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# **The Latvian Law of Obligations: The Current Situation and Perspectives<sup>\*1</sup>**

## **1. Introduction**

The Latvian system of private law is based on the Civil Law, which was adopted in 1937 and came into force on 1 January 1938. After the restoration of independence, Latvia, in a departure from the approach of the other two Baltic States, did not draft a new civil law but, in the early 1990s, reinstated the law that had been adopted prior to World War II. The Civil Law has more than 2,400 sections, which unite and organise within a uniform system the most important provisions of private law. The Civil Law consists of an introduction and four parts: on family, inheritance, property, and the law of obligations. When reinstating the Civil Law, the legislator modernised it to the extent necessary to resume its application under the conditions of the last decade of the 20th century. The amendments that have been made to the Civil Law since the first half of the 1990s have affected mainly family and inheritance law. The amendments to the part on the law of obligations have not been too great; however, most of them have been essential. Over the last two decades, the Civil Law has proved its viability and practical suitability. The high degree of abstraction typical of the Civil Law's provisions significantly facilitates their application in practice.

The purpose of this report is to clarify how the law of obligations incorporated into the Civil Law corresponds to the legal needs of contemporary Latvia. Furthermore, this paper examines the reforms needed for improvement of the law of obligations. This research task is accomplished through discussion of the general characteristics of the Latvian law of obligations, examination of the amendments to the law-of-obligations part, and outlining of the prospects for modernising the law of obligations.

## **2. General characteristics of the Latvian law of obligations**

In its scope, the law of obligations is the most extensive part of the Civil Law. The law of obligations is covered in Sections 1401–2400 of the Civil Law. The latter part of the Civil Law consists largely of the pandect legal provisions derived from Roman law, which have been successfully fused with elements of modern civil law.

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<sup>1</sup> Report for the conference called 'Kümme aastat võlaõigusseadust Eestis ja võlaõiguse areng Euroopas' ['Ten years of the Law of Obligations in Estonia and developments of the law of obligation in Europe'], held in Tartu on 29–30.11.2012.

In the objective sense, the law of obligations is a set of legal provisions that regulate the origin, execution, and termination of obligations, just as much as the legal consequences of their infringement.<sup>\*2</sup> Even though civil-law provisions that regulate obligations are found also in many laws outside the Civil Law, traditionally in Latvia the concept 'law of obligations' is understood as exactly the set of provisions that forms the part of the Civil Law on the law of obligations. Obligation rights as a person's subjective rights are defined in Section 1401 of the Civil Law, according to which obligation rights are rights on the basis of which one person—the debtor—is required to perform certain actions of financial value for the benefit of another person, the creditor. Thus, the civil-law obligation encompasses a legal duty the fulfillment of which, in contrast to that of a moral duty, can be achieved through coercive measures of a legal nature, including the assistance of a court.<sup>\*3</sup>

The portion of the Civil Law on the law of obligations is structured as follows: It starts by addressing legal concepts common to the whole law of obligations and after that considers specific legal relationships. Accordingly, the part on the law of obligations is characterised by proceeding from the general to the specific. Sections 1401–1911 of the Civil Law regulate the institutions of law common to all law of obligations. These sections contain the general provisions on legal transactions and contracts, on entering into a contract, and on wrongful actions (including delict, compensation for loss, mutual relations of joint obligors, reinforcement of obligations rights, protection, interests, cession of right to claim, and termination of obligations rights). Thus, the provisions made in Sections 1401–1911 of the Civil Law do essentially constitute the general part of the law of obligations.

Sections 1912–2400 of the Civil Law, in their turn, address specific legal relationships and, in fact, constitute the special part of the law of obligations. These sections predominantly regulate concrete types of contracts under civil law: contracts of sale, barter, gift, rental, loan, maintenance, authorisation, and carriage, along with other important contracts. The Civil Law contains legal provisions for the most prevalent and typical contracts. A number of non-contractual relations are regulated in the conclusion of the part of the Civil Law on the law of obligations: unauthorised management, specific torts, and unjust enrichment.

Section 6 of the Civil Law indicates that the general provisions addressing obligations are applicable accordingly to legal relations pertaining to family, inheritance, and property. It was necessary to include a section of this sort in the introduction to the Civil Law because the Civil Law has no general portion summarising and addressing legal issues common to all civil law. The majority of civil-law concepts that are important for all branches of civil law—for example, persons' legal ability and capacity, expression of will, legal transaction, and contract—along with other concepts important in civil law, are regulated in the part of the Civil Law on the law of obligations. There would be no logic in specially addressing these issues repeatedly in the sections on property, family, and inheritance law. Moreover, alongside the Civil Law there are laws in Latvia that contain special private-law provisions intended for specific fields, among them the Commercial Law, the Labour Law, and the Law on the Protection of Consumers' Rights. The general law-of-obligations provisions mentioned in Section 6 of the Civil Law, thus, are applicable not only to the legal relationships in family, inheritance, and property law but also to those legal relationships regulated by the special private-law provisions.

### 3. Amendments to the part of the Civil Law on the law of obligations

Most of the fundamental amendments to the part of the Civil Law on the law of obligations were adopted after 2000. The total number of amendments is not large, but they contain important elements for modernisation of legal provisions. According to Section 1635 of the Civil Law, a person who has suffered harm in consequence of a wrongful act has the right to claim satisfaction from the infringer. In January 2006, the Saeima (Parliament) of the Republic of Latvia added to said section of the Civil Law provisions on moral

<sup>2</sup> K. Torgāns. Iepriekšējās piezīmes Civillikuma 1401.–2400 pantam [Preliminary remarks on Sections 1401–2400 of the Civil Law]. – *Latvijas Republikas Civillikuma komentāri. Saistību tiesības. (1401.–2400. p.)* [Commentaries on the Law of Obligations of the Civil Law of the Republic of Latvia (Sections 1401–2400)]. Second edition. Rīga: Mans īpašums 2000, p. 13 (in Latvian).

<sup>3</sup> K. Torgāns. *Saistību tiesības. I daļa* [Law of Obligations, Part I]. Rīga: Tiesu namu aģentūra 2006, p. 12 (in Latvian).

damage.<sup>4</sup> The concept ‘moral damages’ had been known in Latvian doctrine and judicial practice prior to that; however, with these amendments it became more concretely reflected in the law. The second part of Section 1635 of the Civil Law provides that moral damages should be understood as physical or mental suffering inflicted by way of infringement of the victim’s immaterial rights or benefits caused by wrongful actions. The amount of compensation for moral damages is set by the court at its discretion, in view of the severity and consequences of the moral damages.

In January 2006, the part of the Civil Law on the law of obligations was supplemented with provisions following from Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions. In transposition of this directive, first of all, the provisions of the Civil Law’s Section 1652 on the preconditions for default of the debtor applying were added. The new provisions allow establishing the setting in of the debtor’s default with greater accuracy and simultaneously serve as a preventive measure for avoiding the debtor’s default. Section 1765 of the Civil Law, in turn, was supplemented with special provisions on the interest rate that is lawful in the event of late payment of such financial debt as has been addressed in a contract for delivery of goods, purchase, or provision of services. The maximum rate for lawful interest is seven percentage points above the basic interest rate. The basic interest rate is four per cent; however, on each 1 January and 1 July it is adjusted in accordance with the changes in the refinancing rate of the Bank of Latvia. With introduction of the use of a basic interest rate, the rate of interest due has increased. This has a certain disciplinary effect on business transactions. In those transactions to which the new regulation does not apply, including all contracts with consumers, the general interest rate defined in the first part of Section 1765 of the Civil Law, which is six per cent per year, is still to be used.

The next important amendments to the part on the law of obligations were adopted by the Saeima in June 2009.<sup>5</sup> One of the main impetuses for these amendments to the law-of-obligations part of the Civil Law were the Principles of European Contract Law, revised and incorporated into the Draft Common Frame of Reference.<sup>6</sup> Section 1537 of the Civil Law was expressed in a new wording, providing that a contract is concluded by absent parties at the moment when the unconditional agreement by the party to whom the offer was made has reached the offeror (i.e., it codified the ‘mailbox rule’). The new language of Section 1668 of the Civil Law, when compared with the previous wording of this section, regulates clearly and understandably the legal consequences that enter into play if the opposing party accepts performance after default without objection.

Section 1724<sup>1</sup> of the Civil Law is very important in said amendments; it *expressis verbis* provides the right to the payer of contractual penalties to request a decrease in the contractual penalty to a reasonable amount. The legislator also amended a number of provisions on loss and compensation. Section 1776 of the Civil Law states that the victim has to take measures to prevent loss as are reasonable under the concrete circumstances obtaining and that the infringer may request a decrease in the recognised amount of loss in the extent to which the victim, by exercising due care, could have prevented the loss, except in the case of malicious infringement of rights. Also, a new section, Section 1779<sup>1</sup>, was added to the Civil Law; this specifies more accurately the amount of compensation for loss in the event of contract default—i.e., the loss for which the person who has caused the loss compensates the party who has suffered the loss, in the amount that could have been reasonably predicted at the moment of concluding of the transaction as the expected consequences of default, unless the default was caused through malicious intent or gross negligence.

<sup>4</sup> Grozījumi Civillikumā [‘Amendments to the Civil Law’]. – *Latvijas Vēstnesis*, 9.2.2006 (No. 24) (in Latvian).

<sup>5</sup> Grozījumi Civillikumā [‘Amendments to the Civil Law’]. – *Latvijas Vēstnesis*, 17.6.2009 (No. 94) (in Latvian).

<sup>6</sup> See V. Jarkina. Ceļā uz Latvijas Republikas Civillikuma modernizāciju [‘Toward a modernisation of the Civil Law of the Republic of Latvia’]. – *Jurista Vārds*, 19.6.2007 (No. 25), p. 10 (in Latvian); V. Jarkina. Vai sabiedrība ir gatava grozījumiem Civillikumā [‘Is the society ready for changes in the Civil Law?’]. – *Jurista Vārds*, 6.11.2007 (No. 45), p. 15 (in Latvian).

## 4. The outlook on modernisation of the law of obligations

Latvian legal literature offers advice to employ two possible, parallel ways of improving civil law: 1) introducing the necessary amendments to the Civil Law step by step, along with 2) reforming the Civil Law, with examination of the possibilities for drafting a new, 21st-century Civil Law.<sup>7</sup> It is too early to judge how rapidly Latvia could become ready for drafting of a totally new Civil Law, which would also contain a new part on the law of obligations. It is predictable that the coming years will see Latvia take the path of gradually modernising the Civil Law's portion on the law of obligations without making fundamental changes to the structure and system of the Civil Law. It has been emphasised in the legal literature, with good reason, that the attempts to unify the European law of obligations, including the Draft Common Frame of Reference for European Contract Law, will leave a significant impact upon reforms to the Civil Law.<sup>8</sup> In 2007, an extensive scientific study was conducted, commissioned by the Ministry of Justice, on the necessary amendments to the various parts of the Civil Law.<sup>9</sup> Some of the recommendations made in the study have already become reality with the amendments introduced to the part on the law of obligations in June 2009. It must be added that amendments to the Civil Law require the legislator to be especially careful, since a provision of low quality or that is badly considered could dismantle the meticulously built system of the Civil Law.<sup>10</sup>

One can readily agree with the opinion stated in the study commissioned by the Ministry of Justice that those legal provisions that regulate general issues of the law of obligations should be the first to be improved. Some amendments to the provisions addressing specific types of contracts could be considered; however, currently they are not of primary importance. It must be noted that in December 2008 the Commercial Law of Latvia was supplemented with a new part, 'Commercial Transactions'.<sup>11</sup> The main objective of the portion on commercial transactions is to simplify and expedite business transactions. The provisions included in it for the specific types of commercial transactions apply only to those transactions in which at least one party is a merchant. And yet the entry into force of the part on commercial transactions, in 2010, has reduced the need to amend the provisions of the commercial-law part of the law of obligations where specific types of contracts are concerned.

The most significant amendments that should be introduced to the part of the Civil Law on the law of obligations in the immediate future are connected with modification of the *pacta sunt servanda* (agreements must be honoured) principle, which is defined in a restrictive way in Section 1587 of the Civil law. It follows from that section that a contract legally entered into imposes upon the contracting party the duty to do what has been promised, and neither exceptional difficulty of the transaction nor difficulties in performance arising later shall give that party the right to withdraw from the contract, even if the other party is compensated for the attendant losses. Section 1588 of the Civil Law, in its turn, enshrines the general principle that one party may not withdraw from a contract without the consent of the other, even if the latter fails to perform its obligation and in consequence of that failure. Section 1589 of the Civil Law specifies that unilateral withdrawal from a contract is permitted only when it is based on the nature of the contract or when the law provides for it in certain circumstances, or when such a right has been expressly made part of the contract. When modifying the principle of the binding power of a contract, the legislator should expand

<sup>7</sup> K. Torgāns. Eiropas jurisprudences vērtības civiltiesībās: pārņemt vai nogaidīt ['European legal values in civil law: To adopt or to wait']. – *Jurista Vārds*, 20.11.2007 (No. 47), p. 19 (in Latvian).

<sup>8</sup> J. Kārklīšs. Vienotu Eiropas līgumtiesību veidošanās un ietekme uz Latvijas tiesībām ['Development of a unified European contract law and its influence on Latvian law']. – *Jurista Vārds*, 6.12.2012 (No. 49), pp. 6–13 (in Latvian).

<sup>9</sup> K. Torgāns. *Zinātnisks pētījums „Civillikuma Saistību tiesību daļas modernizācijas nepieciešamība un aktuālo privāttiesiskā regulējuma tendenču (UNIDROIT, ELTP) iespējamā ietekme uz Civillikuma Saistību tiesību daļas modernizāciju* ['Scientific study: A need for modernisation of the law of obligations part of the Civil Law and the possible influence of the current private-law drafting tendencies (UNIDROIT, PECL) on the modernisation of the law-of-obligations part of the Civil Law']. Available at [http://www.tm.gov.lv/files/archieve/lv\\_documents\\_petijumi\\_Saistibutiesibas.doc](http://www.tm.gov.lv/files/archieve/lv_documents_petijumi_Saistibutiesibas.doc) (most recently accessed on 22.10.2013) (in Latvian).

<sup>10</sup> K. Balodis. Presentation entitled 'Quality aspects of amendments to the Civil Law' at the international scientific conference at the University of Latvia Faculty of Law. Published in the proceedings 'International scientific conference: The Quality of Legal Acts and Its Importance in Contemporary Legal Space. 4–5 October, 2012.' Riga: University of Latvia Press 2012, p. 470.

<sup>11</sup> Grozījumi Komerclikumā ['Amendments to the Commercial Law']. – *Latvijas Vēstnesis*, 7.1.2009 (No. 2) (in Latvian).

the possibilities for unilateral withdrawal from a contract and should introduce a ‘change of circumstances’ clause.<sup>\*12</sup>

It must be noted that the Ministry of Justice had drafted corresponding amendments to the provisions on the binding force of a contract already in 2007.<sup>\*13</sup> Unfortunately, the legislator did not support the planned amendments in 2009, when other proposed amendments to the part on the law of obligations were introduced. The draft law prepared by the Ministry of Justice, on the one hand, maintained the general principle that a contract legally entered into imposes an obligation upon the contracting parties to fulfil the promise and does not confer on a party the right of unilateral withdrawal from the contract, even if compensation is provided for the other party’s losses. The amendments to Section 1587 of the Civil Law, drafted by the Ministry of Justice, at the same time envisaged the possibility of terminating or amending a contract whose execution has become exceptionally difficult or in response to certain objectively evident changes in circumstances. The wording for the Civil Law’s Section 1587 that was applied in the draft law provided that in cases wherein the meeting of commitments has become excessively difficult on account of objective changes in circumstances, the contracting parties have the duty to negotiate to change or terminate the contract. If the contracting parties are unable to reach agreement within reasonable time on changing or terminating it, any of the contracting parties would have the right to request the court to terminate the contract, setting a date and the conditions for termination, or to amend the contract, providing for fair distribution of the losses and benefits arising from the change in circumstances.

Those opposing the new language prepared for Section 1587 unfoundedly considered the proposed amendments to give contracting parties the right to withdraw practically from any contract and, therefore, concluded that amending the *pacta sunt servanda* principle would neither be reasonable nor be appropriate for the economic situation.<sup>\*14</sup> The fact that provisions similar to the draft for the Civil Law’s Section 1587 were later included in the provisions on franchise agreements in the commercial-transactions part of the Latvian Commercial Law, can be regarded as an interesting legislative paradox. Section 478 of the Commercial Law provides that a party to a franchise contract may withdraw from it unilaterally if the fulfilment of commitments has become too burdensome on account of changes in circumstances as objectively evident or if any party, before entering into the franchise contract, provided false information on circumstances that had a substantial meaning at the time of entry into the franchise contract. Thereby, the franchise contract has become the only contract regulated in Latvian law from which a contracting party may withdraw on the above-mentioned legal basis that the legislator was unwilling to apply to contracts in general. In order for a rationally arranged system of private law to be in place, the legal provisions that in their nature are applicable to contracts in general should be set forth in the Civil Law, not the Commercial Law. It is hoped that it will become possible in the coming years to overcome the scepticism of the banking sector and other opponents with regard to the need to amend the Civil Law’s provisions on the binding force of a contract.

## 5. Conclusions

The material on the law of obligations constitutes the most sizeable part of the Civil Law of 1937, which was reinstated and amended after Latvia regained its independence in the early 1990s. The last two decades have proved that the provisions of the law of obligations as included in the Civil Law are sufficient for meeting the contemporary legal needs of Latvia. The high degree of abstraction of the law-of-obligations provisions facilitates their application in practice, enabling their optimal application in dealing with civil-law cases of diverse types.

The current agenda of Latvia’s legislator does not feature drafting of a new Civil Law. The law of obligations is improved step by step in Latvia, as part of the effort to modernise the Civil Law, through introduction

<sup>12</sup> J. Kārklīšs (see Note 8), p. 13.

<sup>13</sup> Likumprojekts „Grozījumi Latvijas Republikas Civillikumā” [‘Draft law “Amendments to the Civil Law of the Republic of Latvia”]. Available at [http://helios-web.saeima.lv/saeima9/lasa?dd=LPO528\\_o](http://helios-web.saeima.lv/saeima9/lasa?dd=LPO528_o) (most recently accessed on 22.10.2013) (in Latvian).

<sup>14</sup> Vai un cik lielā mērā grozāms Civillikums: ekspertu diskusija „Civillikums ceļā uz modernizāciju” [‘Should the Civil Law be amended, and to what extent?: Experts’ discussion “Towards Modernisation of the Civil Law”]. – *Jurista Vārds*, 29.4.2008 (No. 17), p. 13 (in Latvian).

of amendments—only a few but essential ones—to the provisions of the portion on the law of obligations. The amendments introduced thus far fit quite well into the civil-law system. Cautious and gradual reform of the law of obligations can be expected also in the future. The legislator focuses mainly on improving the general provisions made in the part of the Civil Law on the law of obligations. These include, for instance, the rules on conclusion of a contract and provisions dealing with legal remedies. A reform of the provisions on the binding force of a contract would also help to provide the law of obligations with a more modern outlook.

In general, reforms to the law of obligations in Latvia should correspond to the European trends in civil-law development. The blueprints for unification of the European law of obligations, including the Draft Common Frame of Reference for European Contract Law, will leave a significant impact upon the reform of the Latvian law of obligations.