>13</sup> Viz., in the court practice this norm was interpreted in a way that arbitral tribunal had exclusive competence to decide on its jurisdiction and the court of general jurisdiction could not rule on the invalidity of the arbitration clause in any circumstances. This argument was based on the cited 2004 case of the Constitutional Court, providing that the state should execute the control on arbitrations only at the stage of compulsory execution of the award, not at any other moment. In opposite, it is the author's view that the contested norm of law did not prohibit the challenge of arbitration clause also in the court, however, the courts of the general jurisdiction interpreted this article straightforwardly to reduce the case load of the courts. The author's opinion can also be substantiated by the fact that the contested norm has not been changed even after this judgment of the Constitutional Court.

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<sup>10</sup> In § 7 of the Judgment the Constitutional Court stated: "the concept "fair trial" should be attributed also to the arbitration proceedings. In this regard, not only the lack but also doubt of independence and impartiality in the arbitral procedure shall be evaluated. For example, the structure of the arbitration court, previous relations of the arbitrators with the parties, as well as other factors may serve as the reason for such doubt".

<sup>11</sup> On Compliance of Section 495(1) of the Civil Procedure Law with the first sentence in Article 92 of the *Satversme* of the Republic of Latvia. Judgment of the Constitutional Court of the Republic of Latvia in the Case No. 2014-09-01 dated 28 November 2014. *Latvijas Vēstnesis*, 1 December 2014, No. 238.

<sup>12</sup> Previous name of the company: "Hipotēku bankas nekustamā īpašuma aģentūra".

<sup>13</sup> Civil Procedure Law: Law of the Republic of Latvia. *Latvijas Vēstnesis*, 3 November 1998, No. 326/330.

In the case at hand, the Constitutional Court decided that the internationally well-known principle of the competence – competence does not exclude the possibility that the jurisdiction of an arbitration courts is examined by the court.<sup>14</sup> Namely, the arbitral tribunal is the first to decide on its jurisdiction but not the last. Thus, the Constitutional Court recognized the contested norm as unconstitutional, insofar as it prohibits from contesting the jurisdiction of arbitral tribunal at a court of general jurisdiction.

As the new Law on Arbitration Courts were adopted at the time of deciding the case, and it contained the same clause as in the Civil Procedure Law, the Constitutional Court also indicated that the particular article is unconstitutional, since it does not incorporate the strict, one-step competence – competence principle. It was specifically stressed in the Constitutional Court’s judgment that, as concerns “Hiponia”, this judgment was of retrospective force. Moreover, the “Hiponia” case was not the only one that landed in the Constitutional Court with similar factual grounds and issues.<sup>15</sup>

Taking into consideration the facts of the case, the Constitutional Court became the last judicial resort for “Hiponia” to challenge the arbitration agreement, therefore it can be concluded that there is a need for the broader scope of courts’ of general jurisdiction assistance in arbitration process.

### **3. Progressive case law of the Constitutional Court versus legislative reality**

The analyzed judgments of the Constitutional Court contributed to further interpretation of arbitration law in Latvia. Judgments complement each other, and in both cases the Court also examined the issues not covered by the constitutional claims but of importance at the time of deciding the case.

In both cases, the Constitutional Court has recognized that the UNCITRAL Model Law is a standard of arbitration used throughout the world.<sup>16</sup> Indeed, it is suggested that “the reality is that any seat whose arbitral law is modeled on the UNCITRAL Model Law will likely have legislation which meets the most basic needs.”<sup>17</sup> Even though in the annotation of the new Law on Arbitration Courts it is suggested that the law is based on UNCITRAL Model Law, however, that is not the case in reality, as shown below.

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<sup>14</sup> See: §15.5 of the 2014 Judgment of the Constitutional Court.

<sup>15</sup> On Compliance of Section 495(1) of the Civil Procedure Law with the first sentence in Article 92 of the Satversme of the Republic of Latvia. Judgment of the Constitutional Court of the Republic of Latvia in the Case No. 2014-32-01 dated 6 February 2015. *Latvijas Vēstnesis*, 09 February 2015, No. 27.

<sup>16</sup> See: § 9.1 of the 2004 Judgment of the Constitutional Court and § 15.4 of the 2014 Judgment of the Constitutional Court.

<sup>17</sup> The London Centenary Principles. Chartered Institute of Arbitrators, 2015, § 2.

The recently adopted London Centenary Principles<sup>18</sup> of the Chartered Institute of Arbitrators propose that most likely in those countries, which have not adopted the UNCITRAL Model Law, the legislation framework cannot facilitate fair and just resolution of dispute through the arbitration.<sup>19</sup> In the author's view, the arbitration seat will be only effective, efficient, predictable and clear, if it provides the appropriate state court's support as set by the UNCITRAL Model Law. For example, currently in Latvia the state courts can grant interim measures but only before commencing the arbitral proceedings<sup>20</sup> and the judge may issue the writ of execution when the compulsory execution of the arbitral award is requested.<sup>21</sup> Now, as decided in 2014 case of the Constitutional Court, the courts can rule on the jurisdiction of the arbitral tribunal, but only after the tribunal has done so. No other forms of court's assistance are available under the Latvian law.

There is no set aside procedure available under Latvian arbitration law. This is unacceptable. In both judgments, the Constitutional Court suggested that the legislator shall introduce the set aside of the arbitral award in the law. However, the legislator has not responded to this call. And, indeed, such mechanism is necessary in order to supervise compliance with the fair trial principle in arbitral proceedings; even though it is not a review of the merits, therefore it cannot be considered as appeal.<sup>22</sup> The purpose of challenging an award before a national court at the seat of arbitration is to have that court declare all, or part, of the award null and void.<sup>23</sup>

In Latvia this necessity was perfectly showed in abovementioned "Hiponia" case, when the respondent to the main arbitration proceedings had no remedy to challenge neither arbitration agreement nor arbitral award. In the case of 2004, the Constitutional Court made an interesting suggestion that "[i]n accordance with the general principle, the state is not responsible for violations of the fundamental rights in arbitration court proceedings."<sup>24</sup> Yet, further the Constitutional Court suggested that the state still had an obligation not to recognize the result of arbitral proceedings, in which the procedural rights had been violated and in contrast to the greatest number of states, in Latvia the law did not envisage the assistance by the state court in the arbitral proceedings, thus, the control of arbitration courts is concentrated on the stage of issuance of the writ of execution.<sup>25</sup> However, it is only partially true because in 2014 case the arbitral award did not require a compulsory execution, namely, the award was declaratory and the losing party had no possibility

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<sup>18</sup> It is a set of ten principles for an effective and efficient seat for the conduct of international arbitration.

<sup>19</sup> The London Centenary Principles. Chartered Institute of Arbitrators, 2015, § 2.

<sup>20</sup> Civil Procedure Law: Law of the Republic of Latvia. Latvijas Vēstnesis, 3 November 1998, No. 326/330, Article 139.

<sup>21</sup> Ibid. Article 536.

<sup>22</sup> See Article 34 of the UNCITRAL Model Law.

<sup>23</sup> Blackaby N. et al. Redfern and Hunter on International Arbitration. Kluwer Law International, 2015, p. 569.

<sup>24</sup> § 9.1 of the 2004 Judgment of the Constitutional Court.

<sup>25</sup> Ibid.

to object to this award, consequently, the court also could not perform its control over the arbitral award.

It should be added that Latvia is a party to the European Convention on International Commercial Arbitration,<sup>26</sup> which provides for the mechanism of set aside of the arbitral award. However, in the national law there are no corresponding norms that would allow the parties to use the Convention's mechanism and apply to challenge the arbitral award in the court. Thus, it can be concluded that Latvia does not fulfil the international treaty, to which it is a party.

In addition, currently, even if the enforcement of arbitral award is requested but not granted, the Civil Procedure Law does not state what happens with the arbitral award if the writ of execution is denied.<sup>27</sup> Namely, if the law is read as it is, the award continues to be valid with power of *res judicata* because there is no mechanism that would allow to annul the award. Again, this confirms that there is the need for the set aside procedure.

During the procedure in the 2014 case of the Constitutional Court, the representatives of the Parliament (*Saeima*) argued that by granting a person the right to turn to a court to contest the jurisdiction of an arbitration tribunal would create additional workload to the courts. The Constitutional Court rejected this opinion, stressing that "this argument *per se* cannot serve as grounds for depriving a person substantially of his or rights. I.e., the aim chosen by the legislator – decreasing the workload of the courts of general jurisdiction, thus speeding up other legal proceedings – may not threaten such fundamental rights of a person that he or she has not voluntarily waived." This argument is different than expressed by the Court in the case of 2004, where it has been stated that the dispute settlement in arbitration shall be facilitated, as it reduces the excessive workload of the courts.<sup>28</sup> And, indeed, in 2004 the courts received 7378 applications for the compulsory execution of the domestic arbitral awards, and this figure shows the approximate number of the cases heard by the arbitral tribunals.<sup>29</sup> Therefore, admittedly, if any additional state assistance, including setting aside procedure, existed at that time, it would really overload the courts. However, currently the average number of cases settled by the arbitration has decreased to 979 in 2015,<sup>30</sup> therefore, also from the practical point of view this argument has lost its validity.

Additionally, it is widely known that the quality of arbitration in the country depends on the educated and professional judges. The London principles provide that the basis for an effective, efficient and "safe" seat for the conduct of arbitration

<sup>26</sup> European Convention on International Commercial Arbitration. 484 U.N.T.S. 364, 1961.

<sup>27</sup> See Article 536 and 537 of the Civil Procedure Law. *Civilprocesa likuma komentāri. III daļa* (61.–86. nodaļa) (Prof. Torgāna K. red.), TNA, 2014, 165. lpp.

<sup>28</sup> § 7.2 of the 2004 Judgment of the Constitutional Court, citing European Council Committee of Ministers Recommendation No. R(86)12 Measures to prevent and reduce the excessive workload in the courts, Council of Europe, 1987, p. 6

<sup>29</sup> Approximate number because as explained above not all arbitral awards needs compulsory execution or they are recognized and executed abroad.

<sup>30</sup> Statistics of Courts Information System for 2004, 2015. Available at [https://tis.ta.gov.lv/tisreal?Form=TIS\\_STAT\\_O&topmenuid=0&id=94](https://tis.ta.gov.lv/tisreal?Form=TIS_STAT_O&topmenuid=0&id=94) [last viewed August 22, 2016].

is an independent judiciary, competent, efficient, with an expertise in commercial arbitration and respectful of the parties' choice of arbitration as their method for settlement of their disputes.<sup>31</sup> If the Latvian legislator will adopt UNCITRAL Model law, particular attention should be paid to education of the judiciary on arbitration law, which is the specific field of law.

## Conclusions

The examined Constitutional Court's rulings are a valuable contribution to the development of arbitration law in Latvia. Both judgments of the Constitutional Court discussed above show that issues regarding the interaction between the court of the general jurisdiction and arbitration are topical in Latvia. Although the dimension of the problems differs from those in other countries because Latvia has not accepted the UNCITRAL Model Law but, speaking figuratively, it has invented a new bicycle and is now testing it. However, in author's view, the court's reasonable assistance should be available throughout the arbitration proceedings as provided by the UNCITRAL Model Law. Those notions should be introduced in Latvia to guarantee the fair arbitral procedure, to attract the international players to arbitrate and to make arbitration more predictable in Latvia. But it is rather naïve to hope that the legislator will adopt the UNCITRAL Model Law in the nearest future, however, the Law on Arbitration Courts should provide at least for the set aside of arbitral awards, especially because the Constitutional Court has advised the Parliament twice regarding this need.

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<sup>31</sup> The London Centenary Principles. Chartered Institute of Arbitrators, 2015, § 2.

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