OECD REVIEW OF THE CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

LATVIA
OECD Review of the Corporate Governance of State-Owned Enterprises

LATVIA
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FOREWORD

This report evaluates the corporate governance framework for the Latvian state-owned enterprise sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”). The report was prepared at the request of the Republic of Latvia. It is the second country review conducted by the OECD Working Party on State Ownership and Privatisation Practices, the body responsible for encouraging and overseeing the effective implementation of the SOE Guidelines. The review process is open to OECD countries as well as partner countries.

The report is based on information volunteered by the Latvian authorities, including during discussions held with Latvian governmental and non-governmental representatives during two missions to Riga, as well as independent research undertaken by the OECD Secretariat. It was produced by Hans Christiansen and Mary Crane-Charef of the OECD Secretariat in collaboration with Lars-Erik Fredriksson of the Swedish Ministry of Finance. The report was approved for publication under the authority of the Working Party in November 2014.

The report is structured as follows. Part I provides information about the context in which Latvian SOEs operate. Part II refers successively to the different chapters of the SOE Guidelines, evaluating Latvian norms and practices in their light. The final section sets out the Working Party’s conclusions and recommendations for improving the corporate governance framework applicable to Latvian SOEs. The recommendations are forward-looking, aiming to assist policymakers and the government agencies exercising the ownership function in responding to emerging developments and challenges.
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# ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
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<tbody>
<tr>
<td>Art.</td>
<td>Article</td>
</tr>
<tr>
<td>BAS</td>
<td>Baltijas Aviacijas sistemas</td>
</tr>
<tr>
<td>BICG</td>
<td>Baltic Institute for Corporate Governance</td>
</tr>
<tr>
<td>CMI</td>
<td>Central Management Institution</td>
</tr>
<tr>
<td>CPCB</td>
<td>Corruption Prevention and Combating Bureau</td>
</tr>
<tr>
<td>CSCC</td>
<td>Cross Sectorial Coordination Centre</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>EGM</td>
<td>Extraordinary general meeting</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>EUR</td>
<td>Euro</td>
</tr>
<tr>
<td>FICIL</td>
<td>Foreign Investors’ Council in Latvia</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>IAS</td>
<td>International accounting standards</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>IPO</td>
<td>Initial public offering</td>
</tr>
<tr>
<td>ISA</td>
<td>International standards on auditing</td>
</tr>
<tr>
<td>JSC</td>
<td>Joint stock company</td>
</tr>
<tr>
<td>LLC</td>
<td>Limited liability company</td>
</tr>
<tr>
<td>LMT</td>
<td>Latvijas Mobilais telefons</td>
</tr>
<tr>
<td>LPA</td>
<td>Latvian Privatisation Agency</td>
</tr>
<tr>
<td>LVL</td>
<td>Latvian Lats</td>
</tr>
<tr>
<td>LZRA</td>
<td>Latvian Association of Certified Auditors</td>
</tr>
<tr>
<td>NASDAQ OMX Riga</td>
<td>Regulated securities exchange in Latvia</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-governmental organisation</td>
</tr>
<tr>
<td>NHS</td>
<td>National Health Service</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PUC</td>
<td>Public Utilities Commission</td>
</tr>
<tr>
<td>SCS</td>
<td>State capital shares</td>
</tr>
<tr>
<td>SOE</td>
<td>State-owned enterprise</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollar</td>
</tr>
<tr>
<td>WP SOPP</td>
<td>Working Party on State Ownership and Privatisation Practices</td>
</tr>
</tbody>
</table>
INTRODUCTION

The purpose of this report is to evaluate, at the request of the Republic of Latvia, the corporate governance framework for Latvian state-owned enterprise sector in force at the time of writing against the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”), to which the governments of OECD’s 34 member countries adhere.

Since their inception in 2005, the SOE Guidelines have provided concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient and transparent. The non-binding Guidelines were developed by the OECD Working Party on State Ownership and Privatisation Practices (WP SOPP). They complement and are compatible with the OECD Principles of Corporate Governance. The Guidelines, and therefore this report, are primarily oriented to SOEs using a distinct legal form (i.e., separate from the public administration) and engaging in economic activities (i.e. with the intention that the bulk of their income coming from sales and fees), whether or not they pursue a public policy objective as well. These SOEs may be in competitive or in non-competitive sectors of the economy. When necessary, the Guidelines distinguish between listed and non-listed SOEs, or between wholly owned, majority, as well as in some cases also partly state-owned enterprises, since the corporate governance issues are somewhat different in each case. This report also applies the Guidelines, where relevant, to the subsidiaries of these aforementioned entities.

The report was prepared by staff members in the OECD Corporate Affairs Division providing secretariat support to the WP SOPP with the participation of a member of the WP SOPP Bureau, Mr. Lars Erik Fredriksson of the Swedish Ministry of Finance. Information included in this report is based on a variety of primary and secondary resources current as of 30 September 2014, including: Responses by the Latvian authorities to a standard questionnaire on the SOE Guidelines; Latvian authorities’ written responses to follow-up questions from the WP SOPP Secretariat at various stages throughout this exercise; two visits to Riga: an introductory one-day visit with government officials on 21 February 2014 and a three-day fact-finding visit from 26 to 29 May 2014 that included meetings with government representatives, as well as civil society, business organisations, and SOEs; and additional desktop research. A preliminary version of this report was discussed by the WP SOPP on 3 April 201. This report was discussed by the WP SOPP during its review of Latvia’s position relative to the SOE Guidelines on 23 October 2014.

Following this introduction, Part A of the report provides information about the context in which Latvian SOEs operate. Part B refers successively to the different chapters of the Guidelines, evaluating Latvian norms and practices in their light. The final section sets out the report’s conclusions and recommendations. Complementary information can be found in the annexes.
**Part A**

**THE SOE LANDSCAPE**

1. **Context for Latvia’s SOE sector**

   **Economy.** Latvia has largely recovered from the 2008-2009 economic and financial crisis, which crippled the economy and led Latvia to request financial assistance from the International Monetary Fund and European Commission. In December 2012, Latvia announced it had fully repaid its IMF loans, more than two years in advance, thanks to strict austerity measures.  

   Latvia joined the European Union in 2004 and adopted the euro in January 2014. Latvia’s was the fastest-growing economy in the EU in 2013, according to the European Commission. Economic growth, according to the Latvian Government, was estimated at the time of writing to between 2.9 and 3.5% in 2014. The Latvian Ministry of Economy credits the recovery in part to an increase since 2010 in Latvian exports: Overall exports of goods and services have exceeded the pre-crisis level by 20%, though this growth has slowed on low external demand for Latvian exports (In 2013, 67% of Latvian exports went to the European Union, while 20% went to the Commonwealth of Independent States).  

   Moreover, Latvia’s position has improved on several cross-country rankings. The country ranked 24th out of 189 economies in the Doing Business 2014 annual report prepared by the World Bank and the International Finance Corporation, and was one of 29 economies that ranked as improving the most across three or more Doing Business topics in 2012/13. Latvia ranked 42nd out of 148 economies in the World Economic Forum’s Global Competitiveness Report 2014-2015, from 52nd in the 2013-2014 report. Finally, Latvia ranked 43 out of 175 countries and territories in the 2014 Transparency International Corruption Perceptions Index survey, up from 54 in 2012 and 61 in 2011.

### Table 1. Key economic indicators (2009-2014)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014f</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Increase over the previous year, as percent</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross domestic product</td>
<td>-17.7</td>
<td>-1.3</td>
<td>5.3</td>
<td>5.2</td>
<td>4.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Consumer prices</td>
<td>3.5</td>
<td>-1.1</td>
<td>4.4</td>
<td>2.3</td>
<td>0.0</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>As percent</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>17.5</td>
<td>19.5</td>
<td>16.2</td>
<td>15.0</td>
<td>11.9</td>
<td>10.1</td>
</tr>
<tr>
<td><strong>General government sector balance</strong></td>
<td>-9.1</td>
<td>-8.1</td>
<td>-3.5</td>
<td>-1.4</td>
<td>-0.9</td>
<td>-0.9</td>
</tr>
<tr>
<td><strong>Exports-imports balance</strong></td>
<td>-1.5</td>
<td>-1.4</td>
<td>-4.8</td>
<td>-3.9</td>
<td>-1.9</td>
<td>-1.1</td>
</tr>
</tbody>
</table>

1. The Ministry of Finance has separate, lower forecast figures for many of the measures included in this table for 2014: GDP: 2.9; consumer prices: 0.8; unemployment rate: 10.8; and exports-imports balance -1.7. (See the Ministry of Finance’s economic forecast as of July 2014 online here: www.fm.gov.lv/files/tausaimnieciba/Macro%20board-July-ENG_2014_1.pdf)

Table 2. Structure of the Latvian economy (by value added, %)

<table>
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<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, and fishery</td>
<td>4.5</td>
<td>3.9</td>
<td>3.0</td>
<td>3.8</td>
<td>5.0</td>
<td>5.1</td>
<td>5.0</td>
<td>4.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14.4</td>
<td>12.9</td>
<td>10.8</td>
<td>10.8</td>
<td>13.3</td>
<td>14.1</td>
<td>14.5</td>
<td>13.9</td>
</tr>
<tr>
<td>Other industries</td>
<td>4.2</td>
<td>3.3</td>
<td>4.3</td>
<td>4.9</td>
<td>5.3</td>
<td>5.2</td>
<td>5.1</td>
<td>4.7</td>
</tr>
<tr>
<td>Construction</td>
<td>6.8</td>
<td>7.0</td>
<td>10.1</td>
<td>8.0</td>
<td>5.3</td>
<td>5.4</td>
<td>6.1</td>
<td>6.5</td>
</tr>
<tr>
<td>Trade, accommodation, and catering</td>
<td>18.5</td>
<td>21.6</td>
<td>18.8</td>
<td>16.9</td>
<td>17.3</td>
<td>17.6</td>
<td>17.9</td>
<td>17.8</td>
</tr>
<tr>
<td>Transport and storage</td>
<td>9.5</td>
<td>10.5</td>
<td>8.1</td>
<td>11.1</td>
<td>11.4</td>
<td>12.3</td>
<td>12.1</td>
<td>11.3</td>
</tr>
<tr>
<td>Other commercial services</td>
<td>25.1</td>
<td>25.7</td>
<td>28.4</td>
<td>27.5</td>
<td>27.3</td>
<td>26.3</td>
<td>26.1</td>
<td>27.6</td>
</tr>
<tr>
<td>Public services</td>
<td>17.0</td>
<td>15.1</td>
<td>16.5</td>
<td>17.0</td>
<td>15.2</td>
<td>14.0</td>
<td>13.2</td>
<td>13.4</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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Recent tensions in the Russian Federation (hereinafter “Russia”) and Ukraine present downside risks to Latvia’s economic growth, according to 2014 assessments made by the European Commission, the International Monetary Fund, and the Latvian Government.\(^\text{10}\) Russia receives roughly 12% of Latvia’s exports, while Latvia’s large port and railway cargo transit sectors are particularly exposed to changes in Russia’s economy. (For more on ports see section A.2.d.) Latvia also receives nearly all of its natural gas from Russia. The former Minister of Economy Vjaceslavs Dombrovskis was quoted in May 2014 as saying “it would be hard to find a country with greater relative exposure” to developments regarding Russia.\(^\text{11}\) Additionally, Latvia’s economy could be negatively impacted by prolonged weakness in euro area trade-partner countries.

**Government.** Latvia is a parliamentary republic. Deputies are elected to the 100-seat parliament (the Saeima) under a system of proportional representation. The highest executive power lies with the Cabinet of Ministers, which is led by the Prime Minister. The most recent parliamentary elections took place on 4 October 2014 and reaffirmed the ruling coalition, which secured a 61-seat majority. On 5 November, the Saeima approved the new Latvian cabinet under Prime Minister Laimdota Straujuma.

The Straujuma coalition government represents the following political parties: the conservative Unity Party (Straujuma registered as Unity member just prior to her initial appointment as Prime Minister by President Andris Berzins on 22 January 2014); the conservative-nationalist National Alliance Party (officially the National Alliance All for Latvia-For Fatherland and Freedom/LNNK Party); and the centrist Union of Greens and Farmers.\(^\text{12}\)

**Legal system.** Latvia is a civil law country. The legal system is closely modelled on Germany’s, including the Constitution, commercial law, and rules bearing on public administration. In the context of corporate governance, this for instance implies that companies are overseen by a two-tier system of supervisory boards (henceforth “board of directors”) and management boards. Of note, a general lack of efficiency in Latvia’s court system and other frameworks for settling disputes has been frequently cited as a drag on the economy’s competitiveness.\(^\text{13}\)

**Capital market.** Listed companies are listed on the NASDAQ OMX Riga. The trading platforms, along with the stock markets in Tallinn and Vilnius, form the NASDAQ OMX Baltic Securities Market.\(^\text{14}\) The common NASDAQ OMX Baltic market is meant to minimize to the extent possible the differences between the three Baltic markets in order to facilitate cross-border trading and to attract more investments to the region. At the time of writing, five companies were listed on the NASDAQ OMX Riga “Main list”, accounting for roughly 10% of total Baltic Main list capitalisation for the
three combined NASDAQ OMX Baltic exchanges, and 24 companies were listed on the exchange’s “secondary list”, accounting for 38% of NASDAQ OMX Baltic’s total Secondary list capitalization. NASDAQ OMX Baltic Main list companies must meet a certain size threshold in order to list and apply IFRS; there is no quantitative requirement for the Secondary list.\textsuperscript{15}

Listed companies are regulated by the Financial Instrument Market Law (2004) and other regulations, such as the NASDAQ OMX Riga’s Principles of Corporate Governance and Recommendations on their Implementation\textsuperscript{16} and the NASDAQ OMX Riga Rules on Listing and Trading of Financial Instruments on the Markets Regulated by the Exchange.\textsuperscript{17} International Financial Reporting Standards (IFRS) are recognized. The Financial Instrument Market Law established the Financial and Capital Market Commission (Finanšu un kapitāla tirgus komisija), an autonomous public institution mandated with overseeing the Latvian financial sector and with ensuring stability of financial and capital markets. The Government owns 10\% shares in one entity listed on the NASDAQ OMX Riga Main list, the Latvian Shipping Company (Latvijas kuģniecība) and owns 0.0003% of shares in Latvijas Gāze, which is listed on the Secondary list and is the largest Latvian company on the exchange by market value (estimated at EUR 375 million as of 31 December 2013.)\textsuperscript{18}

2. \textbf{Overview of the state-owned sector}

\textit{a. Types of SOEs and sectorial composition}

As of end-2012, Latvian authorities report that the State fully owns 69 SOEs and owns more than 50\% shares in another eight enterprises and owns between 10\% and 50\% shares in 17 enterprises.\textsuperscript{19} The Government reports that it holds a minority (less than 10\%) share in a further 51 commercial enterprises.\textsuperscript{20} Moreover, Latvian SOEs hold shares in 114 other enterprises, with ownership ranging from 0.01\% to wholly owned subsidiaries. Latvian SOEs take one of two legal forms: state-owned joint stock companies (“akciju sabiedrība”; JSC) and limited liability companies (sabiedrība ar īerobežotu atbildību; LLC). There are no statutory corporations in Latvia’s SOE sector.

The SOE sector in Latvia, measured relatively to the size of the national economy, is larger than OECD averages. Figure 1, below, provides a comparison with those OECD countries that, according to a recent study, have the largest SOE sectors. With 6.25\% of total employment, Latvia’s SOE economy is exceeded only by Norway, as well as – by a narrower margin – France and Slovenia.\textsuperscript{21}

However, when the comparison is broadened to include all state-invested enterprises (with a state ownership of at least 10\%), Latvia, which has few major investments of this kind, becomes less of an outlier. Arguably, the Latvian SOE sector is, in overall terms, largely comparable with many of the other post-transition economies in Eastern Europe.

The sectorial composition of the Latvian SOE economy shows, also broadly consistent with a pattern in many East European countries, that much of the corporate valuation is concentrated in a few companies in the utilities and network industries, financial institutions, as well as a large SOE in the forestry sector (Table 3).
In two aspects, Latvia is perhaps less typical. First, it is one of the relatively few post-transition governments to have wholly divested of all companies in the manufacturing industry. Second, there is a number of sizeable companies in the “others” category, which in most other countries would comprise mostly small-scale real estate management companies, special-purpose vehicles, etc. The reason is that the Latvian authorities have corporatized a number of public sector activities that might in other jurisdictions have resided with government agencies, including with regards to the provision of public health services. As discussed below, even the national privatisation agency is incorporated under company law.

A few individual SOEs stand out in terms of individual importance. For instance, the electricity company Latvenergo is by far the most valuable corporate asset in the state portfolio, with a book equity value exceeding EUR 1.9 billion. Latvenergo enjoys a monopoly position as the largest producer of electricity in Latvia and controls all of the country’s public electricity distribution networks. The next-largest SOEs are the railway company, Latvijas Dzelzceļš, which manages the public-use railway infrastructure and owns shares of Latvia’s largest freight rail company, and the state forestry company, Latvijas Valsts Meži, both with an equity value just above EUR 300 million. The largest SOE employer is Latvijas Dzelzceļš, followed by Latvijas Pasts (the postal service), Latvenergo and some of the health care providers. A detailed list of the largest Latvian SOEs is provided in Annex 1.

Figure 1. Share of SOEs of total dependent employment

Table 3. An overview of the companies majority-owned by the Latvian government

<table>
<thead>
<tr>
<th>Main sector</th>
<th>Number of enterprises</th>
<th>Number of employees</th>
<th>Value of enterprises (EUR million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>74</td>
<td>52 240</td>
<td>3 702.8</td>
</tr>
<tr>
<td>Primary sectors</td>
<td>1</td>
<td>1 234</td>
<td>306.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Finance</td>
<td>5</td>
<td>2 230</td>
<td>351.3</td>
</tr>
<tr>
<td>Telecoms</td>
<td>5</td>
<td>3 138</td>
<td>338.7</td>
</tr>
<tr>
<td>Electricity and gas</td>
<td>2</td>
<td>4 517</td>
<td>2 012.6</td>
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<tr>
<td>Transportation</td>
<td>6</td>
<td>16 071</td>
<td>220.4</td>
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<tr>
<td>Other utilities</td>
<td>1</td>
<td>4 470</td>
<td>8.2</td>
</tr>
<tr>
<td>Real estate</td>
<td>5</td>
<td>960</td>
<td>151.1</td>
</tr>
<tr>
<td>Other activities</td>
<td>49</td>
<td>19 620</td>
<td>313.8</td>
</tr>
</tbody>
</table>


b. Organization of state enterprise ownership by sector

Latvia has a decentralized SOE ownership structure, under which Latvian SOEs are overseen and managed by 11 ministries and three public institutions. These 14 institutions are tasked with ownership responsibilities under the Law on State and Local Government Capital Shares and Capital Companies. In line ministries, decisions are made by the state secretary, or another official of the ministry authorized by the state secretary (Art. 12). In public institutions, this responsibility is assigned to the head of the institution (Art. 15). The representative of the holder of state capital shares (state secretaries or heads of institutions) are assisted in his or her functions by a “responsible employee” (Art. 16), who is a civil servant and is appointed by the state secretary or institution head to keep the shareholder up to date on the operations of the SOE. Finally, reporting on the SOE sector to the Cabinet and Parliament is decentralized: Line ministries and institutions individually submit reports on behalf of the SOEs in their portfolios.

Under the current SOE framework, there is no clear distinction between the state’s ownership function from other state functions that could influence conditions for Latvian SOEs. Latvian authorities stated that, “with some exceptions, ministries often simultaneously carry out sectorial policy planning and SOE management”. They are also entitled to set the SOEs’ commercial and non-commercial objectives, as described more fully below (sections A.4.a.ii and B.1.c). Latvia adds that “using SOEs as a vehicle for sectorial policies is a widespread practice in Latvia across various sectors”. In a number of cases, ministries are also the main or only shareholder in an SOE and its main or principal client; this is most often the case in relation to state-owned real estate enterprises.

The remainder of this section summarises the sectors in which Government ministries set sectorial policy and also own capital shares in SOEs. In some cases, SOE ownership has been transferred to a separate ministry or institution, either in preparation for privatisation (the Latvian Privatisation Agency [LPA]) or to conform to specific directives from the European Parliament and Council of the European Union. The list of sectors is organised according to their commercial orientation. This categorisation is based on sectors that may receive Government subsidies to finance
their social or public policy objectives; SOEs in more commercially oriented sectors are expected to finance their operations through commercial activities (see section B.1.c, below for more information).

(i) Sectors that are mostly commercially oriented

Energy

The Ministry of Economy is responsible for developing and implementing state policies in the energy sector. The Ministry also holds 100% of the state shares in Latvenergo, which is Latvia’s largest SOE and the leading electricity supplier in Latvia and in the Baltic region, with a 32% regional market share. It is also the only supplier and vendor of electricity for Latvian households. (For note, Latvenergo is preparing for the liberalisation of the Latvian electricity market, which is scheduled to be opened to competition as of 1 January 2015. As a result, Latvenergo will be competing in an open market against other electricity suppliers and will no longer be subsidizing household electricity consumption.)

The Ministry of Economy, via Latvenergo, is also the ultimate beneficiary shareholder of the following Latvenergo subsidiaries: Sadales tīkls (electricity distribution); Elektrum Eesti (electricity trade in Estonia) and its subsidiary, Elektrum Latvija (electricity trade in Latvia); Elektrum Lietuva (electricity trade in Lithuania); and Latvijas elektriskie tīkli (transmission system asset management). The Ministry is also the ultimate beneficiary shareholder in these additional Latvenergo subsidiaries: Liepājas enerģija (thermal energy generation and trade, electricity generation); Pirmais Slēgtais Pensiju Fonds; Nordic Energy Link; and Rīgas siltums. Enerģijas publiskais tirgotājs (“Public Trader of Energy”) is a new Latvenergo subsidiary that began operating in April 2014, which will perform public electricity trader functions according to the Electricity Market Law.

The Ministry of Finance owns 100% of the shares in the electricity transmission company, Augstsprieguma tīkli. The company is a former Latvenergo subsidiary that was spun off in 2012 in order to comply with Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity. The Ministry of Finance paid Latvenergo EUR 5.5 million for the company in 2011.

Transport

Transport sectorial policy is set by the Ministry of Transport. The sector includes railways, road traffic, maritime and aviation, as well as passenger carriage and transit branches. The Ministry owns 100% of the shares in a number of major SOEs in this sector. These include Latvijas Dzelzceļš ("Latvian Railway": railway infrastructure management); Pasažieru vilciens ("Passenger Train": railway passenger transport services, spun off from Latvijas Dzelzceļš in 2009 according to EU rules); Starptautiskā lidosta "Rīga" (Riga International Airport); Ceļu satiksmes drošības direkcija (registration and technical supervision of road vehicles, qualification of drivers, registration of watercrafts intended for inland waterways); Latvijas Autoceļu uzturētājs (maintenance work, construction and repair of state highways and engineering structures and communication systems related); Latvijas Gaisa satiksme (air navigation services); Latvijas Jūras administrācija (maritime services); Latvijas Valsts ceļi (management of the state road network, administration of the State Road Fund); and Autotransporta direkcija (commercial cargo transportation licensing and monitoring). The Ministry is also the ultimate beneficial owner in LatRailNet, a 100%-owned subsidiary of Latvijas Dzelzceļš, which is responsible for determining rail infrastructure charges and the allocation of rail infrastructure capacity and whose tasks are directly overseen by the State Railway Administration (SRA).
The Ministry of Transport also owns 99.77% of shares in the Air Baltic Corporation, though the Government is in the process of selling these assets. The remaining 0.2% shares are held by three private investors.\textsuperscript{32} (See also section A.3.a.)

Electronic communications and postal services

The Ministry of Transport is also responsible for setting policy in the electronic communications sector, as per Art. 5(1) of the Electronic Communications Law, and wholly owns one SOE in the sector, Latvijas Valsts radio un televīzijas centrs (operator of the terrestrial radio and television broadcasting network, electronic communication services). The Ministry is also responsible for policy in the postal sector, as per the Latvian Postal Law, and wholly owns the Latvian postal operator, Latvijas Pasts, though Latvijas Pasts’ compliance with Latvian laws and regulations is regulated by the Public Utilities Commission (PUC).\textsuperscript{33}

The Ministry of Environmental Protection and Regional Development owns shares in the SOE Elektroniskie sakari, which is responsible for the administration of Latvia’s radio frequency spectrum and related services, and is also responsible for supervising the installation and construction of electronic communications networks. The Ministry of Environmental Protection and Regional Development—and not the Ministry of Transport—exercises ownership over Elektroniskie sakari in conformity with Art. 3(2) of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002, which requires that EU member states that retain ownership or control of undertakings providing electronic communications networks and/or services must ensure effective structural separation of the regulatory function from activities associated with ownership or control.

The LPA represents the State as an owner of 51% of capital shares in Lattelecom.\textsuperscript{34} The LPA directly holds 5% shares in Latvijas Mobilais telefons (LMT). The State indirectly holds additional shares in LMT, via the 23% of shares held by Lattelecom (in which the LPA has a controlling interest) and the 23% of shares held by Latvijas Valsts radio un televīzijas centrs (100% owned by the Ministry of Transport).\textsuperscript{35} The mission team has not been able to establish the degree to which the Ministry of Transport may be able in practice to exercise influence over the shares held by LPA. If consolidated, the different stakes amount to majority ownership for the State as an ultimate beneficiary owner.

![Figure 2. Latvijas Mobilais telefons ownership structure](source: Latvia’s responses to questions from the Secretariat, received 18 July 2014; LMT website [www.lmt.lv/lv/lmt-dalu-ipasnieki](http://www.lmt.lv/lv/lmt-dalu-ipasnieki))
Finance

The Ministry of Finance oversees policy in this sector, including short- and long-term financial policy and financial markets. Until 2013, the Ministry of Finance was a shareholder in the Hipotēku un zemes banka (the Mortgage and Land Bank of Latvia [MLB]), which after the sale of the bank’s commercial operations in 2012, was reorganized and renamed in 2014 as Latvijas Attīstības finanšu institūcija “Altum”. The Ministry has since sold its shares in the bank’s commercial operations, and Latvia reports that the Ministry of Finance now has no shares in any bank. (The Ministry of Finance owns 100% of Latvijas Loto. See Box 3 in section A.4.a.ii, below.)

A new SOE was created in the financial sector in September 2014: the joint stock company, Attīstības finanšu institūcija (“Development Finance Institution”). The new SOE is the result of a merger between three former SOEs: the non-commercial arm of the Mortgage and Land Bank of Latvia (MLB), Latvijas Attīstības finanšu institūcija “Altum” (Latvian Development Institution “Altum”); Latvijas Garantiju Aģentūra (Latvian Guarantee Agency) and Lauku Attīstības Fonds (Rural Development Fund). The merger is scheduled for completion by the end of 2014. The Ministry of Finance, Ministry of Economics and Ministry of Agriculture will exercise the ownership function over the enterprise, whose overall objective will be to support small- and medium-sized enterprises through the provision of soft loans, equity investments, and guarantees. (See section B.2.c, below, for more on the Development Finance Institution’s board of directors.)

The LPA exercises controlling interest in two companies in the finance sector: Reverta and Citadele bank, the two financial institutions (following a “good bank – bad bank” model) that were created out of the failed Parex Bank in 2008. Before the financial crisis, Parex bank was the second-largest bank in Latvia in terms of assets with a market share of 18% in the Latvian deposits market and 12% in the Latvian lending market. The LPA owns 75% of the commercially operating Citadele Bank; the European Bank for Reconstruction and Development (EBRD) owns the remaining 25%. The LPA owns 84.15% of Reverta, which inherited Parex’s distressed assets. EBRD owns 12.74% of Reverta shares, and “other shareholders” own 3.11%. Only Citadele was slated for privatisation. (On 5 November 2014, the LPA announced the Government had agreed to sell its 75% stake in Citadele to a group of international investors.) Based on the Government’s sales strategy, approved by the Cabinet of Ministers in 2011 and reapproved in 2013, Reverta will not be sold and is continuing the orderly recovery of state funds.

Agriculture and forestry

The Ministry of Agriculture is both responsible for setting and implementing rural and forest policy, and owns 100% shares in the State forestry company, Latvijas valsts meži (Latvian State Forests). Latvijas valsts meži was established under the Law on Forests to administer and manage State forest property. The Law also stipulates that the Ministry of Agriculture is responsible for determining the aims of the state forest policy and to supervise their fulfilment. The SOE’s operations are divided into the following areas of business: Silviculture; forest infrastructure and development; lumber production and supply; forest seeds and plants production; hunting and recreation; and real estate, including leasing 19 000 hectares of land and access to Latvijas valsts meži’s sand and gravel pits around the country. (See section A.4.ii above for more on Latvijas valsts meži’s objectives.)
Box 1. Spotlight on: The Ministry of Agriculture and the forestry sector

Brief overview of the forestry sector

The Latvian forestry sector is crucial to Latvia’s economy. Forests account for 52% of Latvia’s territory, and 47% of all forest lands are owned by the state. Other than the state-owned Latvijas valsts meži, forest owners in Latvia include (in order from largest to smallest area of forest land owned): Swedish forest owner Bergvik Skog; Riga municipality-owned Rīgas meži; Latvia-based Foran Real Estate, owned by foreign and Latvian investors; and Swedish forest owner Sodra Mežs. As of 2011, forestry, wood processing and furniture-making represented 6% of Latvia’s GDP. The forest sector also represents a large proportion of the value of Latvia’s goods exports, totalling EUR 1.72 billion in 2012.

Figure 3. Share of the forestry sector in total Latvian exports, 1993-2013

Source: Latvia’s responses to questions from the Secretariat, received 18 July 2014

Figure 4. Added value of the forest sector and share in total GDP, 2000-2013

Source: Latvia’s responses to questions from the Secretariat, received 18 July 2014
Forestry sector policy-making

Latvian forestry policy is set forth in the 1998 forestry policy document. It sets the goals and principles for the sustainable management of all Latvia’s forests, including forest lands owned by the state, local authorities, and natural or legal persons. To this end, the Government has four key responsibilities:

- Policy and legislation development;
- Monitoring compliance with forestry policy and legislation by forest owners and managers;
- Providing support functions to ensure the sector’s sustainable development (i.e., education and training, research, forest protection, etc.); and
- Fulfilling the ownership function for state-owned forests.

Implementing forestry policy

To meet these objectives, the Ministry divided its responsibilities between the Ministry itself, an enforcement body (the State Forest Service), and an SOE (Latvijas valsts meži).

- The State Forest Service is an independent organization, subordinate to the Ministry of Agriculture, which is charged with monitoring implementation of state forest policy, laws, and regulations. The Ministry of Agriculture cannot give direct orders to the State Forest Service and can only intervene in the organisation’s operations if the law has been violated. The Service’s Director-General is appointed by the Cabinet on the recommendation of the Ministry of Agriculture.

- Latvijas valsts meži, or Latvia State Forests, was established in 1999 upon the adoption of the state forestry policy document to fulfil the two state forest ownership objectives included in the policy document: (1) to preserve the value of Latvian state forests, and (2) to create a profit for the owner—the State. Latvijas valsts meži’s role in the forestry sector was further codified in the Law on Forests. Art. 4(2) of the law states that Latvijas Valsts meži is responsible for managing and protecting Latvia’s state-owned forest property.

The Ministry of Agriculture also holds capital shares in the following SOEs: Lauku attīstības fonds (rural business support programmes); MeliorprojeCTS (land and water resource management, rural infrastructure and development); and Latvijas Lauku konsultāciju un izglītības centrs (rural consultancy and training). The Ministry is also the ultimate beneficial owner of the following Latvijas valsts meži subsidiaries: Jaunmoku Castle (100% owned by Latvijas valsts meži); “Meža koknes produktu pētniecības un attīstības institūts” (“Latvia’s Forest and Wood Products Research and Development Institute”, 40.22% owned by Latvijas valsts meži); and Latvijas finieris (“Latvian Plywood”, 0.82% owned by Latvijas valsts meži). Finally, the LPA holds shares, which were formerly held by the Ministry of Agriculture, in Sertifikācijas un testēšanas centri un testēšanas centru (certification and laboratory services) and Piensaimnieku laboratorija (“Dairy Farmers’ Laboratory”), since both are being prepared for sale.

(ii) Sectors that are less commercially oriented

Healthcare

The Ministry of Health is responsible for public health, healthcare, and pharmacies. The Ministry’s portfolio includes 13 wholly owned SOEs and a 14th SOE that is co-owned by the Ministry of Health and a hospital that is fully owned by the Ministry of Health, making the Ministry the full ultimate beneficial owner. The main objective of these SOEs (mostly hospitals and treatment
centres) is of a social nature: to provide healthcare services, including emergency medical assistance guaranteed by the State. The services provided by Ministry of Health SOEs are purchased under an annual agreement with the National Health Service (NHS), which is an administrative institution subordinate to the Ministry of Health. The NHS’ aim is to implement State policy for planning and providing healthcare services, to administer State budgetary funds allocated to healthcare, and to implement the Government’s e-health programme. One-third of the hospitals from which the NHS buys in-patient services are owned by the Ministry of Health; two-thirds are owned at the local level. Since 2009, the NHS no longer buys in-patient services from privately owned hospitals, which make up a very small percentage of total in-patient service providers in Latvia.

The Ministry of Interior holds capital shares in one SOE operating in the health sector, Iekšlietu ministrijas poliklīnika, though this SOE’s main objective is to maintain health services for Ministry of Interior employees (i.e., police, fire rescue workers, etc.).

Culture

The Ministry of Culture oversees the following areas: copyrights and neighbouring rights, libraries, museums, music, fine art, amateur and folk art, theatre, literature, film art, cultural education, protection of cultural heritage, archives and architecture. The Ministry holds capital shares in six orchestras and concert organisations and in seven theatres. The Ministry also holds capital shares in a literature support programme and in an SOE responsible for distributing and producing films, though this enterprise will soon be sold by the LPA.

Education and sports

The Ministry of Education and Science regulates education, science, sports, and Latvia’s official language policy. It holds capital shares in two education institutions and in five sports institutions (a bobsled and luge track, a culture and sport centre, two sports centres, and the Latvian Olympic team).

Public media

The National Electronic Mass Media Council was established as a derived public person under Latvia’s Electronic Mass Media Law (Art. 57) to regulate electronic mass media in Latvia. It holds capital shares in two wholly-owned SOEs: Latvijas Televīzija and Latvijas Radio. Both Latvian State Radio and Television Centre are responsible for ensuring the distribution of radio and television programmes.

Environment

The Ministry of Environmental Protection and Regional Development sets and implements policy on environmental protection, regional development, and information and communication technologies. Other than its shares in Elektroniskie sakari (see above, under “Transport”), the Ministry holds shares in three other SOEs: Latvijas Vides, ģeoloģijas un meteoroloģijas centrs (environmental monitoring system, meteorological services and weather forecasting), Vides Investīciju fonds (implementation of environmental protection projects) and Vides projekti (also responsible for environmental projects, but currently inactive and undergoing a process of insolvency).
(iii) Other sectors

Legal services

The Ministry of Justice holds capital shares in two SOEs that serve specific justice-related state functions. The first, Tiesu namu agentūra, provides real estate and IT services for Latvia’s justice system. The second, Latvijas Vēstnesis, Latvia’s Official Gazette, provides official legal publications and systemizes legal acts according to the Law on Official Publications and Legal Information. It maintains and develops the online legislation portal Likumi, which offers consolidated and systemized legal acts. (As of 1 January 2016, a new state agency shall be established to take over these functions.)

LPA portfolio

The LPA holds shares in a number of SOEs in different sectors. More information on the LPA’s holdings is included in section A.6, below. As noted above, the LPA is itself an SOE reporting to the Ministry of Economy, which is the ultimate beneficial owner of LPA state capital shareholdings.

State Social Insurance Agency portfolio

The State Social Insurance Agency does not hold any shares in any SOEs. Its current portfolio includes 10% or less of shares in 47 private companies with a total nominal value as of September 2014 of EUR 32.5 million. The investments were made in hopes that dividends from these investments will help finance its social welfare and pension budget, but none of the companies have been profitable, and the Agency, in co-operation with LPA, is in the process of divesting shares in 37 of the 47 companies in its portfolio; the remaining ten companies are insolvent.

c. Latvia’s port authorities: A case for corporatisation?

Latvia’s port authorities are not considered SOEs under Latvia’s SOE framework. However, given their function and their role in the Latvian economy, this section invites consideration of whether it would be feasible and appropriate to corporatise Latvia’s port authorities. This could be done, for example, by bringing them under the SOE framework.

(i) Basic information on Latvia’s largest port authorities

Latvia’s main ports are Riga and Ventspils, followed by Liepaja. Together, these ports handle more than 60 million tons of cargo per year, with bulk cargoes (like oil and coal) transiting through Ventspils and bulk and containerised cargo transiting through Riga. According to the World Bank, the share of GDP derived from port activities is estimated at 5% to 7% of Latvia’s GDP. Riga port accounts for 10% of the city’s workforce, while Ventspils port accounts for about 20%.

(ii) Status and operational framework

Ports are jointly controlled by the State and local governments. According to the Law on Ports, port lands may be owned by the State, local government, or other legal or natural person, while the inner water area of the port is the property of the State. Port infrastructure (i.e., jetties for regulating currents, shore reinforcements, etc.) may belong to the State or the local government.

Port authorities manage port assets and oversee port operations. Under the Law on Ports, port authorities are established by the relevant city or local council and are supervised by the Ministry of
Transport on behalf of the Cabinet of Ministers. The Riga and Ventspils port authorities are established as derived public persons, whose bylaws require Cabinet approval. The port authority for the Liepaja port, the smallest of the three, operates as part of the low-tax Liepaja Special Economic Zone. Its bylaws must be approved by the Liepaja city council and its procedures are stipulated by the Law on the Liepaja Special Economic Zone. Overseeing policy for all ports in the country is the Latvian Port, Transit and Logistics Council, which is chaired by the Prime Minister. Port authorities are also governed by Cabinet regulations and port authority bylaws.

Port authorities’ administrative functions include: determining and collecting port dues and charges; monitoring compliance with laws, Cabinet regulations and port rules; protecting the port territory from environmental damage; and ensuring winter navigation in the ports. Port authorities are also responsible for commercial functions, including: formulating and implementing ports’ development strategies; managing the ports’ physical assets, such as port lands, infrastructure, and technologies; managing the ports’ financial assets; monitoring the supply and demand for port services; and entering into contracts with port commercial companies.

The operations of the Riga and Ventspils port authorities are managed by an Executive Body (or administration), headed by a CEO, which reports to an eight-member board of directors. Half of the directors are officials from the municipal governments, and the other half are government officials nominated by the Ministers of Economy, Finance, Transport, and Environmental Protection and Regional Development. Board members are public officials who generally have little private sector experience.

Ports do not receive Government funding, though they have received significant support from EU Cohesion Funds. Ports do not pay corporate income tax. Until 2014, they did not pay dividends to the State budget. Since January 2014, port authorities are required to pay 10% of their annual revenues to the state budget as payment for the use of public infrastructure under amendments to the Law on Ports (Art. 14.2). Port authorities are financed largely by land lease fees, real estate lease fees, and port dues paid by port operators and users, such as channel dues (fees for entering the port area), port access fees, and cargo dues (also known as “wharfage”).

(iii) Governance risks

It is not the objective of this assessment to evaluate the governance structures of Latvia’s ports, since as noted above, these bodies technically fall outside the scope of this assessment. However, it is worth highlighting the recent and comprehensive findings of a recent assessment of Latvia’s port authorities undertaken by the World Bank at the request of the Latvian Ministry of Transport in 2013. The assessment finds that governance shortcomings have hampered the long-term sustainability and competitiveness of Latvia’s ports. These shortcomings are rooted in the lack of distinction between the state’s ownership function from other state functions influencing conditions for the port authorities, which is consistent with the overall SOE environment in Latvia. The World Bank assessment identifies three major governance concerns, in particular: (1) the lack of independence of port boards, due to political appointment processes, emphasis on the political accountability of each individual to its appointing authority, and uneven consideration of professional appointment criteria; (2) weak collective accountability of the port management and of port boards to the State and local governments who have entrusted them to manage public assets; and (3) a lack of transparency in ports’ decision-making processes and activities, which results in allegations of mismanagement and corruption that, in turn, undermine investor and operator confidence in Latvia’s ports.
On the first and second points on board independence and accountability, the World Bank report highlights the concerning lack of specific practices, rules or laws for ensuring boards are sufficiently independent, professional and accountable. For example, neither the Law on Ports, nor port regulations or bylaws include provisions for establishing board committees, criteria for selecting board members, board-election procedures, terms of reference for the responsibilities of the chair of the board and board members, conduct of board meetings, or managing conflicts of interest. There is also no mechanism in place to evaluate board performance. Latvia’s port authorities face only limited accountability to the Latvian Port, Transit and Logistics Council.

A 2010 State Audit Office audit of the Ventspils port authority provides an illustrative example of poor corporate governance at the board level. The audit reviewed the port authority’s procedures for supervising port operations and found that no measures had been established to nominate and appoint members of the board. At the time of the audit, the members’ terms on the board had expired but no new elections had been held. (In general, municipal government representatives on port authority boards have held their positions anywhere from two to 15 years, while State-level representatives change with changes in government.) The audit also showed there were no internal controls in place to ensure that the board of directors was effectively taking and monitoring decisions on the management of port assets and operations.

| Table 4. Structure and membership of Latvian port authorities boards of directors |
|----------------------------------|-----|-----|-----|
| Total # of members of boards of directors | 8   | 8   | 9   |
| Members of the board of directors approved by government institutions | 4   | 4   | 3   |
| Members of the board of directors approved by municipality institutions | 4   | 4   | 3   |
| Independent directors | -   | -   | 3   |
| Members of the management board | 1   | 1   | 1   |

1. Independent members of the board of directors are appointed by the Liepaja City Council.

Source: KPMG, Competitive Position of the Baltic States Ports, p. 15

Regarding the transparency of port operations, allegations of mismanagement and corruption continue to plague Latvia’s port authorities (in particular Riga and Ventspils) and expand beyond practices related to board procedures. For example, a 2013 audit of the Riga Freeport Authority by the State Audit Office found that the authority had repeatedly violated laws and regulations and lost millions of euros in inefficient and sometimes illegal expenses. The auditors’ report found that, in an 18-month period from 2009 to 2011, the port authority had: misused more than EUR 7.5 million in port funds; illegally spent more than EUR 800 000 on bonuses, gifts, and health insurance for board members; lost at least EUR 3.8 million in uncollected dues; entered into legally inappropriate public procurement contracts worth more than EUR 31 million; and completed projects worth more than EUR 35 million that were not included in the port’s development strategy and had not been approved by the Latvian Port, Transit and Logistics Council.

As noted in the World Bank report, such behaviour damages investor and operator confidence in Latvian ports in an increasingly competitive market. This situation is further impacted by the lack of transparency and disclosure of information by the port authorities. Latvian port authorities must publish Annual Reports. However, the KPMG assessment of Latvia’s port sector found that Riga and Ventspils publish only limited financial information without detailed explanations of key positions, while Liepaja does not publish financial statements at all. The disclosure of financial information, lease contracts and other information related to port authorities’ management of Latvia’s ports remains limited.
Corporatizing Latvia’s port authorities?

One of the ways in which the World Bank assessment of Latvia’s port sector suggests addressing the abovementioned governance challenges is to corporatize port authorities. This would better align the rules governing port authorities with the nature of their business. Corporatization would also require port authorities’ management and governance practices to comply with corporate law. Similar changes in other jurisdictions have yielded positive results, such as the change in legal status of the Port of Rotterdam Authority to a “corporation structure” in 2004.53 In discussions with the Secretariat during the fact-finding visit to Riga in May 2014, representatives from the Ministry of Transport indicated a willingness to consider whether Latvia’s ports would operate more efficiently if they were corporatized. This could be an area for further consideration by the Latvian authorities and the WP SOPP, separate from this current review.

3. Governance and operational performance of select SOEs

As noted above, a few SOEs stand out in terms of individual importance. This section aims to highlight the application of the current SOE framework to five of Latvia’s most important SOEs—Air Baltic, Latvenergo, Latvijas valsts meži (Latvian State Forests), Latvian Post, and Latvijas Dzelzceļš (Latvian Railway)—before assessing recent and ongoing reforms in Latvia’s SOE sector (see section A.7) and the more technical aspects of Latvia’s compliance with the SOE Guidelines (see Part B). These case studies also aim to highlight the perceived ownership “styles” of Latvia’s largest SOE shareholders: the Ministries of Agriculture, Economy, and Transport. Each case study addresses the SOEs’: (1) financial and non-financial performance, where possible; and (2) the overall corporate governance framework, including the composition of current and past management, disclosure and reporting practices, and shareholder and stakeholder relations.

a. Air Baltic

The Ministry of Transport owns 99.77% of Air Baltic. The remaining 0.23% are held by Russian airline company, Transaero Airlines (0.228%); Riga-based sole proprietorship SIA Frontier Enterprises (0.0002%), managed by Mr. Karl Gunther Sollinger, a former member of Air Baltic’s board of directors; and Air Baltic reports that it is the third shareholder in the company, owning 0.001% of shares.

i. Financial and non-financial performance

Air Baltic recorded a net profit in 2013 for the first time since 2010, when the company was struggling and facing the possibility that Krajbanka, the bank backing shares held by Air Baltic’s minority shareholder Baltijas Aviacijas sistemas (BAS), appeared on the verge of bankruptcy. In November 2011, the Ministry of Transport bought out BAS’ shares, increasing its ownership stake in Air Baltic from 52.6% to 99.77%.54

The company’s financial reports include reference to the short- and long-term debt that the company owes the Government, totalling EUR 108.99 million. (These loans were investigated by the European Commission for possibly violating EU state aid rules; though the Commission closed the investigation in July 2014 concluding that state aid to Air Baltic was in line with EU rules. See Box 8, in section A.6, below.) The loans were made to help finance Air Baltic’s five-year business restructuring plan, “ReShape”, which was developed jointly by Air Baltic, the Ministry of Transport, and financial advisor Boston Consulting Group, and which foresees modernizing Air Baltic’s air fleet, optimizing costs, improving networks, and returning the company to profit by 2014.55
Table 5. Air Baltic financial performance, 2007-2013 (EUR millions)

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<tr>
<td>Turnover</td>
<td>279</td>
<td>277</td>
<td>288</td>
<td>288</td>
<td>257</td>
<td>249</td>
<td>200</td>
</tr>
<tr>
<td>Net profit</td>
<td>2.2</td>
<td>-31.1</td>
<td>-118.8</td>
<td>-48.7</td>
<td>8.5</td>
<td>-39.6</td>
<td>1.56</td>
</tr>
<tr>
<td>Assets</td>
<td>126</td>
<td>126</td>
<td>108</td>
<td>73</td>
<td>86</td>
<td>76</td>
<td>52</td>
</tr>
<tr>
<td>Equity</td>
<td>-181</td>
<td>-183</td>
<td>-152</td>
<td>33</td>
<td>-27</td>
<td>-36</td>
<td>4</td>
</tr>
<tr>
<td>Short-term debt</td>
<td>145</td>
<td>127</td>
<td>147</td>
<td>89</td>
<td>112</td>
<td>112</td>
<td>4</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>115</td>
<td>116</td>
<td>65</td>
<td>18</td>
<td>11</td>
<td>0</td>
<td>44</td>
</tr>
<tr>
<td>Provisions1</td>
<td>46</td>
<td>66</td>
<td>49</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>1.6%</td>
<td>-24.6%</td>
<td>-109.7%</td>
<td>-66.4%</td>
<td>9.9%</td>
<td>-52.3%</td>
<td>2.9%</td>
</tr>
<tr>
<td>ROE</td>
<td>-1.1%</td>
<td>17.0%</td>
<td>78.2%</td>
<td>146.4%</td>
<td>-31.3%</td>
<td>110.0%</td>
<td>42.0%</td>
</tr>
</tbody>
</table>

1. “Provisions” are described in Air Baltic’s annual report as funds set aside to meet specific expenses, including, for example: ongoing litigation related to the State’s buyout of BAS shares in 2011 (42% of provisions listed in 2013), disadvantageous contracts (17% of the provisions listed in 2013), and unpaid liabilities owed to BAS and debtors linked to BAS.

Source: Air Baltic annual reports and financial statements available via the online enterprise database, Lursoft (www.lursoft.lv), supplemented and updated by figures received by the OECD Secretariat from the Latvian authorities.

ii. Corporate governance framework

Management and board

Air Baltic is one of six state-owned or state-controlled enterprises with a board of directors (see section A.5.b). Air Baltic representatives state that it operates like a privately owned company, including by instituting a board of directors, in order to comply with the Commercial Law and private-sector investor interests.

There are three members on Air Baltic’s board of directors who serve three-year terms. (Until June 2012, there were five directorships, but the meeting of shareholders decided to decrease the total to three, reportedly to increase board efficiency.) The Ministry of Transport nominates Air Baltic directors, including those currently on the board. Two of the three current directors have ties to the Ministry of Transport or to agencies owned or controlled by the Ministry (i.e., Riga Freeport; see also Table 15, below.) The third member reports to the Ministry of Economy. They include: Mr. Andris Liepiņš (Chair), Ministry of Economy Deputy State Secretary; Mr. Kaspars Biškens, currently adviser to the Minister of Transport and former Deputy State Secretary of Transport; and Mr. Niks Bulmanis, former Chair of the Riga Freeport management board (until 2006).

More than half of the individuals who served as members of the board of directors in the past decade have links with Ministry of Transport, either serving as members of the management boards of other SOEs owned or controlled by the Ministry or working directly for the Ministry. One former director served as Minister of Finance and another for the Ministry of Economy’s State Tourism Development Agency. (See Annex 4 for more on Air Baltic’s former management.)

The board of directors elects members of the management board and appoints its Chair. The management board consists of three members who are elected to three-year terms. The current management board was brought in after the State’s buyout of BAS shares in 2011 and are responsible for applying Air Baltic’s ReShape restructuring plan. Members include air industry expert Mr. Martin Gauss (Chair); Mr. Vitolds Jekoļevs (Chief Financial Officer), former chairman of the management board of the Latvian freight and shipping logistics company SIA Holdinga kompānija Felix; and Mr. Martin Sedlacky (Chief Operations Officer), formerly a consultant working on airline restructuring at the Boston Consulting Group.
Disclosure and reporting

In terms of SOE objectives, little information is publicly available regarding the specific objectives set by the ReShape plan, which was not made public due to ongoing litigation involving the company. Nor are there publicly available explicit short-, medium-, or long-term objectives for the company. In addition, there is only limited information on Air Baltic’s financial and non-financial performance on the company’s website. Detailed annual reports are only available on subscription-based company database websites, such as Lursoft (www.lursoft.lv) in Latvian. Financial results are prepared according to Latvian Generally Accepted Accounting Principles (GAAP).

Air Baltic representatives report that the company has an internal audit function which is performed by one internal auditor and one internal audit assistant and which is managed by the head of the management board. The internal audit function reports to the management board and board of directors. Air Baltic reports it also has a quality audit function, which comprises five auditors and one quality audit manager, who are together responsible for Air Baltic’s conformity with aviation standards and requirements. Air Baltic is also regularly audited by an independent external auditor, which is selected by the board of directors. PricewaterhouseCoopers has served as the company’s external auditor since 2008.

b. Latvenergo

i. Financial and non-financial performance

Latvenergo is one of the largest companies in Latvia. It is a parent company of a Group with seven subsidiaries and three shareholdings. This power supply utility operates in electricity and thermal energy generation and supply, electricity distribution services and transmission system asset management. Latvenergo is one of the largest SOEs in the Government’s portfolio in absolute terms. At the same time, the average return on assets for the last five years has been 1.62%, while the average return on equity has been 2.86%.

As described in further detail below in section B.1.f, Latvenergo has issued on the NASDAQ OMX Riga exchange two series of bonds in 2012 and 2013 totalling EUR 105 million, which led to total proceeds over both years of approximately EUR 104.8 million. The company, which does not receive any Government subsidies, reported that the bonds were issued with an aim to diversify borrowing sources and to invest in Latvenergo’s development projects, including investments in transmission and distribution networks. Major investment projects include an international energy infrastructure development project that involves constructing the Kurzeme Ring, which will strengthen the transmission network in western Latvia and integrate with the Sweden-Lithuania electricity supply channels. The second major project is the reconstruction of Daugava HPPs hydropower units. In addition, in late 2013, Latvenergo completed the reconstruction of the Riga TEC-2 power plant.
Table 6. Latvenergo financial performance, 2006-2013 (EUR millions)

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,100</td>
<td>1,064</td>
<td>962</td>
<td>804</td>
<td>710</td>
<td>677</td>
<td>515</td>
<td>416</td>
</tr>
<tr>
<td>EBITDA</td>
<td>249</td>
<td>244</td>
<td>255</td>
<td>294</td>
<td>207</td>
<td>152</td>
<td>128</td>
<td>115</td>
</tr>
<tr>
<td>Net profit</td>
<td>46</td>
<td>51</td>
<td>62</td>
<td>63</td>
<td>28</td>
<td>10</td>
<td>11</td>
<td>34</td>
</tr>
<tr>
<td>Assets</td>
<td>3,575</td>
<td>3,518</td>
<td>3,256</td>
<td>3,243</td>
<td>2,418</td>
<td>2,391</td>
<td>1,872</td>
<td>924</td>
</tr>
<tr>
<td>Equity</td>
<td>2,022</td>
<td>2,007</td>
<td>1,923</td>
<td>1,913</td>
<td>1,266</td>
<td>1,241</td>
<td>1,015</td>
<td>424</td>
</tr>
<tr>
<td>Total debt</td>
<td>1,554</td>
<td>1,511</td>
<td>1,332</td>
<td>1,333</td>
<td>1,153</td>
<td>1,150</td>
<td>857</td>
<td>499</td>
</tr>
<tr>
<td>ROA</td>
<td>1.3%</td>
<td>1.5%</td>
<td>1.9%</td>
<td>2.2%</td>
<td>1.2%</td>
<td>0.5%</td>
<td>0.8%</td>
<td>4.0%</td>
</tr>
<tr>
<td>ROE</td>
<td>2.3%</td>
<td>2.6%</td>
<td>3.2%</td>
<td>4.0%</td>
<td>2.2%</td>
<td>0.9%</td>
<td>1.5%</td>
<td>8.3%</td>
</tr>
</tbody>
</table>

Source: Latvenergo annual reports and financial statements, supplemented and updated by figures received by the OECD Secretariat from the Latvian authorities.

iii. Corporate governance framework

Management and board

Latvenergo’s articles of association and Rules of the Management Board, which are both available online in Latvian and English, state that the management board should have five members, who are elected to three-year terms by the meeting of shareholders (the Ministry of Economy). The current members of the management board include: Āris Žīgurs, Chair and Chief Executive Officer; Zane Kotāne, Chief Financial Officer; Uldis Bariss, Chief Commercial Officer; Māris Kuņickis, Chief Operating Officer; and Arnis Kurgs, Chief Administrative Officer. Latvenergo’s website clearly states each member’s responsibilities and their professional and educational backgrounds. (More information on Latvenergo’s management structure is available in Annex 4.) The management board meets regularly with the shareholder (see also section A.5), including to seek Ministry approval for procurement purchases exceeding specific thresholds.

As described in further detail, below (section B.5.b), Latvenergo established an audit committee in 2012, in compliance with Latvia’s Financial Instruments Market Law, which applies to Latvenergo as a bonds issuer. Members of the committee are selected through an external recruitment process and are nominated by and responsible to Latvenergo’s shareholder.

Disclosure and reporting

Regarding company objectives, Latvenergo’s business strategy for 2012 to 2016, described in the company’s 2012 and 2013 annual reports, establishes key strategic objectives and development tasks, as well as financial targets. Goals include: strengthening Latvenergo’s position in the Baltic electricity market; diversifying its electricity-generation sources; and developing its networks. The company’s 2012 annual report also states as a goal observing and strengthening good corporate governance principles. The strategy, which the company says was developed in cooperation with key stakeholders, was adopted in 2012. The company provided a progress report on steps taken to implement this strategy in its 2013 annual report.

Latvenergo had previously adopted a strategy for 2008 to 2010, which aimed to improve efficiency, address customer needs, to restore and improve its production capacity, and to expand to new markets. Little information is publicly available regarding the company’s efforts to meet the goals outlined in this earlier strategy.

Regarding disclosure of Latvenergo’s financial and non-financial performance, the company publishes all of its financial (annual and interim), sustainability, and corporate governance reports online in English and in Latvian. Financial reports are prepared according to international financial
reporting standards. As noted above, annual financial reports are monitored by Latvenergo’s internal audit committee and an independent external auditor. The external auditor is appointed by the shareholder for a period of one year, on the recommendation of the audit committee. (From 2005-2011, PricewaterhouseCoopers served as Latvenergo’s external auditor, and from 2012-2014, this function was performed by EY.)

c. **Latvijas valsts meži (Latvian Forestry Company)**

i. **Financial and non-financial performance**

As noted above, the Ministry of Agriculture wholly owns the Latvijas valsts meži (Latvian State Forests) and the Government’s shares, by law, cannot be privatised. Like Latvenergo, Latvijas valsts meži is one of the largest SOEs in the Government’s portfolio. It has consistently recorded healthy returns on assets and returns on equity, and profits have remained fairly consistent despite the financial and economic crisis.

However, from the company’s financial reports filed on Lursoft, Latvijas valsts meži’s subsidiaries appear to represent a drag on the SOE’s bottom line. The company operates, apparently in the public interest, a castle open to the public and a forestry research and development institute. With one exception both subsidiaries have recorded significant losses as far back as 2004, according to Latvijas valsts meži’s and its subsidiaries’ financial reports. However, it must be recognised that the amounts involved have not been large compared to the parent company’s turnover and net profits.

Table 7. Latvijas valsts meži financial performance, 2006-2013 (EUR millions)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>260</td>
<td>253</td>
<td>306</td>
<td>307</td>
<td>194</td>
<td>211</td>
<td>231</td>
<td>142</td>
</tr>
<tr>
<td>EBITDA</td>
<td>85</td>
<td>77</td>
<td>112</td>
<td>138</td>
<td>61</td>
<td>90</td>
<td>157</td>
<td>81</td>
</tr>
<tr>
<td>Net profit</td>
<td>61</td>
<td>55</td>
<td>73</td>
<td>111</td>
<td>47</td>
<td>74</td>
<td>132</td>
<td>63</td>
</tr>
<tr>
<td>Dividends</td>
<td>54</td>
<td>49</td>
<td>73</td>
<td>74</td>
<td>28</td>
<td>59</td>
<td>41</td>
<td>24</td>
</tr>
<tr>
<td>Assets</td>
<td>349</td>
<td>340</td>
<td>362</td>
<td>362</td>
<td>273</td>
<td>294</td>
<td>266</td>
<td>145</td>
</tr>
<tr>
<td>Equity</td>
<td>319</td>
<td>307</td>
<td>326</td>
<td>327</td>
<td>244</td>
<td>263</td>
<td>234</td>
<td>126</td>
</tr>
<tr>
<td>Provisions'</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>18</td>
<td>14</td>
<td>13</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>2</td>
<td>1</td>
<td>17</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Short-term debt</td>
<td>12</td>
<td>15</td>
<td>2</td>
<td>16</td>
<td>13</td>
<td>17</td>
<td>23</td>
<td>13</td>
</tr>
<tr>
<td>ROA</td>
<td>17.3%</td>
<td>16.1%</td>
<td>20.1%</td>
<td>30.8%</td>
<td>17.3%</td>
<td>25.3%</td>
<td>49.5%</td>
<td>43.6%</td>
</tr>
<tr>
<td>ROE</td>
<td>19.0%</td>
<td>17.8%</td>
<td>22.3%</td>
<td>34.1%</td>
<td>19.4%</td>
<td>28.3%</td>
<td>56.2%</td>
<td>49.8%</td>
</tr>
</tbody>
</table>

1. “Provisions” are described in Latvijas valsts meži’s 2010 Annual Report as funds allocated to forest restoration. No further explanation is provided in the 2010 report, and no definition is provided in the reports submitted from 2011 to 2013.

Source: Latvijas valsts meži’ annual reports and financial statements
iii. Corporate governance framework

Management and board

As noted below (section B.2.c.ii), Latvijas valsts meži’s management board members have stayed largely the same since the company’s establishment in 1999. Since then, the company has only ever had one head of the management board, Chairman and CEO Roberts Stripnieks. The other members of the four-member management board are: Mr. Gints Bumbieris, Mr. Arnis Melnis, and Mr. Edvīns Zakovicš. (See also Annex 4.) Three of the four current members worked for the Ministry of Agriculture’s State Forest Service prior to joining Latvijas valsts meži’s management team, and there is little publicly available background information for any of the management board members on their prior work experience.

The Ministry of Agriculture changed Latvijas valsts meži’s articles of association in December 2011 to decrease the number of required management board members from seven to four. The State Secretary explained to the media at the time that the change aimed to improve the board’s efficiency, though news reports indicated the move was made to exclude from the board directors without day-to-day management responsibilities at the company.68

While the number of shareholder meetings held with the management board is not disclosed in Latvijas valsts meži’s annual reports, the Ministry of Agriculture has stated that meetings are held regularly, and six EGMs were convened in 2013.

Disclosure and reporting

In terms of Latvijas valsts meži’s objectives, the company has developed and made publicly available a corporate strategy document outlining the company’s goals for 2010 to 2015.69 (See also section A.4.a.ii and Box 2) The strategy was adopted by the Ministry of Agriculture in 2010 and includes fairly broad medium-term economic, social, and environmental targets, but no specific financial targets:
Box 2. Latvijas valsts meži 2010 strategy targets

1. Economic targets
- To ensure stable profit and positive cash flow from the economic activity.
- To increase the value of the company assets and forest stands managed by the company.
- To raise the quality of customer services.
- To become a stable and predictable partner to our customers, suppliers and service providers.
- To increase the efficiency of the business processes and to facilitate growing efficiency of service providers.
- To facilitate and develop production of timber products, services and knowledge with high added value.

2. Social targets
- To manage the forest in a manner that is balanced and acceptable to Latvian society.
- To be a responsible and reliable member of society.
- To develop a work environment that is motivating to LVM employees.

3. Environmental targets
- To preserve the diversity of the environment.
- To foster a caring attitude in society towards the forest.
- To reduce the influence of economic activity on the environment.
  - To increase the contribution of the forests managed by Latvijas valsts meži into reduction of global climate change.

Latvijas valsts meži’s annual reports since 2010 do not provide updates on the enterprise’s progress toward meeting every economic target laid out in its corporate strategy, though some updates have been provided on social and environmental targets. Unclear objective-setting was also alleged by the State Audit Office’s 2008 audit Latvijas valsts meži’s compliance with Latvian laws and regulations. The audit criticized the lack of specific performance indicators by which to measure the company’s efficiency by, as well as the Ministry of Agriculture’s failure to properly monitor Latvijas valsts meži’s financial performance in its capacity as the SOE’s shareholder.

Regarding the overall disclosure of Latvijas valsts meži’s financial and non-financial performance, the company publishes financial reports on its website in Latvian and English. Reports on the company’s website date back to 2000, though only reports since 2010 include a detailed notes section explaining specific inputs in the financial report. More detailed reports are available via Lursoft. All financial reports are prepared applying Latvian GAAP. Financial reports are externally audited (since 2005 by EY), though there is no publicly available information regarding how the external auditor is appointed, nor whether Latvijas valsts meži includes an internal audit function. Latvijas valsts meži informed the OECD Secretariat that its external auditor is selected according to Latvian public procurement procedures and is appointed by the annual shareholder meeting each year. The SOE also reported that it has an internal audit division, which supports the shareholder meeting. Some shareholder decisions are published in the larger collection of news releases on Latvijas valsts meži’s website.
d. Latvijas Pasts

i. Financial and non-financial performance

In 2007, Latvijas Pasts’ financial reports show that the enterprise suffered a significant loss in net profits of almost EUR 20 million. The company’s annual report that year explains that the loss is due to a decline in economic growth, a rapid increase in inflation, an increase in the price of utilities, and an increase in employee remuneration. On the latter, remuneration rates were increased for employees involved in operational activities. Post carrier salaries, for example, increased 20% in 2008, year-over-year, while customer service salaries increased 15%. These increases are fairly consistent with increases in average monthly wages throughout Latvia at that time.

In the following years, the Latvijas Pasts depended heavily on short- and, to a greater extent, long-term loans from commercial lenders (Parex bank, and then Citadele). Latvijas Pasts’ loans were so high by end-2008, in fact, that its borrowings exceeded current assets by EUR 17 million. That year, the company reported a EUR 5 million loss. The following year borrowings exceeded current assets by EUR 28 million. To address this challenge, Latvijas Pasts has since engaged in deep cost-saving measures, including optimizing the number of post offices, employees’ working hours, and looking for new, more-profitable areas of business. In 2010, the Ministry of Transport decided to increase Latvijas Pasts’ share capital by EUR 1.3 million by investing a rare and valuable stamp collection. By 2011, the company was able to balance its books and turn a profit.

Latvijas Pasts was exempted from paying dividends to the State budget from 2007 through 2012. Profits made in 2011 and 2012 were reinvested in the company. The company also receives compensation for the fulfilment of its universal service obligations. In 2007, Latvijas Pasts’ annual report states that losses associated with postal delivery to rural areas resulted in EUR 5.7 million that year. According to the Postal Law, Latvijas Pasts is a designated postal operator, which has the right to provide the universal service obligations to provide universal postal services throughout Latvia from 2015 to 2019. In 2019, a designation procedure will be open to competition, and there is no guarantee Latvijas Pasts will win the competition.

The company receives an annual compensation from the government to cover additional costs incurred due to an obligation to distribute newspapers nationwide. Since 2007, the subsidy has generally been in the range between EUR 4 – 6 million per year.

| Table 8. Latvijas Pasts financial performance, 2006-2012 (EUR millions) |
|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Turnover         | 58             | 54              | 52              | 55              | 63              | 67              | 63              | 55              |
| EBITDA           | 10             | 10              | 6               | 4               | 4               | -2              | -13             | -2              |
| Net profit       | 5              | 5               | 1               | 0.4             | -0.2            | -5              | -20             | -7              |
| Assets           | N/A            | 75              | 66              | 72              | 71              | 107             | 101             | 93              |
| Equity           | N/A            | 8               | 3               | 2               | 2               | 6               | 6               | 6               |
| Long term debt   | N/A            | 18              | 22              | 25              | 5               | 6               | 6               | 6               |
| Short term debt  | N/A            | 48              | 41              | 45              | 64              | 100             | 88              | 61              |
| Debt/equity ratio| N/A            | 8.25            | 21              | 35              | 34.5            | 53              | 13.4            | 2.5             |
| ROA              | N/A            | 6.5%            | 1.5%            | -0.6%           | -0.3%           | -4.7%           | -19.8%          | -7.5%           |
| ROE              | N/A            | 58.9%           | 28.9%           | -16.5%          | -14.5%          | 279.1%          | 293.5%          | -25.9%          |


Source: Latvijas Pasts annual reports and financial statements
Management

There has been an extremely high level of turnover on Latvijas’ Pasts management board (see Annex 4). The Chair has changed eight times since 2007 and 19 people have occupied the three posts of members of the management board in the same period. Latvijas Pasts’ annual reports do not explain the reason behind the Ministry of Transport’s decisions to nominate and/or remove members of the management board. News reports allege that, for example in 2012, the entire management board was replaced due to concerns about Latvijas Pasts’ financial performance.

The current four-member board has been in place since 2013: Mr. Arnis Salnājs (Chair); Mr. Arnis Gulbis; Mr. Aigars Vītols; and Mr. Egons Štrauzdīņš. Three of the four board members have professional experience in the finance sector; a fourth, Mr. Vītols, simultaneously serves as executive director of Valmiera City Council. The Chair of the management board personally attends the weekly face-to-face meetings with the Transportation State Secretary at the Ministry and, as noted below (section A.5), must submit in writing requests for shareholder approval of large public procurement purchases.

Disclosure and reporting

Latvijas Pasts’ business objectives are guided by the State’s 2011-2017 strategy for the postal sector. As for Latvijas Pasts, the company has no clear, publicly available short-, medium-, or long-term business objectives. Latvijas Pasts’ previous business plan, for 2004 to 2008, had specific financial and business targets, but annual reports did not state whether the company had met these objectives.

Regarding the overall disclosure of Latvijas Pasts’ financial and non-financial performance, annual reports are available on Latvijas Pasts’ website, but only in Latvian. Beginning in 2013, Latvijas Pasts annual reports on the SOE’s website only include financial summaries. More detailed financial reports are available on Lursoft. Reports are prepared according to Latvian GAAP. The company’s financial reports are externally audited, though no information is available as to how the external auditor is selected and nominated. Latvijas Pasts reports that it has an internal audit function. It also has a quality audit function, undertaken by one representative from the Quality Management Division, who combines audit responsibilities with other duties. Audit results are submitted to the enterprise’s management board.

e. Latvijas Dzelzceļš (Latvian Railway)

i. Overview

As noted above, the Ministry of Transport is the holder of shares of the State owned JSC Latvijas Dzelzceļš. According to the law, these shares cannot be privatised. Latvijas Dzelzceļš has a number of wholly-owned subsidiaries, all of which are directly linked with the provision of railway services. Until 2008, Latvijas Dzelzceļš owned shares of Pasažieru vīciens (“Passenger train”), but this was spun off in 2008 as its own company. Latvijas Dzelzceļš also owns a 5.84% stake in Riga Freeport-based shipping and marine supplier LLC “Strek” and a 3% stake in LLC “Mirigo”, a Belarusian-Latvian joint venture specializing in metalwares.
ii. Financial and non-financial performance

According to the company’s 2013 annual report, Latvijas Dzelzceļš’s main source of revenue is the sale of infrastructure capacity of the public-use railway infrastructure lines managed by Latvijas Dzelzceļš. The sale of infrastructure capacity and railway-related services accounted for 84.9% of the company’s net revenue in 2013.

Latvijas Dzelzceļš’s net profits and returns improved after the financial and economic crisis, but have declined, generally, since 2011 (see Table 9 below). In 2013, consolidated net profits in 2013 for the Latvijas Dzelzceļš group was more than EUR 29 million lower than the average net profits of the previous two years. The company explains that the decline “was due to the decreasing business of the group’s companies”. Latvijas Dzelzceļš’s external borrowings from credit institutions (including from private banks as well as from the European Bank of Reconstruction and Development and the European Investment Bank) have also steadily increased since 2008 (the earliest year for which information is available), mostly to fund (with support from EU Cohesion Funds) major railway reconstruction and development projects. In 2013, Latvijas Dzelzceļš’s long-term liabilities totalled nearly EUR 370 million.

Meanwhile, dividends paid by Latvijas Dzelzceļš’s subsidiaries have increased over the last decade (mostly from LDZ Cargo Ltd) from EUR 214,000 in 2006 to EUR 3 million in 2012. In fact, LDZ Cargo Ltd’s annual turnover has consistently been higher than Latvijas Dzelzceļš’s and the subsidiary’s net profit also exceeded the parent company in 2010 and 2011 (see Table 10).

Table 9. Latvijas Dzelzceļš’s financial performance (consolidated), 2007 – 2013 (EUR millions)

<table>
<thead>
<tr>
<th>Turnover</th>
<th>EBITDA</th>
<th>Net profit</th>
<th>Assets</th>
<th>Equity</th>
<th>Provisions</th>
<th>Long term debt</th>
<th>Short term debt</th>
<th>ROA</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>439</td>
<td>10</td>
<td>3</td>
<td>859</td>
<td>No such position reported</td>
<td>369</td>
<td>133</td>
<td>0.4%</td>
<td>1.0%</td>
</tr>
<tr>
<td>2012</td>
<td>475</td>
<td>40</td>
<td>37</td>
<td>775</td>
<td>41</td>
<td>328</td>
<td>136</td>
<td>4.7%</td>
<td>11.8%</td>
</tr>
<tr>
<td>2011</td>
<td>454</td>
<td>56</td>
<td>27</td>
<td>702</td>
<td>26</td>
<td>297</td>
<td>129</td>
<td>3.9%</td>
<td>9.8%</td>
</tr>
<tr>
<td>2010</td>
<td>366</td>
<td>19</td>
<td>-3</td>
<td>656</td>
<td>250</td>
<td>265</td>
<td>141</td>
<td>-0.5%</td>
<td>1.20%</td>
</tr>
<tr>
<td>2009</td>
<td>405</td>
<td>52</td>
<td>2</td>
<td>566</td>
<td>254</td>
<td>217</td>
<td>96</td>
<td>0.4%</td>
<td>0.8%</td>
</tr>
<tr>
<td>2008</td>
<td>426</td>
<td>71</td>
<td>19</td>
<td>466</td>
<td>194</td>
<td>173</td>
<td>71</td>
<td>4.0%</td>
<td>9.8%</td>
</tr>
<tr>
<td>2007</td>
<td>373</td>
<td>77</td>
<td>40</td>
<td>406</td>
<td>198</td>
<td>134</td>
<td>61</td>
<td>9.9%</td>
<td>20.3%</td>
</tr>
</tbody>
</table>

Source: Latvijas Dzelzceļš’s annual reports and financial statements

Table 10. Comparison of Latvijas Dzelzceļš (unconsolidated) and LDZ Cargo Ltd. financial performance (EUR millions)

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>Net profit</td>
<td>Turnover</td>
<td>Net profit</td>
<td>Turnover</td>
</tr>
<tr>
<td>Latvijas Dzelzceļš</td>
<td>218</td>
<td>80</td>
<td>231</td>
<td>24</td>
</tr>
<tr>
<td>LDZ Cargo Ltd</td>
<td>362</td>
<td>5</td>
<td>396</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: Latvijas Dzelzceļš’s annual reports and financial statements supplemented and updated by figures received by the OECD Secretariat from the Latvian authorities.
iii. Corporate governance framework

Management

The current members of the Latvijas Dzelzceļš’s four-member management board include: Chair and President of the management board Uģis Magonis (a position he has held since 2005); Vice-President of Finance Aivars Strakšas (also since 2005); Vice-President of Technical Operations Ėriks Šmuksts; and Vice-President of Real Estate Management, Legal and Administrative Issues Edvīns Bērziņš. Latvijas Dzelzceļš’s website includes each member’s professional and educational backgrounds. Each member has worked for at least one other SOE owned by the Ministry of Transport before joining Latvijas Dzelzceļš. (See also Annex 4.) Like other SOEs owned by the Ministry of Transport, the Chair of the management board meets weekly with the shareholder (see section A.5), including in order to seek approval for procurement purchases exceeding specific thresholds.

Disclosure and transparency

According to a 2012 State Audit Office audit of the Ministry of Transport’s management of Latvijas Dzelzceļš, there were no clear objectives for the SOE, nor had the Ministry apparently taken concrete steps to evaluate Latvijas Dzelzceļš’s performance. First, the audit criticized the Ministry of Transport’s transport sector policy, which was broad, was too focused on short-term goals, and was inconsistent with Latvia’s national Sustainable Development Strategy until 2030. (The strategy includes a sub-section on development of Latvia’s railways.) More specifically, the audit also criticized the Ministry of Transport for not setting actionable economic and operational targets for Latvijas Dzelzceļš’s in furtherance of the Ministry’s transport sector policy, making it impossible to evaluate the company’s effectiveness. Latvian authorities report that, since this audit, Latvijas Dzelzceļš has a new business strategy through 2030, which includes aims, objectives and key performance indicators (KPI). The Ministry of Transport also approves annually a three-year business plan. The Ministry also evaluates Latvijas Dzelzceļš’s performance and that of its management board, based on approved aims, objectives and KPI.

Regarding disclosure of annual and financial reports, Latvijas Dzelzceļš publishes this information on its website. More detailed financial reports are also available in Latvian on Lursoft. Unconsolidated and consolidated financial reports are prepared according to Latvian GAAP. Consolidated annual reports have been externally audited by PricewaterhouseCoopers since 2009 and, from 2007 to 2008, a smaller Latvian audit firm, S.Vilcānes Audits. In 2011, S.Vilcānes Audits continued to audit the financial reports of Latvijas Dzelzceļš subsidiaries. The SOE does have an internal audit function.

4. The legal and regulatory framework applicable to SOEs

a. Legal framework

The following laws provide the overall legal framework for Latvia’s SOE sector and are described in further detail throughout this report:

- The Law on State and Local Government Capital Shares and Capital Companies outlines the responsibilities of the Government as the owner of state assets, including provisions related to the oversight of SOE corporate governance. The law sets procedures for establishing, reorganising, liquidating, or selling state-owned enterprises, as well as increasing or decreasing state shares in commercial enterprises. The law also includes specific provisions
on the governance of SOEs and of enterprises in which the State exercises a decisive influence.78

- The *State Administration Structure Law* provides basic rules for the operation of Latvia’s State administration. It includes important provisions for the SOE sector, including the State’s enterprise ownership rationale, described in further detail below.

- The *Commercial Law* governs SOEs’ commercial activities, except where the Law on State and Local Government Capital Shares and Capital Companies provides otherwise.

- The *Group of Companies Law* applies to SOEs with one or more subsidiaries, therefore operating in a so-called “group situation”. Groups of companies are legally considered in a group situation either via a formal contract between the parent company and the dependent company or companies, or the group operates as a *de facto* “factual” group of companies, in which a parent company has a controlling influence in another company without entering into a formal group of companies’ agreement.79 Whether an SOE operates as a parent company in a group situation will affect, in particular, the parent company’s reporting obligations under the Commercial Law, the Annual Accounts Law, the Consolidated Annual Accounts Law, and the Law on Budget and Financial Management (described further in section B.5).80

(i) Establishing SOEs and regulating their commercial activities

Under Latvia’s legal framework for SOEs, the State may perform commercial activities if public interests are not met by privately owned enterprises. This principle underlies the Government’s state enterprise ownership rationale, which is expressed under Section 88(1) of the State Administration Structure Law.81 Under this provision, the State may establish or continue to own or control a commercial enterprise:

- If the market is not able to ensure the implementation of the public interest in the relevant field;
- In a sector in which a natural monopoly exists, thus ensuring the public availability of the relevant service;
- In a strategically important sector;
- In a sector, for the development of the infrastructure of which large capital investments are necessary; or
- In a sector, in which, in conformity with the public interest, it is necessary to ensure higher quality standards.
(ii) SOE objective-setting

Legal framework

While some Latvian SOEs operate in competitive markets with commercial objectives, all SOE activities must be undertaken “in the public interest”, and as a result, most SOEs also have social and public policy objectives. SOE objectives are formally set via:

- “Laws, Cabinet regulations, and approved sectorial development concepts, strategies and other documents governing sectorial development,” as per Art. 19.3 of the Law on State and Local Government Capital Shares and Capital Companies. This provision also tasks the State’s representative (either a Ministry’s state secretary or the head of a public institution) with ensuring the SOE fulfils these goals.

- “Delegation of administrative tasks” by the State to an “authorized person” (i.e., an SOE) via so-called delegation contracts, as per Chapter 5 of the State Administration Structure Law. These contracts, entered into between SOEs and line ministries or public institutions, must include a description of the specific delegated task and “quality evaluation criteria for the performance of the task, but, if the subject-matter of the contract is a one-time task, also the results to be achieved” (Art. 46.2,5). Delegation contracts are normally valid for up to three years, and contracts lasting longer than three years must receive Cabinet approval.

Objective-setting, more generally, is usually guided by sector-specific, non-legally binding policy documents for SOEs that set overall sectorial objectives. Responsible Ministries develop these policy documents, which must then receive Cabinet approval. Latvian authorities provide as an example of SOE objective-setting state-owned theatres and concert organisations, whose objectives are determined by delegation contracts between the SOEs and the Ministry of Culture, as well as by the Law on Cultural Institutions (Art. 23.2) and the sectorial policy document, “State Culture Policy Guidelines ‘Creative Latvia’ 2014-2020”.

Box 3. Examples of SOE special requirements established by law

- Latvijas Loto: According to Article 63(1) of the Gambling and Lotteries Law, state-level lotteries may be organized only by Latvijas Loto, which cannot be subject to privatisation and whose stocks cannot be sold.

- Latvijas Dzelzceļš: According to Article 5(1) of the Railway Law, the management of the public-use railway infrastructure is granted to Latvijas Dzelzceļš by the Cabinet Order No 759 (2004) “On Granting of the Status of Public Use Railway Infrastructure”.

- Latvijas Vides, ģeoloģijas un meteoroloģijas centrs: Article 11 of the Law on Circulation of Genetically Modified Organisms mandates that Latvijas Vides, ģeoloģijas un meteoroloģijas centrs (Latvian Environment, Geology and Meteorology Centre) monitors the release of genetically modified organisms. The legal requirements of the Latvian Environment, Geology and Meteorology Centre are stipulated by a number of other laws as well, including the Law on Participation of the Republic of Latvia in the Flexible Mechanisms of the Kyoto Protocol; the Environmental Protection Law; and the Law on Subterranean Depths.

Source: Latvia’s questionnaire responses
Box 4. Case study: Objective-setting for Latvijas valsts meži

According to Latvian authorities, the objectives for Latvijas valsts meži (Latvia State Forests) are determined in the following instruments:

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Forest Policy Document</td>
<td>Sets general objectives for the sector</td>
</tr>
<tr>
<td>Law on Forests</td>
<td>Codifies the role of the Ministry and Latvijas valsts meži in the management of state forests</td>
</tr>
<tr>
<td>Corporate Strategy Document</td>
<td>Developed in coordination between the Ministry of Agriculture, the management board of Latvijas valsts meži, and stakeholders, including the Latvian Forest Industry Federation and Forest Owners Association. Provides economic, social, and environmental targets, which are reviewed every five years. The first corporate strategy was adopted in 2002 and was last updated in 2009. Implementation of the corporate strategy is reviewed during the annual general shareholder meeting.</td>
</tr>
</tbody>
</table>

Source: Discussions with the Ministry of Agriculture and Latvijas valsts meži during the May 2014 fact-finding visit to Riga. See also section A.3.c.iii above.

Setting and evaluating SOE objectives in practice

Despite these provisions, the process for setting and communicating commercial and non-commercial objectives is unclear. Nor is there any standard practice or legislative regulations for balancing commercial and non-commercial SOE objectives, authorities state. For example, a 2012 State Audit Office audit of the Ministry of Transport’s implementation of transport sector policy and management of Latvijas Dzelzceļus criticizes the Ministry’s objective-setting for Latvijas Dzelzceļus, stating that sectorial policy documents and the company’s business strategy do not set specific short, medium, and long-term economic and business targets, thereby making it “not possible to evaluate the effectiveness of [the] performance results” of LDZ “as a manager of the public-use railway infrastructure”.

85 Without a clear distinction of, and accounting for, commercial versus non-commercial objectives, it is difficult to assess whether an SOE is operating efficiently. Critics—including representatives of the Latvian Government—have targeted unclear SOE objective-setting as one of the major obstacles to monitoring and assessing the sector’s overall efficiency and transparency. For example, the 2013 State Audit Office’s audit opinion of the implementation of the State and municipal 2012 budget finds:

> It is not possible to gain assurance that the management of state and local government corporate enterprises is transparent and executed effectively since no written document exists that governs the state policy concerning corporate enterprises, determining goals for state capital investment, and the methods and activities of state-owned enterprises with which to achieve these goals.88

The difficulty in assessing SOEs’ objectives is further exacerbated by the fact that most shareholders do not expect their SOEs to generate profits, but rather, to meet costs—including those associated with the fulfilment of non-commercial objectives. (For example, EGMs are typically called to approve material transactions, which in combination with an expectation only to meet costs, implies
EGMs—and therefore active shareholder interest—are effectively often triggered by cases of potential financial losses.) Commercially oriented SOEs are expected to cover the costs of non-commercial objectives out of their revenue streams. Subsidies, authorities say, are not often disbursed to commercially oriented SOEs to help cover these expenses. In some cases, SOEs are granted the right to charge a service fee, set by the Cabinet, to help pay for the fulfilment of a non-commercial objective. (For example, the Road Traffic Safety Directorate charges Cabinet-approved fees for fulfilling its tasks, such as registering vehicles, license plates and driver’s licenses.) Or, SOEs can be exempt from fulfilling all of their dividend obligations to the State budget (see the dividend policy section of A.4.b.iii).

Behind this practice is the Government’s expectation that budget shortfalls for the administration of public tasks carried out by SOEs will be addressed by profits generated by commercially oriented SOEs. As a result, first, there is little transparency regarding the budgeting of public administration tasks undertaken by SOEs and little understanding of the actual costs of such tasks. For instance, the State Audit Office’s 2013 audit report on the implementation of the 2012 State and municipal budget states that, from 2009 to 2012, the State “failed to ensure the determination of funding required for the implementation of the State policy according to the scope of measures and services implemented within the framework of the budget program.” Second, the Government’s expectations for SOE dividend pay-outs are often unaligned with SOE’s actual operating costs and financial needs and therefore unsustainable. Latvian authorities stated, for example, that SOE dividend pay-out policies are set in large part to supplement the state budget. See section A.4.b.iii below). Examples of non-commercial tasks carried out by SOEs and the tariffs set for the provision of these tasks are included in Table 11.

(iii) Corporate criminal liability

There may be some question over whether SOEs can be held criminally liable. The Latvian authorities state that SOEs as legal persons are liable as “private law legal persons” under Arts. 12 and 70<i>1</i> of Latvia’s Criminal Law. However, in the June 2014 review of Latvia’s anti-bribery framework under the OECD Anti-Bribery Convention, the OECD Working Group on Bribery in International Business Transactions noted that “private law legal persons” is an undefined term. CL Section 70<i>1</i> also provides for liability against state and municipal capital companies, but these only cover SOEs that are wholly owned by the State, as per Section 1 of the State Administration Structure Law, and not to SOEs with non-commercial objectives, SOEs whose operations are considered to be wholly non-commercial, and SOEs with some—but not complete—State ownership. This will be an area for further follow up by the Working Group on Bribery.
Table 11. Main non-commercial SOE services and price-setting for these services (as of 2011)

<table>
<thead>
<tr>
<th>Service Provider</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ceļu satiksmes drošības direkcija [Road Traffic Safety Directorate]</td>
<td>Services predominantly under monopoly conditions. The Cabinet sets the prices for part of the services provided in the framework of public administration functions. Prices of other services, which, predominantly, also belong to the functions of administration, are established by the joint stock company [management] board.</td>
</tr>
<tr>
<td>Kultūras un sporta centrs „Daugavas stadions” [Culture and Sports Centre “Daugavas Stadiums”]</td>
<td>Management and maintenance of State property, for which an agreement with Ministry of Education and Science (which simultaneously is the holder of shares) has been concluded. The prices of services offered in the market are set by the [management] board.</td>
</tr>
<tr>
<td>Lauku attīstības fonds (LAF) [Rural Development Fund]</td>
<td>Sale of services under the conditions of monopoly, which, essentially, is a public administration function. Main revenue of LAF is constituted by issuing guarantees for a charge, the amount of which is defined by the Cabinet of Ministers, as well as investments into deposits.</td>
</tr>
<tr>
<td>Latvijas Dzelzceļš [Latvian Railroad]</td>
<td>Infrastructure management fees are set according to the methodology, issued by the PUC. Since 01.01.2011, the price for using railroad infrastructure in public use is set by a capital company whose shares are 100% owned by LDZ, LatRailNet, using PUC methodology. Prices for services of subsidiaries are set under conditions of market competition.</td>
</tr>
<tr>
<td>Latvijas Loto [Latvian Lottery]</td>
<td>Revenue from services under the conditions of state established monopoly. Product prices are set by the joint stock company.</td>
</tr>
<tr>
<td>Latvijas Nacionālais meteo logijas centrs [Latvian National Meteorology Centre]</td>
<td>Provides commercial services in the market. In some categories of services no competition exists, even though the market is open. Prices for services are set by the [management] board.</td>
</tr>
<tr>
<td>Latvijas Nacionālā opera [Latvian National Opera]</td>
<td>State budget resources allocated by the Ministry of Culture (which simultaneously is the holder of shares) in accordance with an agreement on performance of culture functions delegated by the State and own revenue (the agreement defines the limit of average ticket price).</td>
</tr>
<tr>
<td>Latvijas Valsts ceļi (LVC) [Latvian State Roads]</td>
<td>State budget resources allocated by the Ministry of Transport (which simultaneously is the holder of shares) in accordance with the agreement on delegating administration tasks. The share of revenue from providing unregulated services offered in the market on the balance sheet of LVC is small (approximately 1% of net turn-over in 2009).</td>
</tr>
<tr>
<td>Latvijas Vides, ģeoloģijas un meteoroloģijas centrs (LVGMC) [Latvian Environment, Geology and Meteorology Centre]</td>
<td>State budget resources allocated by the Ministry of Environment (which simultaneously is the holder of shares) in accordance with the agreement on delegating administration tasks. In 2009 state budget resources were insufficient for covering LVGMC expenditure, and to decrease the losses the company was providing service for a charge in the market.</td>
</tr>
<tr>
<td>Paula Stradiņa kliniskā universitātes slimnīca (PSKUS) [Pauls Stradins Clinical University Hospital]</td>
<td>Funding on the basis of the agreement on state remit (approximately 85% of services). Tariffs are set by Ministry of Health (National Health Service). Opinions differ as to the extent PSKUS itself can influence them. Remaining revenue formed by services offered in the market and funding attracted by other means.</td>
</tr>
<tr>
<td>Tiesu namu aģentūra [Court House Agency]</td>
<td>Revenue from lease payments, the formula for calculating these is established by the Cabinet of Ministers, and leasing property in the market and revenue from IT infrastructure maintenance to justice sector.</td>
</tr>
<tr>
<td>Valsts nekustamie īpašumi [State Real Estate]</td>
<td>Revenue from lease payments, the formula for calculating these is established by the Cabinet of Ministers, and leasing property in the market. Other services.</td>
</tr>
</tbody>
</table>
b. Regulatory framework

According to the Latvian authorities, SOEs are not exempt from any laws and regulations that apply to private enterprises. Examples include the Law on Regulators of Public Utilities, enforced by the Public Utilities Commission (PUC), and the Competition Law, enforced by the Competition Council. The sections below describe the role and function of the PUC and Competition Council, vis-à-vis SOEs, for two reasons: to assess the treatment of SOEs in these areas, as well as to highlight specific instances in which the state ownership and regulatory functions are somewhat separated.

(i) Law on Regulators of Public Utilities and the PUC

Some of Latvia’s largest SOEs operate in sectors regulated by the PUC. The PUC, established in 2001 under the Law on Regulators of Public Utilities, is an institutionally and functionally independent, autonomous body responsible for regulating the energy, electronic communications, post, railway infrastructure, municipal waste management, and water management sectors. The PUC is managed by a five-member Board, whose members are appointed by Parliament to five-year terms. The Board oversees the operations of the Executive Institution, which performs the functions of the secretariat to the Board and is responsible for implementing the decisions adopted and administrative acts issued by the Board. The Executive Institution includes three sectorial departments and three regional offices. PUC operations are financed by a state fee on public service regulation, which is calculated from turnover of regulated services and which is paid by all regulated companies, including SOEs.

Article 9 of the Law on Regulators of Public Utilities lists the PUC’s main functions. The PUC’s responsibilities include approving tariffs for public utilities; licensing the provision of public utilities; addressing disputes between providers and users of public utilities; promoting competition in regulated sectors; ensuring compliance with utilities licenses and other relevant requirements; liaising with ministries responsible for regulated sectors; and informing the public of the activities of the PUC and public utility providers. In fulfilment of its tasks, the PUC can adopt decisions and issue administrative acts that are binding to specific providers and users of public services, as per Art. 6 of the Law on Regulators of Public Utilities.

Providers of public utilities include both private and state-owned or state-controlled enterprises. These providers are responsible for suggesting to the PUC fees for the public utilities they provide, according to the PUC-developed methodology for determining tariffs. Providers who violate PUC regulations can have their licenses revoked under Art. 19 of the Law on Regulators of Public Utilities. To date, the PUC has not revoked licenses from any SOEs acting as public utilities providers.
The PUC is also responsible for determining and regularly reviewing the list of services that are considered to be “universal service obligations”. These are services – provided by any kind of company, including SOEs in the affected sectors – that the Government considers should be available to all users at an affordable price, irrespective of users’ geographic location. Such services include post services, energy, and electronic communication. For example, Latvijas Pasts is responsible for processing and delivering postal items of up to two kilos, inland and cross-border postal parcels under 10 kilos, cross-border postal parcel items (including insured items) that are received from other EU states under 20 kilos, and periodicals. Lattelecom is required to provide universal access to Lattelecom’s public telephone network to allow Latvians to make and receive calls at a set minimum connection speed. Likewise, the passenger rail company, Pasažieru vilciens, is responsible for providing discounted rail-transport access for certain passengers (i.e., elderly or physically challenged passengers). Most SOEs are reimbursed for losses incurred from providing universal services, and these reimbursements must be properly recorded in SOEs’ books and records.

Box 5. SOEs in the marketplace: Liberalisation of the fixed voice, postal, and electricity markets

The PUC’s responsibility to oversee the provision of services of general economic interest in Latvia is developing as regulated sectors continue to become further liberalized. Three of these sectors featuring SOEs as major market operators are highlighted, below, and they serve to illustrate sector-specific regulatory considerations.

- **Fixed voice market**: The fixed voice market was opened up to competition in 2003. The state-owned (51% share) market incumbent, Lattelecom, remains the dominant player in the sector, but competitors have steadily grown over the last decade. The PUC estimates that the number of active electronic communications service providers has increased from 202 in 2005 to 396 in 2010. Since 2003, however, the mobile communications market has largely surpassed the fixed voice market, accounting for only 24.1% of voice traffic as of December 2010. Lattelecom continues to dominate the fixed voice market.

- **Postal market**: This sector includes traditional, express, direct and other postal services. This market was liberalized in 2013. Since then, 360 new companies have entered the postal market. These new entrants focus on the most profitable market segments (i.e., provision of value-added services like express and courier mail, delivery in cities only, etc.), processing 7% of the total number of postal items in Latvia but accounting for 28% of the total sector turnover.

- **Electricity market**: The process of liberalizing Latvia’s electricity market has been gradual, beginning in 2006. Today, Latvian authorities say the market should be fairly open, with only the household segment still regulated with capped tariffs. (Non-household electricity consumers account for 75% of all electricity consumption in Latvia, according to the Ministry of Economy.) However, despite the registration of more than 240 electricity producers and more than 50 electricity traders by the end of 2013, the state-owned incumbent still accounted for 90% of electricity generation and 73% of the electricity market. These statistics may change, as the household segment of the market is scheduled for liberalization in January 2015.

SOEs are not excluded from competition rules under Latvia’s Competition Law, Latvian authorities assert. In general, Latvian authorities stated in exchanges with the OECD Secretariat\textsuperscript{98} that “strategic” SOEs\textsuperscript{99} mostly operate in monopoly situations and therefore do not negatively impact competition in horizontal markets. Where SOEs operate in competitive horizontal markets, they are not awarded any special advantages or privileges that would give them an unfair competitive advantage, authorities say.

The Competition Council enforces the Competition Law, as well as potential violations of EU competition law. It is a State administrative institution under Art. 4 of the Competition Law. The Competition Council reports to, and is supervised by, the Ministry of Economy, though Latvian authorities explain that the Ministry of Economy cannot directly influence the decisions of the Competition Council. The Competition Council is allocated its budget and resources via the Ministry of Economy, and not directly from the State budget. (In 2013, the Council’s total budget was EUR 827,294). The three members of the Council’s board of directors are appointed to five-year terms by the Cabinet of Ministers on the recommendation of the Ministry of Economy. The Executive Directorate serves as the Competition Council secretariat. The Executive Directorate is divided into subject-specific and administrative departments to support the implementation and enforcement of the Competition Law.\textsuperscript{100} As of 2013, the Council employed 35 people: six lawyers, 22 case handlers and seven support staff.\textsuperscript{101}

Under Latvian Competition Law, persons wishing to report a violation of the law may submit a written complaint to the Competition Council. Decisions of the Competition Council regarding alleged violations of the Competition Law can only be challenged in court. The Competition Council provided the OECD Secretariat with case summaries of 16 cases involving SOEs since 1999.\textsuperscript{102} Of the 16 cases, 12 were opened over possible abuse of dominance (Art. 13); two dealt with prohibited agreements (Art. 11); one dealt with illegal mergers; and one dealt with a merger request (Chap. 4). Two of these cases were dismissed, one was dismissed upon appeal, and one case was closed. The Riga Freeport Authority\textsuperscript{103} was involved in three cases; the Riga International Airport was involved in two cases; and Lattelecom was involved in two cases. In the cases where information was available on fines imposed on SOEs for violations of the Competition Law, the imposed fines were lower than the fines allowed under the law. For violations of Art. 13 (abuse of dominance), fines imposed against SOEs were lower than those imposed against private sector companies: While the maximum fine allowed is 5% of the company’s net turnover for the previous financial year, the Competition Council has imposed fines equalling, on average, 0.45% of SOE’s net turnover, versus 1.03% of private companies’ net turnover.\textsuperscript{104}

It can be argued that there is the potential for a conflict of interest in the application of Competition Law to SOEs owned by the Ministry of Economy and the LPA (which is owned by the Ministry of Economy), given the Competition Council’s subordination to the Ministry of Economy. (Four of the 15 aforementioned cases involved two SOEs for which the Ministry of Economy is the ultimate beneficial owner: Lattelecom and Citadele.) As of late 2014, internal consultation processes had commenced to evaluate the current Council’s independence aspects and to come to an agreement on what additional powers for the Competition Council should be foreseen to improve its capacity and to strengthen its independence.
Box 6. Case Study: Riga International Airport found to abuse its dominant position in the market

The Competition Council decided on 10 February 2012 that Riga International Airport had abused its dominant position by charging to the Irish airline Ryanair substantially lower prices for airport services than those charged to the Latvian airline Air Baltic, in violation of Article 102 a) and c) of the Treaty on the Functioning of the European Union. (Art. 102 is largely replicated in Latvia’s Competition Law under Art. 13(1), abuse of dominance.)

The case was opened after Air Baltic submitted a complaint to the Council claiming that the airport gave special treatment to Ryanair between November 2009 and December 2010 by allowing them to pay lower tariffs on services such as luggage processing, ensuring passenger stairs, aircraft pushback, etc., in an effort to entice Ryanair to service Riga International. The Council found that prices charged to Air Baltic for the same services were 82% higher and Air Baltic had to cover additional administrative costs that were not charged to Ryanair.

As a result, the Council imposed on the Airport a fine of EUR 71,143 and obligations to apply sound and non-discriminatory terms of payments for its services, as well as to provide airlines with comprehensive information on the formation of its prices. The Council argued that, while the airport has the right to decide its own fees, the fees in this case were discriminatory and contrary to the Competition Law.


(iii) SOE-specific regulations

SOE dividend policy

SOE dividend pay-out obligations, or “dividend policy,” are set by the Cabinet with input, to a certain extent, from line ministries and the SOEs under their responsibility, as per Art. 3(1) of the Law on State and Local Government Capital Shares and Capital Companies. Dividend pay-out rates are high and generally not sustainable, according to observers, line ministries, and a number of SOEs.

Current dividend pay-out rates were set by Regulation 1471 of December 2009 on the “Procedure for Determining the Share of Profit to be Paid for Use of State Capital and Paying Thereof to the State Budget”. The Regulation requires the minimum share to be paid out as dividends for accounting years 2009-2013 as 50% for capital companies under decisive influence of the state (including capital companies under indirect decisive influence) and 90% of the net profit for capital companies in which the state directly or through an intermediary holds shares. (If the State is a minority shareholder, Commercial Law provisions on setting dividend policy apply.) The Latvian authorities state that failure to meet these dividend pay-out targets would have a material impact on the state budget, though they also say that most SOEs are generally not expected to be profit-making, but rather to balance their budgets.

Beyond the universal dividend policy rate set forth via Cabinet regulation, the Cabinet can decide to impose dividend requirements on individual SOEs, as was the case for Latvenergo and the state forestry company, Latvijas Valsts meži, which were required to pay higher dividend policies during and after the financial crisis. Latvian authorities state that higher dividend policies were set for these SOEs because their dividend pay-outs are among the highest among all Latvian SOEs.
State regulations allow an SOE shareholder to request Cabinet approval for a different (i.e., lower) dividend policy as that set by Law or regulation, though this is rare. Five such requests were made in the 2012 financial year, which the Cabinet of Ministers approved in 2013.107

Fees for public services

The Cabinet has also issued regulations that are specific to SOEs. For instance, the Cabinet is entitled to approve the amount of fees for public services and exemptions thereof, as per Art. 43(2) of the State Administration Structure Law. This measure only applies to administrative tasks and special requirements assigned to an SOE, either by law or by the SOE’s line ministry. As an example, the Latvian authorities cite the Electronic Communication Law, which states in Art. 7(4) that the Cabinet determines the fees and tariffs of public paid services provided by the SOE Elektroniskie sakari (“Electronic Communications Office”), which is responsible for the administration of Latvia’s radio frequency spectrum and related services, and which is also responsible for supervising the installation and construction of electronic communications networks. The same applies to a number of SOEs, including Čeļu satiksmes drošības direkcija (the Road Traffic Safety Directorate) and Latvijas gaisa satiksme (air navigation services).

It appears that more consideration could be made of the financial health of the SOE when setting tariffs for public services delivered by these enterprises. An illustrative example would be fees for health services charged by the National Health Service (NHS), which are calculated based on tariffs of bed days, procedures, and hospitalisations. Calculation of tariffs is based on a formula of tariffs and hospital financial reports. All tariffs are decided by the Cabinet of Ministers. Latvian authorities state that NHS fees are set below cost and, as a result, SOEs in this sector operate at a loss. (SOEs in this sector sector account for 18% of the Latvian SOE sector by number of enterprises, but only 1.57% in terms of total SOE value.) Occasional losses in health care SOEs due to mismanagement has also been reported by the press and was allegedly behind recent managerial change in some companies.

To finance operations, SOEs in the healthcare sector are heavily subsidized by State budget funding: In 2012, the Government estimated that 70% or more of revenues for most SOEs came from state grants in 2011, and State hospitals could only finance major projects, such as constructing new facilities or purchasing medical equipment, through loans backed by state guarantees.108 For its part, the Ministry of Health stated during discussions with the Secretariat that, while it does not have direct input into the fee-setting process for NHS tariffs, it estimates its SOEs largely meet costs via NHS fees (roughly 85% of SOE income) and income received from special services, such as outpatient services, training at teaching hospitals, medical research, etc.

5. SOE ownership function and corporate governance responsibilities

a. Responsibilities of the shareholder representative

SOE boards of directors were abolished for most SOEs in 2009, as a result of a series of major political and corruption scandals involving political appointees abusing their positions as directors on SOE boards. As per Art. 98 of the Law on State and Local Government Capital Shares and Capital Companies, only SOEs operating as credit institutions, investment management companies, or financial institutions are required to have boards of directors. As a result, State Secretaries de facto act as the board of directors for some of the country’s largest enterprises and are individually responsible for the corporate governance and management oversight of all SOEs in their ministry’s portfolio. Under the current SOE framework, most SOEs are managed by a management board, which reports directly to the line ministry’s state secretary or head of institution, or another authorized official. The
Latvian authorities have informed the OECD Secretariat that, “basically, shareholders meetings have taken over the role of the boards”.

In practice, this translates to heavy involvement of state secretaries in the day-to-day operations of (often multiple) SOEs in their ministry’s or institution’s portfolio. A specific example of a board function appropriated by state secretaries is the requirement by most line ministries that SOEs seek approval from their shareholder (the state secretary) for all purchases above EUR 143 000. This is the case, for instance, at Latvenergo. There, management board members reported 13 EGMs were held with the State Secretary of Economy in 2013, mostly triggered by procurement purchases exceeding EUR 143 000, though Latvenergo’s articles of association and Rules of the Management Board allow the Management Board to sign off on purchases below EUR 360 000 (except for major construction projects, projects related to Latvenergo’s electricity transmission or distribution system, and procurement of energy, water, fuel, and European Union emission allowances and certified emission reduction units). The Ministry of Transport stated it has a similar threshold requirement for its SOEs and that procurement purchase requests over this threshold must be submitted to the State Secretary in writing for formal approval. Heads of management boards of SOEs under the Ministry of Transport are also required to attend weekly face-to-face meetings at the Ministry, while further consultation between the Ministry and management boards is held “almost daily”. At the Ministry of Agriculture, communication with the management board of Latvijas valsts meži is “intense”, with meetings held every one to two months. (Six EGMs were convened in 2013.) The Ministry of Finance stated it convenes an EGM with each of its SOEs usually once per quarter.

Critics say the 2009 abolishment of boards of directors has exposed SOEs to continued corporate governance abuses and represent one of the most important challenges to ensuring a transparent and efficient SOE sector. For example, the Baltic Institute for Corporate Governance (BICG), which monitors corporate governance in the Latvian SOE sector, stated in a recent survey of corporate governance in the Baltic region there is a “chronic lack of capacity” at the State level for ensuring good corporate governance in Latvian SOEs. “[O]fficials tasked with SOE oversight are clearly stretched beyond the limits of their technical and physical capacity. The absence of properly established professional boards of directors, or structures better able to monitor management…could be leaving Latvian SOEs vulnerable to further governance failures in the future.” It is little surprise that the BICG survey ranked Latvian SOEs that have retained boards of directors highest in terms of corporate governance. (See also section B.2.c.ii below.)
Box 7. Cases of alleged corporate governance failures and corruption in Latvian SOEs

- **Latvenergo**: The Latvian Corruption Prevention and Combating Bureau (CPCB) opened criminal investigations in June 2010 into the alleged bribery of 17 former Latvenergo employees (including the former company president) for receiving bribes from 2006 onwards, allegedly from Spanish, Swedish, and Turkish companies seeking favourable treatment in the award of contracts in Latvia relating to the modernization of power stations. According to news reports, the bribes promised and paid totalled approximately USD 24 million.  

- **Air Baltic**: In November 2011, the State increased its share in Air Baltic from 52.6% to 99.77%. The share buyout followed several allegations of corruption and improper business conduct by former CEO Bertolt Flick, who currently faces criminal charges in multiple jurisdictions. Allegations include BAS’ registering bogus shares to gain a controlling interest in the company and funnelling illicit money to support the political campaigns of Latvian public officials, among others. Reports on the Government’s purchase of Air Baltic shares also indicated that these shares had been paid up with loans from a bank that later became insolvent, putting Air Baltic’s business at major risk.  

- **Ventspils Nafta**: The overpayment of members of this former SOE’s board of directors reportedly contributed to the Government’s decision in 2009 to abolish the requirement for SOEs to establish boards of directors in Latvia. Allegedly, members of the Ventspils Nafta board of directors used the company for their personal illicit enrichment. Ventspils Nafta was privatized in 2006.  

- **Latvian Shipping Company (Latvijas kuģniecība)**: Allegations linked to the Latvian Shipping Company (LSC) are linked to allegations concerning Ventspils Nafta, which today owns a 49.94% stake in the LSC. (The LSC is also a former SOE in which the State maintains 10% ownership, via the State Social Insurance Agency.) The allegations of fraud and corruption involve Ventspils Mayor Aivars Lembergs, who faces corruption and embezzlement charges in the United Kingdom and in Latvia. A legal representative defending LSC against fraud and corruption allegations was murdered in 2010. Recent reports indicate efforts made by the company to improve its corporate governance, including a 2013 donation to Transparency International’s Latvia chapter, Delna.  


b. **Responsibilities of boards of directors in six SOEs**

Six state-owned and state-controlled companies have boards of directors. Attīstības finanšu institūcija (Development Finance Institution) has a board of directors as per Art. 98 of the Law on State and Local Government Capital Shares and Capital Companies. The remaining five have boards of directors in compliance with the Commercial Law and to meet the demands of external shareholders: Reverta; Citadele bank; LMT; Lattelecom; and Air Baltic.

Currently, only the Attīstības finanšu institūcija is subject to board of director provisions in the Law on State and Local government Capital Shares and Capital Companies. These provisions include clarifying the responsibilities of the members of the board, rules and procedures for holding board meetings, and reporting requirements. (See also section B.6.a.) However, this framework does not provide for an independent body to nominate members to SOE boards of directors, and there are no checks and balances on ministers’ powers to nominate directors. Nor are there any rules limiting the ability of government employees, civil servants, or politicians to serve as members of SOE boards of directors. Nomination criteria are broad: Art. 98(4) of the Law on State and Local Government Capital Shares and Capital Companies states candidates should be “fluent in the official language and whose work experience, education, and qualification ensure professional fulfilment of the tasks of a member of the [board of directors]”. Table 12, below includes the board makeup for the six SOEs. (The remaining five SOEs with boards of directors are subject to provisions in the Commercial Law on the establishment of boards of directors, their responsibilities, and procedures.)
Where the LPA is empowered to nominate board members, it promotes the application of governance measures that go beyond the Commercial Law’s minimum legal requirements, in order to bring corporate governance practices closer to international standards. These practices, the LPA states, are based on the principles promoted by the OECD, NASDAQ OMX Riga and BICG. The LPA nomination process includes the elements, below. (The full text of LPA’s “defined principles for nomination of Supervisory boards” is included as Annex 2.)

- In order to prevent political influence, predefined requirements for board members including previous experience and professionalism;
- Establishing a nomination committee and defining the competence of the committee;
- Consultations with relevant NGOs;
- Drawing up a “long list” of potential candidates based upon the recommendations of the NGOs and nomination committee;
- Reviewing the persons on the “long list” based on conditions established by law and the nomination committee;
- Narrowing the field of candidates to a “short list” with whom interviews are conducted;
- Based on the interviews, selecting one or more candidates and making a recommendation to the shareholder;
- Publishing the outcomes of the nomination process.

The LPA reports it has applied these measures five times since 2012 for boards of directors at Citadele Bank, Reverta, Lattelecom, Latvijas Mobilais telefons (LMT), and Riga District Heating (on behalf of the Ministry of Economy). In the Citadele case, for example, the nomination committee was made up of representatives from the LPA, the Ministry of Economy, and the Ministry of Finance, as well as Latvia’s national chapter of Transparency International, Delna, which participated at the LPA’s request as a non-voting observer on the committee. The Citadele nomination committee also invited candidate proposals from professional organisations, including the Association of Commercial Banks of Latvia, the BICG, and the Latvian Chamber of Commerce and Industry.
### Table 12. Composition of boards of directors in six Latvian SOEs

<table>
<thead>
<tr>
<th>SOE</th>
<th>Shareholder</th>
<th>Board members in or linked to the Latvian Government</th>
<th>Independent board members</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Board Member</td>
<td>Government association</td>
</tr>
<tr>
<td>Air Baltic (Website: <a href="https://www.airbaltic.com/en/corporate-governance">https://www.airbaltic.com/en/corporate-governance</a>)</td>
<td>MoT</td>
<td>• Kaspars Bliškens</td>
<td>• Adviser to the Minister of Transport and former Deputy State Secretary</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Niks Bulmanis</td>
<td>• Former Chair of the Riga Freeport management board (until 2006)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Andris Liepiņš (Chair)</td>
<td>• Deputy State Secretary, Ministry of Economics</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>None</td>
</tr>
<tr>
<td>Attīstības finanšu institūcija (Development Finance Institution)</td>
<td>MoF</td>
<td>• Liga Kļaviņa (Chair)</td>
<td>• Deputy State Secretary, Ministry of Finance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Gatis Sniedziņš</td>
<td>• Deputy Director, EU Funds Implementation Department, Ministry of Economics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Jānis Šnore</td>
<td>• Deputy State Secretary, Ministry of Agriculture</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>None</td>
</tr>
<tr>
<td>Citadele Bank (Website: <a href="http://west.citadele.lv/en/about/governance/supervisory-board/">http://west.citadele.lv/en/about/governance/supervisory-board/</a>)</td>
<td>LPA</td>
<td>• Klāvs Vasks (Chair)</td>
<td>• Geoffrey Dunn (Deputy Chair)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Laurence Phillip Adams</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Aldis Greitāns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Baiba Rubesa</td>
</tr>
<tr>
<td>SOE</td>
<td>Shareholder</td>
<td>Board members in or linked to the Latvian Government</td>
<td>Independent board members</td>
</tr>
<tr>
<td>-----------</td>
<td>-------------</td>
<td>-----------------------------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Board Member</td>
<td></td>
</tr>
<tr>
<td>Lattelecom</td>
<td>LPA</td>
<td>Jānis Brazovskis</td>
<td>Juha-Pekka Weckstrom</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Uldis Ivars Grava</td>
<td>Yvonne Djerf</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Raitis Tukāns</td>
<td>Kārlis Krēslīns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Justin Bancroft</td>
</tr>
<tr>
<td>LMT</td>
<td>LPA</td>
<td>Toms Meisītis</td>
<td>Kennet Râdne (Chair)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Anrī Leimanis (Deputy Chair)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Stefan Block</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hannu-Matti Mäkinen</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Mariss Mežgals</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Claes Nykander</td>
</tr>
<tr>
<td>Reverta</td>
<td>LPA</td>
<td>Andris Ozoliņš</td>
<td>Michael Joseph Bourke (Chair)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Kaspars Āboliņš</td>
<td>Mary Ellen Collins</td>
</tr>
</tbody>
</table>

Source: Latvia’s questionnaire responses; publicly available resources, including annual reports of above-mentioned SOEs, as well as supplementary information provided by the Latvian authorities.
6. Privatisation

a. Legal framework for privatisation of state assets

Privatisation procedures are provided in the following laws:

- The Law on Privatisation of State and Local Government Property Entities, which established the LPA in 1994.
- The Law on Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates.
- Law on State and Local Government Capital Shares and Capital Companies.

The Law on Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates sets forth procedures for privatising state assets prior to 2006 (Art. 5.1). After 2006, the Law on Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates states that privatisation of state assets should follow procedures set forth in the Law on State and Local Government Capital Shares and Capital Companies. (This law also sets forth procedures for the state to acquire assets.) In all cases, under Art. 6(3), of this law, the Cabinet of Ministers makes the final decision on whether to privatise a state asset. (Annex 3 provides further details on procedures for changing SOE capital structures. Nearly all of the procedures for alienating, privatising, or selling state capital shares involve the LPA.)

As per Art. 17 of the Law on Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates, six SOEs cannot be privatised: Latvenergo, Latvijas Pasts (the Latvian post service); Riga International Airport; Latvijas dzelzceļš (Latvian Railway); Latvijas Gaisa Satiksme (air traffic control); and Latvijas valsts meži (Latvian State Forestry). The Gambling and Lotteries Law also prevents the Government from selling its ownership of Latvijas Loto, which is owned by the Ministry of Finance.

b. Privatisations to date

Latvia has privatised 95% of its corporate assets since declaring independence from the Soviet Union in 1991. The privatisation process took place in two phases. In the first phase, from 1991 – 1995, the Government privatised mostly small enterprises, typically in the form of a management/employee takeover. During this phase, the responsibility for preparing an SOE for privatisation fell with the ministry or ministries that had previously owned the enterprise.

The second privatisation phase was initiated with the establishment of the LPA in 1994. The LPA is a state-owned joint stock company owned by the Ministry of Economy that is tasked with carrying out the privatisation of state assets approved by the Cabinet of Ministers for privatisation. From September 2005 to December 2010, the Cabinet of Ministers considered privatisation proposals for a total of 53 SOEs and made a decision to privatise state-owned capital shares in nine companies, including in three companies with 100% shareholding and in two with decisive influence. The Cabinet of Ministers rejected privatisation of capital shares in 44 capital companies. A number of these companies were privatised via listing on the local stock exchange (today the Nasdaq OMX Riga exchange). A number of these companies were privatised via listing on the local stock exchange (today the Nasdaq OMX Riga exchange).

The LPA currently holds state-owned shares with a significant degree of control in six companies. LPA holdings are included in Table 13.
Table 13. List of LPA State Capital Shares as of end-2013

<table>
<thead>
<tr>
<th>Company</th>
<th>Status</th>
<th>State-Owned Shares, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lattelecom</td>
<td>Slated for privatisation</td>
<td>51</td>
</tr>
<tr>
<td>Latvijas Mobilais Telefons</td>
<td>Slated for privatisation</td>
<td>5</td>
</tr>
<tr>
<td>Liepājās sērkociņi</td>
<td>Slated for privatisation</td>
<td>10,62</td>
</tr>
<tr>
<td>Sertifikācijas un testēšanas centrs</td>
<td>Slated for privatisation</td>
<td>100</td>
</tr>
<tr>
<td>Piensaimnieku laboratorija</td>
<td>Slated for privatisation</td>
<td>5,56</td>
</tr>
<tr>
<td>RAF</td>
<td>Insolvent</td>
<td>63</td>
</tr>
<tr>
<td>RAF-inženieru tehniskais centrs</td>
<td>Insolvent</td>
<td>6,83</td>
</tr>
<tr>
<td>Agroleasing S.I.A. MSIA</td>
<td>Insolvent</td>
<td>50</td>
</tr>
<tr>
<td>Gulbenes Timbers</td>
<td>Slated for privatisation</td>
<td>45,64</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LPA-owned Capital Shares</th>
<th>Status</th>
<th>State-Owned Shares, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citadele bank</td>
<td>In the process of being privatised&lt;sup&gt;1&lt;/sup&gt;</td>
<td>75 minus one share</td>
</tr>
<tr>
<td>Reverta</td>
<td>The orderly recovery of state funds</td>
<td>84,15</td>
</tr>
<tr>
<td>Hipotēku bankas nekustamo īpašumu aģetūra (HipoNIA)</td>
<td>As part of restructuring of the Mortgage and Land bank in 2013, LPA has become the sole owner of HipoNIA, the former subsidiary of the Mortgage and Land bank specializing in real estate and non-performing loans. Similarly to Reverta, HipoNIA will gradually work out its portfolio with the aim to recover funds provided by the State.</td>
<td>100</td>
</tr>
</tbody>
</table>

1. As noted in section A.2.b(i) above, the Latvian Government announced on 5 November it had signed a deal with a group of 12 international investors to sell its 75% stake in Citadele. (See: http://www.pa.gov.lv/english/citadele-bank/news/ripplewood-and-latvian-privatization-agency-sign-agreement-for-sale-of-citadele-bank/)

Source: Latvia’s responses to questions from the Secretariat, received 20 May 2014.

A so-called “third phase” of privatisations was proposed in 2012 and 2013, following a comprehensive assessment process carried out by the Cabinet in collaboration with a working group led by the Cross Sectorial Coordination Centre (CSCC), which was established under the Decree of the Prime Minister dated 29 February 2012. The assessment resulted in a report that was accepted by the Cabinet on 11 June 2013 that suggests a significant reduction of state ownership, including the reorganisation of 16 SOEs as non-commercial public institutions, public agencies, or foundations; merging nine SOEs; to divest State ownership in 132 wholly-, majority- and minority-owned enterprises (including SOEs with the State’s indirect participation); to liquidate 14 SOEs, due to business inactivity, ongoing insolvency or bankruptcy processes; and to retain state ownership in 77 enterprises. Recommendations for reducing state ownership were made based on the CSCC-led working group’s opinion that State ownership in many cases was “unreasonable”. In a number of cases, the working group found that SOEs had been created not according to the state enterprise ownership rationale under Latvian law, but either to supplement the State budget or to make them self-financing to decrease the State budget during the economic crisis.

Of note, the working group’s privatisation assessment recommended increasing State participation in one company. The report suggests that Latvia’s only passenger rail company, Pasažieru vilciens, increase its ownership from 51% to 100% of shares in VRC Zasulauks, a train repair and maintenance company, with a view to a possible merger of the two companies. (The Ministry of Transport supervises both enterprises.) The report also recommends the State maintain its stake in 77 companies that are considered to be “operating under conditions of market failure or their activity contributes to implementation of the country’s strategic development and security interests.”
The Cabinet also decided that all Government SOE shareholders (ministries and other institutions) must evaluate the report’s recommendations and submit to Cabinet proposals for future action. This review process was ongoing at the time of writing, as some of the recommendations cannot be implemented until the adoption of proposed SOE sector reforms, included in the Public Persons Enterprises and Capital Shares Governance Law (discussed in section A.7, below). Nevertheless, some institutions holding minority shares in commercial enterprises have actively started divesting their shares. For instance, the State Social Insurance Agency is working with the LPA to sell its shares in 37 privately owned enterprises.

Box 8. Recent significant privatisations and restructuring of Latvian SOEs

The list below provides highlights of privatisations of some major Latvian SOEs, as of mid-2014. Information included in this list is based on information provided by the Latvian Government and other publicly available resources.

- **Sale of Air Baltic:** The Government invited expressions of interest to buy Ministry of Transport shares in the company in 2012, but as of mid-2014, no stocks have been sold. In April 2014, Air Baltic’s CEO Martin Gauss indicated an initial public offering (IPO) of Air Baltic shares could be a viable option after the company returned to profit in 2013, with a net income of more than EUR 1 million, though Latvian authorities had expressed in mid-2014 that this could be complicated, especially given ongoing fallout from the departure of former Air Baltic CEO Bertolt Flick (see section A.3.a), as well as concerns related to the European Commission’s investigation into whether public support measures provided by the Government to Air Baltic were in line with EU state aid rules. For note, in July 2014, the European Commission closed its investigation, concluding state aid to Air Baltic was in line with EU state aid rules.

- **Sale of Citadele Bank:** In November 2014, the Latvian Government announced it had agreed to sell its stake in Citadele to a group of international investors led by the U.S. investment firm, Ripplewood Holdings and Tim Collins, the founder and CEO of Ripplewood. In 2013, the Government had approved a two-track sale strategy for Citadele Bank, which included simultaneously contacting strategic and financial investors to sell shares via a trade sale and exploring the potential for an IPO. The Government had aimed to complete the sale by end-2014. The sale of State shares in Citadele was put at risk when the European Commission opened an investigation in April 2014 into whether Government assistance to Citadele and Reverta violated EU state aid rules which are meant to prevent companies who receive government support from having an advantage over their competitors in the market, as well as the terms of the Commission-approved restructuring plan to protect Latvia’s financial system from Parex’s collapse. In July 2014, the Commission closed its investigation, concluding that state aid to Citadele and Reverta was in line with EU state aid rules. Citadele’s net profit in 2013 totalled EUR 15.2 million, and in 2012, the bank was ranked as the best governed enterprise in the Baltic region by the Baltic Institute of Corporate Governance.

- **Creation of Attīstības finanšu institūcija (Development Finance Institution, DFI):** The Institution was created in 2013 out of the merger of three former financial-sector SOEs. The DFI is expected to implement state aid programmes that had been implemented by the Mortgage and Land Bank of Latvia, the Latvian Guarantee Agency and the Rural Development Fund. The DFI is also expected to promote one-stop-shop agency state aid services, ensure more efficient monitoring of invested resources and optimizing costs. The merger is scheduled for completion by end-2014.

- **Possible merger and sale of Lattelecom and Latvijas Mobilais Telefons (LMT):** According to news reports, the Latvian Government may be considering merging Lattelecom and LMT in order to prepare for a sale of the state's shares in the two companies. As noted above, the LPA owns 51% of Lattelecom and 5% of LMT. Lattelecom in turn owns 23% of LMT. The Government reportedly turned down a prior takeover bid in 2008 from TeliaSonera for both companies.

In 2011, Latvia launched a comprehensive programme of SOE reform, led by the Ministry of Economy. That year, the Cabinet approved a Declaration of the Intended Activities that envisaged an assessment of the possibility to completely or partially privatize Government shares in state-owned and local government-owned enterprises, except for strategic assets, as set forth in Latvian law. The Strategic Development Plan of Latvia for 2010-2013, approved by the Cabinet in April 2010, tasks the Government with: “improv[ing] management of state-owned and local government-owned assets.” This reform effort included a critical review of the SOE sector that involved Cabinet adoption of two policy planning documents in June 2012: the Concept for Commercial Activities of Public Persons and the Concept for Management of State Capital Shares. In these policy planning documents, the Government identifies the following specific challenges, among others, to the effective corporate governance of the Latvian SOE sector:

- The holders of state capital shares simultaneously play several roles: owner, customer, policymaker, and ensurer of corporate governance rules.
- There is no clear definition of the economic and policy objectives to be achieved by the SOE, and there is no monitoring and evaluation of SOE performance.
- There is no single and transparent model for the management of state assets.
- Non-governmental professionals do not play enough of a role in the SOE sector.
- Regulations for the management of the SOE sector are “fragmented, open to interpretation and incomplete”.
- There is political interference in the day-to-day decision-making by SOE management.
In short, the Government concludes: “The existing model for SCS [State capital share] governance is far from being transparent, as no one is in charge of carrying out centralised summary of the state ROE [return on equity] indicators, the available information on overall activity of a capital company is rather limited, and thus the public have no common perception of the efficiency level of SCS governance.”

A new SOE law was prepared to address these shortcomings. The Cabinet approved a draft legislative reform package that included the Public Persons Enterprises and Capital Shares Governance Law on 28 May 2013. Other laws included in the legislative package include amendments to the State Administration Structure Law, the Law on Prevention of Conflict of Interest in Activities of Public Officials, and the Law on State and Local Government Property Privatisation. The Saeima adopted the Public Persons Enterprises and Capital Shares Governance Law on 16 October 2014 during its third and final reading and, at the time of writing, was scheduled to enter into force in January 2015. (Other laws in the legislative package await further parliamentary consideration and adoption.)

a. Core SOE reforms: The Public Persons Enterprises and Capital Shares Governance Law

The SOE reforms included in the Public Persons Enterprise and Capital Shares Governance Law are the result of consultations by the CSCC, which also consulted on proposed upcoming SOE privatisations (discussed above). The law also incorporates changes made after extensive debate in the Saeima during the law’s first and second readings over provisions concerning an SOE sector coordination function and a requirement to reintroduce SOE boards of directors. (Opposition to these measures is discussed further in section A.7.c below.) The resulting Public Persons Enterprises and Capital Shares Governance Law, adopted on 16 October 2014, will, if fully implemented:

- Introduce by March 2015 a Coordination Institution, responsible to the Cabinet of Ministers;
- Require the largest SOEs to establish boards of directors by January 2016 according to criteria determined by the Cabinet by January 2015;
- Set forth procedures under which SOEs are founded, operated and liquidated;
- Set forth procedures for managing state capital shares, including procedures for setting goals and assessing business operations;
- Set forth the procedure for determining the portion of SOE profits to be paid out in dividends; and
- Introduce a “motivating salary system” for members of SOE boards.

(i) The Coordination Institution

The new law has the potential to broadly address a number of shortcomings assessed in this report, if fully implemented. Of the reforms contained in the law, the two most important elements are the introduction of a coordination function for Latvian SOEs and the reintroduction of boards of directors, at least for the largest SOEs. On the former, the Cabinet of Ministers is required to decide by 1 March 2015 which administrative institution will fulfil the tasks of the Coordination Institution (established under Chap. IV). The Latvian authorities indicated in late 2014 that the Ministry of Economy, the Ministry of Finance, or the CSCC of the Prime Minister’s Office could take over this role. The Coordination Institution’s overall responsibility is SOE corporate governance oversight, in
cooperation with line ministries and institutions, in order to more clearly separate policy-making functions from ownership functions. The responsibilities of the Coordination Institution, once established, are described in Box 9, below. The law does not clarify the Coordination Institution’s human or financial resource needs, nor does it provide criteria for determining and meeting these needs. The Coordination Institution’s responsibilities do not include holding state capital shares in any SOEs on behalf of the State.

Box 9. Main responsibilities of the Coordination Institution according to the Public Persons Enterprises and Capital Shares Governance Law

The Public Persons Enterprises and Capital Shares Governance Law, adopted on 16 October 2014 and scheduled to enter into force on 1 January 2015, stipulates the establishment of a Coordination Institution by the Cabinet by 1 March 2015. The Coordination Institution’s role is largely advisory. It will be responsible for monitoring the performance of Latvia’s SOE and counselling the Cabinet and shareholder ministries and institutions on SOE management and corporate governance. Art. 22 of the law sets forth the following tasks for the Coordination Institution:

- **Issuing corporate governance guidelines**: The Institution will elaborate guidelines related to the efficient governance of SOEs and state-owned shares, including, for example, guidelines for the definition of general strategic aims for state enterprise ownership (Art. 25.5) and guidelines for assessing SOE operational results (Art. 27.1).

- **Corporate governance advice**: The Institution will advise the Cabinet and line ministries and institutions on issues related to the implementation of corporate governance measures and will arrange for training of representatives from line ministries and institutions on corporate governance. These responsibilities also include recommending individuals to sit on nomination committees for nominating candidates to SOE boards of directors (Art. 31.4).

- **Monitoring performance**: The Institution will provide line ministries and institutions statements on the financial aims set in SOEs medium-term operation strategy and on their financial performance (i.e., profit share paid for dividends, profit figures, return on equity, etc.), as well as the conformity of such aims with non-financial aims set in the medium-term strategy. In this capacity, the Coordination Institution can request an audit of an SOE, if deemed necessary (Art. 27.6). The Coordination Institution can also provide input, with the Ministry of Finance, on SOEs’ dividend pay-out obligations set by the Cabinet (Art. 28).

- **Collect and publish SOE information**: The Institution will coordinate the publication of information on the SOE sector. This includes preparing a public website with up-to-date information on the SOE sector (i.e., turnover, assets and their value, financial efficiency and dividend payments, as well as other issues related to corporate governance) and ensuring each shareholder ministry or institution also provides this information on their websites (Art. 29). It also includes preparing an annual aggregate report on the SOE sector (Art. 30).

- **Assessment of the State’s SOE portfolio**: The Institution will advise the Cabinet on any shareholder’s request to obtain, maintain, or sell State shares in an enterprise. In addition, when necessary, and at least every five years, the Institution must assess the State’s SOE portfolio and whether the State’s enterprise ownership confirms with State-ownership laws and objectives (Art. 25).

Finally, Art. 24 of the law provides for an Advisory Council, which will include experts and industry professionals. The Council will advise the Institution on matters related to policy-planning and the drafting of laws on SOE corporate governance and management. The Advisory Council will not advise the Coordination Institution on its operational tasks (i.e., performance-monitoring, collecting and publishing information, advising the Cabinet and shareholder agencies, etc.). The law does not stipulate who will sit on the Advisory Council, how members will be nominated, nor term limits for Council members.
(ii) Reintroduction of boards of directors for large SOEs

On the second major reform in the Public Persons Enterprises and Capital Shares Governance Law, large SOEs must have boards of directors in place by 1 January 2016. According to the law, members are nominated by the meeting of shareholders and elected to the Board for a five-year term (Art. 109). Candidates must have the appropriate professional and educational background to execute their duties as members of the board (Art. 108). Responsibilities of the Board of Directors include (Art. 107):

- Electing and recalling members of the management board;
- Determining the remuneration of management board members, following remuneration regulations set by the Cabinet;
- Approving the SOE’s medium-term operations strategy;
- Supervising the conduct of the SOE’s business in accordance with Latvian laws, regulations, the SOE’s articles of association and shareholder decisions;
- Reviewing the SOE’s annual report, the management report and management board dividend proposals, as well as preparing a report by the board of directors on the aforementioned documents and submitting all of these documents to the meeting of shareholders;
- Representing the SOE in court for claims pursued by the SOE against members of the management board and for claims pursued by the management board against the SOE;
- Approving deals concluded between the SOE and members of the management board or the auditor;
- Reviewing all issues to be assessed by the shareholder or the shareholders meeting, as well as reviewing and providing a statement on issues submitted by members of the board of directors or management board for discussion during the shareholders meeting; and
- Submitting to the shareholder proposals for improving business operations.

Line ministries and institutions are responsible for nominating candidates for SOE boards of directors, under Art. 31 of the law. Line ministries or institutions, as well as SOE boards of directors (where they exist) are responsible for nominating members of management boards. The law states that nominations for both boards of directors and management boards “should happen according to good principles of corporate governance”, but does not define what these principles are. First, the line ministry or institution, with the SOE board of directors and assistance from human resources experts, prepares a list of candidates. This list is then reviewed by a nomination committee, made up of representatives nominated by the line ministry, the SOE board of directors (if one has been established), and the Coordination Institution. If necessary, the nomination committee can also include independent experts as observers.

b. Additional reforms — Amendments to the State Administration Structure Law

Draft amendments to the state enterprise ownership rationale set forth in the State Administration Structure Law were also approved by Cabinet and submitted to Parliament in 2013, as part of the aforementioned SOE legislative reform package. (At the time of writing, however, these amendments
had not yet received a second reading in the Saeima.) The amendments streamline Latvia’s ownership rationale under Art. 88(1) to two criteria: (1) to manage strategically important assets, and (2) to address cases of market failure, including if there exists a natural monopoly. For the former, the Cabinet of Ministers defines and monitors the definition of “strategically important” assets, though the law does not specify what criteria the Cabinet would apply for this assessment. For the latter, the law justifies state enterprise ownership in situations where “it is not possible to effectively prevent market failure in another administrative manner or providing support and [state] participation [in the market] is [a] proportionate way of improving public welfare.” Latvian authorities further define “market failure” as “a situation where free markets fail to allocate limited resources efficiently, thus systematically causing overproduction or lack of goods and services that might arise if the following issues exist in a non-regulated market system: public goods, externalities or imperfect competition. The main market failures are: (1) monopolies or lack of competition; (2) externalities or unexpected side effects of production or consumption; (3) public goods.”

The amendments draw from the findings of the aforementioned policy planning documents, Concept for Commercial Activities of Public Persons and Concept for Management of State Capital Shares. It should be noted that the revised criteria under draft amendments to Art. 88(1) were applied in the CSCC proposals for SOE privatisations, described in section A.6.b, above.

c. Status of SOE reforms

(i) Legislative process and developments through 2014

Reform of the SOE sector is a sensitive issue in Latvia, and changes to the sector submitted as part of the Public Persons Enterprises and Capital Shares Governance Law were met with resistance. There is little public pressure for SOE reform in Latvia. Most Latvians see inefficiencies in the SOE sector as just part of “business as usual”, though a 2012 BICG survey found more than 80% of Latvians expressed little to no confidence in the government’s ability to act as an effective, competent owner of public enterprises. A lack of public pressure for SOE reform resulted in parliamentary reticence to move forward with the draft law, which was seen as politically risky ahead of October 2014’s parliamentary elections. (Parliamentarians’ constituencies were sceptical of the draft bill: A 2013 survey of 1 000 Latvians found that only 14% thought the draft reforms would have a positive impact.) As a result, during the draft law’s first reading in the Saeima in September 2013, parliamentarians expressed their resistance to the draft law by tabling a record-high 181 proposed amendments to the Law. Parliamentarians’ concerns focused on two main issues: (1) an SOE coordination function, and (2) reintroduction of SOE boards of directors. Pushback to the draft reforms was exacerbated by political considerations ahead of the October 2014 parliamentary elections.

On the coordination function, the original draft law had foreseen an independent SOE coordination function, the State Capital Shares Governance Office, or “Office”. Unlike the Coordination Institution established in the adopted law, the Office would have had the right to hold state capital shares, carry out the privatisation of state capital shares, and would also have been responsible for creating SOE board nomination criteria, maintaining a public database of candidates for SOE boards, and would have had a more active role in the nomination of SOE directors.

On the second issue, the Saeima agreed in the second reading to keep reference to the reinstatement of SOE boards of directors. However, there remains widespread concern that the reinstatement of SOE boards would open the door to political abuse and corruption, despite efforts to legislate for appropriate controls. To address these concerns, the Public Persons Enterprises and Capital Shares Governance Law limits the board requirement to large SOEs, though Latvian authorities state that 12 of Latvia’s largest and most strategic wholly state-owned enterprises would
meet this threshold (not including the five with boards of directors to comply with Commercial Law and external investors’ preferences). The law also delays the entry into force of the board of director provisions until January 2016, which could address concerns that, currently, there is an insufficient pool of professional experts prepared to take up duties as members of boards of directors. This is partly due to Latvia’s overall lack of experience—in both the SOE and private sectors—of selecting and appointing boards of directors. Finally, the Cabinet also approved—prior to the new SOE law’s third reading in Parliament—a resolution on procedures for selecting candidates for members of SOE boards of directors and members of the management board (see section B.2.f).

(ii) Implementation of Latvia’s new SOE corporate governance framework

At the time of writing, the Saeima had passed the Public Persons Enterprises and Capital Shares Governance Law, but the law had not yet entered into force. The law’s passage, despite opposition to certain reforms, is due in part to the linkages between SOE reform and Latvia’s possible accession to the OECD, which experts say provided the political impetus necessary to push through the draft law. For example, Latvian President Andris Bērziņš released a statement after his 12 September 2014 meeting with OECD Secretary-General Angel Gurría, stating that the adoption of the Public Persons Enterprises and Capital Shares Governance Law should be adopted as soon as possible for the successful progress of Latvia towards OECD accession.

The Law will enter into force in January 2015. The law, if implemented fully and effectively, has the potential to address a number of the corporate governance challenges identified in this review. According to the new SOE law’s transitional provisions and reports by Latvian authorities, the Government aims to elaborate over the next 18 months governmental bylaws and implementation guidelines that have the potential to address certain questions requiring further clarification, including the placement and resourcing of the Coordination Institution.
Part B

ASSESSMENT OF LATVIA’S SOE SECTOR UNDER THE SOE GUIDELINES

This section of the WP SOPP assessment of Latvia’s SOE corporate governance framework builds on the landscape provided under Part A. It assesses the framework in force at the time of writing, relative to the 2005 SOE Guidelines.

1. Ensuring an effective legal and regulatory framework for SOEs

The legal and regulatory framework for state-owned enterprises should ensure a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

a. Separation of functions

There should be a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

As noted above (section A.2.b), under the current SOE framework, there is no clear distinction between the state’s ownership function from other state functions that could influence conditions for Latvian SOEs, except perhaps in some specific instances (i.e., the provision of public utilities and enforcement of the Competition Law). SOEs are also, by the Government’s own admission, widely used “as a vehicle for sectorial policies”.

Annotations to Chap. I, Rec.A, further explain that using SOEs as an instrument for industrial policy can easily result in confusion and conflicts of interest between industrial policy and the ownership functions of the state, particularly if the responsibility for industrial policy and the ownership functions are vested with the same branch or sector ministries. To avoid conflicts of interest, the State should separate the ownership function from any entities in the administration that might be clients of, or suppliers to, SOEs.

Latvian authorities state that its Public Procurement Law applies equally to SOEs competing to win government public procurement contracts for a commercial activity. In these cases, SOEs must participate in the regular bidding process, alongside private sector competitors, and the State may not procure directly from an SOE. The Public Procurement Law does not apply, however, when the commissioning party enters into a contract regarding goods or services provided by institutions that are controlled or owned, directly or indirectly, by the commissioning party. These regulations appear to be in line with EU Public Procurement Directives and related case law in this area. A 2011 European Bank for Reconstruction and Development assessment of Latvia’s public procurement framework came to a similar conclusion.
The Latvian authorities further state that the public procurement rules apply to public procurement contracts signed between SOEs, “thus ensuring commercially based operations between SOEs.” These rules do not apply to contracts signed between SOEs and private-sector providers (i.e., a public tender process is not required for such contracts). For example, Latvijas valsts meži includes approximately 850 companies in its roster of providers. The SOE’s agreements with these providers are considered to be of a commercial nature and, therefore, not subject to the State’s public procurement procedures, the Chair of the management board reported.

b. Simplification of operational practices and legal form

Latvian SOEs are established as either joint stock companies or limited liability companies. As noted above, SOEs are not exempt from any laws and regulations that apply to private enterprises. This includes insolvency or bankruptcy procedures and is equally applicable to commercially and non-commercially oriented SOEs. (Latvijas Pasts subsidiary, Latvijas Pasta Nodaļu Tīkls was undergoing insolvency proceedings at the time of writing. Proceedings were initially launched in 2011.) A moot point relates to some entities that would in many other countries be considered as statutory corporations – notably the various port authorities. However, as they are owned by local authorities (or co-owned by local and central authorities), they fall mostly outside the scope of the present review. (See section A.2.d.)

Latvian authorities further stated that SOE board members (where boards of directors exist) are not subject to any special privileges or immunities. Some caution may, however, be called for: Board members may not enjoy statutory preferential treatment, but since they have traditionally been serving politicians, some questions regarding the application of appropriate laws and regulations may nevertheless impose themselves.

c. Public service and other obligations and responsibilities

Section A.4.a(ii), above, describes how SOE objectives are set and identifies shortcomings in the current objective-setting framework. Further to this initial assessment, and in relation to Chap. 1, Recommendation C of the SOE Guidelines, Latvian authorities informed the OECD secretariat that there is no statutory obligation to communicate to the public an SOE’s objectives, other than under the annual reporting requirements under Art. 301 of the Law on Budget and Financial Management (see section B.5.a below). This provision requires line ministries to provide to Cabinet an operations and financial forecast for the coming year for SOEs in their portfolio.131 In practice, some SOEs have published their objectives and strategy on their websites. These include Latvijas Valsts meži.132

The unclear delineation between SOEs’ commercial and non-commercial objectives was one of the major critiques included in a 2009 State Audit Office recommendation for improving SOE corporate governance. The recommendation was based on the Office’s annual audits of ministries’ books, including subsidies to SOEs in ministries’ portfolios. The recommendation also included a call
for the Government to clarify its state enterprise ownership policy and to address the corporate governance risks posed by the lack of SOE boards of directors.\footnote{133}

d. General application of laws and regulations

| D. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated. |

As noted earlier, Latvian SOEs are in principle not exempt from any laws and regulations that apply to private enterprises (section A.4, above.). SOEs may be challenged via the courts or any other legal mechanism by stakeholders without restrictions, Latvian authorities state. SOE stakeholders may enforce their rights through different mechanisms and a number of state institutions through civil action or administrative procedures. These include, for example: appeals for a direct compensation of damages due to a violation of law by an SOE; civil action for direct compensation for damages or other claims due to the violation by an SOE of a contractual obligation; or appeals on annulment of administrative or other acts issued by an SOE or state institution. Latvia provides four examples of such cases (in addition to the competition cases described above). Claims brought by three natural persons in three separate cases (in 2007, 2011, and 2013) were rejected by the courts; two of these cases were under appeal. The complainants won in a fourth case, from 2011, though the decision was later reversed in favour of the SOE. At the time of writing, the complainants had appealed the decision in favour of the SOE and were awaiting a final decision.

e. Flexibility of the legal and regulatory framework

| E. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives. |

The annotations to Chap. I, Rec.E, indicate that the State as an owner should develop an overall policy and provide mechanisms that allow appropriate changes in SOEs’ capital structure to develop or fulfil their objectives. These mechanisms can include, for example, indirect capital transfers between SOEs, or the raising of capital on capital market terms.

In Latvia, SOEs may adjust their capital structure upon the decision of a meeting of shareholders, according to Articles 42 (for limited liability companies) and 73(1) (for joint stock companies) of the Law on State and Local Government Capital Share and Capital Companies. The Latvian authorities have stated that a formal Cabinet approval is required for such adjustments only if required by the SOE’s articles of association, as per Art. 49(3)(2) and Art. 77(3)(2) of the same law. All decisions in this respect are taken according to Art. 88(1) of the State Administration Structure Law. However, in practice it would be considered normal to bring such matters to the Cabinet’s attention. Annex 3 includes detailed procedures and legal references for increasing or decreasing the State’s ownership in a company.

The Latvian authorities have further explained that the State can increase its shareholding in a company by investing money or property, as per Art. 151(1) of the Commercial Law. If the State’s investment is considered “state-owned immovable property”, then the decision to increase the SOE’s equity capital in this way requires Cabinet approval, as per Arts. 40(1) and 5(1) of the Public Persons Property Alienation Law. The Latvian authorities state that, in 2013, the State invested “state-owned immovable property” (i.e., land or real estate) into the following SOEs to increase their equity capital: Valsts Nekustamie īpašumi (“State Real Estate”, MoF); Latvenergo (MoE); Latvijas dzelzceļš (“Latvian Railway”, MoT); and Tiesu namu aģentūra (“Courthouse Agency”, MoJ).
In terms of trade credit shared between SOEs, Latvian authorities explain that “SOEs are not engaged in substantial related party transactions or provide each other commercial loans.” Latvia further stated that business and commercial transactions that do take place between SOEs are based on purely commercial grounds and are carried out in compliance with general market principles. Latvian authorities explain that “there are no special rules or procedures for transactions among SOEs” and there is no data available on the level of commercial and financial transactions between SOEs. According to State Audit Office publicly available audits of SOEs, however, there have been cases of questionable transactions between SOEs. For example, a 2009 audit of the Ministry of Transport’s Latvijas Valsts radio un televīzijas centrs indicates that the Ministry of Transport transferred a part of loss-making business service from Latvijas Pasts (also owned by the Ministry of Transport) to the Latvian State Radio and Television Centre, with the sole purpose of “improving the financial situation of the State Joint Stock Company Latvijas Pasts, which was operating with losses”. The Centre was also required to cover all losses that Latvijas Pasts had incurred from this business service since mid-2009. In total, the State Audit Office’s audit estimated that the Centre’s total incurred liability from this transfer totalled over EUR 881,000. (See also Table 1 in section B.5.c below.)

Concerning the “debt side” of SOEs’ capital structure, Latvenergo has issued two series of bonds. The first series of 2.8% five-year bonds was issued in 2012 and 2013 in three phases and totalled EUR 70 million. The second series of 2.8% seven-year bonds was issued in two phases in 2013 and totalled EUR 35 million. All bonds are traded on the NASDAQ OMX Riga exchange. Latvenergo is the first, and so far only, Latvian SOE to have issued traded debt, and one of the first companies in Latvia to do so. In 2012, Latvenergo states that total proceeds from issued debt securities totalled EUR 19,949, and in 2013 totalled EUR 84,835. The Latvian authorities did not describe how the aforementioned capital structure adjustments were necessary for the SOEs in question to achieve their objectives, nor whether these adjustments were in line with the State ownership objective, as recommend by the SOE Guidelines’ Chap. I, Rec. E, and its annotations.

f. Access to finance

| F. SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds. |

Latvian authorities have highlighted the fact that there is no automatic guarantee in respect of SOEs’ liabilities. State guarantees can only be issued within very limited cases, as stipulated under Art. 37(1) of the Law on Budget and Financial Management. According to this provision, State guarantees may be issued in support of State investment projects implemented by capital companies in which the state or local government owns at least 50%. The decision to provide the guarantee requires Cabinet approval, in accordance with the state annual budget law. If the Cabinet approves, the Ministry of Finance provides the guarantee. A 2013 State Audit Office audit of the implementation the State budget revealed “serious deficiencies in the process of public guarantee assignment and supervision of assigned guarantees,” though these deficiencies are not specific to guarantees provided to SOEs. As a result, the Office’s audit found state liabilities for state-guaranteed loans was as high as EUR 270.5 million in 2012.

The Ministry of Finance reports that four state guarantees were issued to two SOEs for SOE liabilities in 2011 and 2012. This information appears incomplete, as it does not include state guarantees afforded to state hospitals needing to take out loans to cover large investment projects, such as construction, purchasing technology, etc. Also, the possibility cannot be discarded that perceived guarantees give some SOEs access to loans on preferential terms from commercial lenders. The fact that some SOEs are designated as "strategic" arguably sends a signal to markets that they most
probably will not be allowed to fail. For example, Latvijas Dzelzceļš took out EUR 51 million in loans between 2007 and 2010 to finance construction projects, despite significant decreases in net profits and returns during the same period.141

Table 14. State Guarantees Recently Extended to SOEs

<table>
<thead>
<tr>
<th>SOE</th>
<th>Purpose for the State Guarantee</th>
<th>Issue Date</th>
<th>Repayment Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valsts nekustamie īpašumi (&quot;State Real Estate&quot;)</td>
<td>Reconstruction of Daugavpils fortress complex</td>
<td>2011</td>
<td>24.10.2041.</td>
</tr>
<tr>
<td>Latvian Development Finance Institution Altum (Mortgage and Land Bank of Latvia)</td>
<td>Improving competitiveness of SME’s</td>
<td>2012</td>
<td>15.09.2014</td>
</tr>
<tr>
<td>Latvian Development Finance Institution Altum (Mortgage and Land Bank of Latvia)</td>
<td>Implementation of SME’s competitiveness support program</td>
<td>2012</td>
<td>Yet to be disbursed</td>
</tr>
</tbody>
</table>

Source: Latvia’s responses to questions from the Secretariat, received 20 May 2014.

SOEs are also able to apply for State loans, as per Art. 36(5) of the Law on Budget and Financial Management, under which the Ministry of Finance and the Treasury can issue loans to SOEs where the State’s fixed capital, separately or combined, exceed 50%. Latvian authorities informed the OECD secretariat that such loans are rarely issued to SOEs that raise capital on market terms from banks. Further, Latvia reports that SOEs do not receive preferential treatment by partially state-owned banks, as per Art. 4 of the Law on Prevention of Squandering of the Financial Resources and Property of a Public Person. This provision states that state-owned banks must grant loans in accordance with the procedures laid down in the Credit Institution Law and other laws and regulations. The Ministry of Finance reports that nine State loans were issued to six SOEs under the Law on budget and Financial Management between 2011 and 2013 (see Table 15). Of note, state loans to two Latvian SOEs—Air Baltic and Citadele—were recently investigated by EU authorities for possibly violating state aid rules, as noted above (section A.6.b). These rules are meant to prevent companies who receive government support from having an advantage over their competitors in the market. The Commission closed both investigations in July 2014, concluding in both cases that Latvia had not violated EU state aid rules.142
Table 15. State Loans Recently Issued to SOEs

<table>
<thead>
<tr>
<th>SOE</th>
<th>Purpose for the State Loan</th>
<th>Issue Date</th>
<th>Repayment Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Baltic Corporation</td>
<td>Two loans were lent to provide Air Baltic with the necessary liquidity pending the appointment of the new CEO and the finalization of the business plan</td>
<td>2011 (for both loans)</td>
<td>fulfilled</td>
</tr>
<tr>
<td>Rural Development Fund</td>
<td>For ensuring the loans for purchase of the agricultural lands</td>
<td>2012</td>
<td>20.07.2034.</td>
</tr>
<tr>
<td>Riga International Airport</td>
<td>For the implementation of the Cohesion Fund project No Nr.2010LV161PR001 “Development of the Riga International Airport infrastructure”</td>
<td>2012</td>
<td>20.02.2035.</td>
</tr>
<tr>
<td>Bulduru Horticultural High School</td>
<td>For the implementation of the European Regional Development Fund project “Development of the Bulduru Horticultural High School infrastructure and modernization of equipment”</td>
<td>2012</td>
<td>20.12.2014.</td>
</tr>
<tr>
<td>Bulduru Horticultural High School</td>
<td>For the implementation of the Climate change financial instrument project “Renovation of the Bulduru Horticultural High School training corps and sport and convention centre according with high energy efficiency requirements”</td>
<td>2012</td>
<td>20.12.2016.</td>
</tr>
<tr>
<td>Air Baltic Corporation</td>
<td>To provide it with the necessary liquidity pending the appointment of the new CEO and the finalization of the business plan</td>
<td>2012</td>
<td>14.06.2014.</td>
</tr>
<tr>
<td>Latvian Post</td>
<td>For effective changeover to euro in cash circulation and payments</td>
<td>2013</td>
<td>fulfilled</td>
</tr>
</tbody>
</table>

Source: Latvia’s responses to questions from the Secretariat, received 20 May 2014.

2. The State acting as owner

The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

a. Ownership policy

A. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state’s role in the corporate governance of SOEs, and how it will implement its ownership policy.

SOEs with commercial activities are established in Latvia according to criteria provided in Section 88(1) of the State Administration Structure Law. According to this provision, the state may establish and may continue to own a commercial enterprise: in cases of market failure; in sectors in which a natural monopoly exists; in strategically important sectors; in sectors that require large capital investments in order to develop; and/or in sectors where higher quality standards must be met in order to protect the public interest (see A.4.a.i). Critics—including the Government itself—note that these provisions may be interpreted broadly, including for example, the definition of strategically important sectors, which is not defined in law. For example, the Government’s 2009 Annual Review of Latvian
State-Owned Assets states that “there is no clear policy to define which assets should be controlled by the State, municipalities, or other public sector authorities and why the State still owns many non-strategic assets without clear justification why the State should administer those assets.”

As noted in section A.7.b above, amendments to these criteria have been submitted to the Saeima, which would condense state enterprise ownership criteria to two criteria: to address cases of market failure and to manage strategically important assets, though “strategically important assets” is not defined.

b. Political intervention and operational autonomy

Latvian authorities state that the Government is, as a general rule, not involved in the day-to-day management of SOEs and that the State allows SOEs full operational autonomy to achieve their defined objectives. As a general principle, Latvian authorities explain that, under Art. 64 (applicable to state-owned LLCs) and Art. 98 (applicable to state-owned JSCs) of the Law on State and Local Government Capital Shares and Capital Companies, SOE management boards are entitled to take decisions on all issues regarding activity of a company, except those in which decisions in accordance with this Law and articles of association of the company are taken by the Cabinet, as well as the meeting of shareholders. Latvian authorities further explained to the OECD Secretariat that “the Cabinet or the respective ministry as a representative of the State does not have the right to give directions directly to SOEs’ management boards in cases not explicitly prescribed by law”.

In practice, however, the Latvian authorities concede that there has been “significant political influence” over SOE governance and operational decisions. This influence has been facilitated by the lack of boards of directors in most SOEs, which means that the corporate management of SOEs is appointed and dismissed by the state secretaries of the relevant ministries. A specific example of a board function appropriated by state secretaries since the 2009 abolition of boards of directors is the requirement that state secretaries personally approve all purchases above EUR 143,000. The current governance framework for Latvian SOEs provides the State, and particularly state secretaries, considerable leeway to exercise direct influence if they so choose. (See section A.5 above.)

SOEs with non-government investors enjoy greater operational and management autonomy in the conduct of their commercial activities. This is the case, for example, at Air Baltic, which is 99.8% owned by the Ministry of Transport and 0.2% owned by two non-government shareholders, and at Citadele, which is 75% owned by the Privatisation Agency and 25% owned by the EBRD. As mentioned above (see A.5, these are among the relatively few SOEs that currently have functioning boards of directors.

Finally, it should be noted that the governance and management of SOE subsidiaries are largely managed by their parent companies and not the State shareholder representative. For example, shareholder approval is only required for decisions to acquire or sell a subsidiary company. In addition, parent SOEs nominate the members of their subsidiaries’ management boards (see also section B.2.c below). Finally, it remains unclear whether remuneration restrictions applicable to members of SOE boards of directors and management boards apply to SOE subsidiary companies.
c. Independence of boards

C. The state should let SOE boards exercise their responsibilities and respect their independence.

(i) Boards of directors

As described in fuller detail above (section A.5.b), the SOE framework in force in Latvia at the time of writing does not provide for an independent body to nominate members to SOE boards of directors, and there are no checks and balances on ministers’ powers to nominate directors. An analysis of the makeup of boards of directors in the six SOEs that have them (see Table 11) indicates that more could have been done to strengthen the independence of SOE board members, in particular SOEs with little or no external investment from non-government investors. This issue may not be specific to SOEs, however: The Commercial Law does not include independence requirements for boards of directors. For listed companies, Principles 7.6-8 of the NASDAQ OMX Riga Principles on Corporate Governance recommend independence measures for boards of directors. (See section B.2.f, below, for more on board nomination practices and procedures.)

The establishment in 2013 of Latvia’s youngest SOE, Attīstības finanšu institūcija (“Development Finance Institution”), might have provided an opportunity to ensure the independence of the board of directors and to ensure members carry out their duties and do not act as representatives for different constituencies, as suggested in Chap. II, Rec. C, and its annotations. While the Institution is not yet operational, its board makeup raises questions under this provision. Representatives for nomination to the board are set in the decision of the Cabinet of Ministers. Current nominees include the Deputy Director of the Ministry of Economy’s EU Funds Implementation Department, Deputy State Secretary of the Ministry of Agriculture, and Deputy State Secretary of the Ministry of Finance, who may serve as the chair of the board. Nominees to the board do not include any external or independent representatives.

(ii) Management boards

In the absence of boards of directors, some SOEs have been equipped with what is effectively a one-tier board framework where executive as well as non-executive directors coexist in what is formally a management board. In some cases, the informal one-tier board framework in certain Latvian SOEs could be as prone to the risk of politicization and corruption as the pre-2009 supervisory councils, due to the lack of laws and regulations stipulating who, how and why members should be appointed to management boards.146 This risk is exacerbated by the general assessment that state shareholder representatives often do not have the capacity or the professional expertise to effectively perform the function of a board of directors, thus sometimes resulting in an “inadequately primitive model of governance”.147 (See also section A.4 above.)

Until late 2014, when the Cabinet adopted a resolution on procedures for selecting candidates for members of SOE boards of directors (where they exist) and management boards (described in section B.2.f below), board members in the majority of SOEs were appointed without competition or according to specific nomination criteria, though there were exceptions.148 The State Audit Office highlighted the specific risk of political appointments of non-executive directors to management boards. Some of these board members simultaneously hold government office; a practice that is allowed under law but which Latvian authorities say is discouraged. One example is the appointment by the Ministry of Transport to the management board of Latvijas Pasts of Mr. Aigars Vītols, who at the time of writing was also executive director of Valmiera City Council. Further examples of management board nomination and selection practices are included in Box 10.
Box 10. Examples of management board nomination and selection practices

There are no established rules for selecting and nominating management boards in Latvian SOEs. As a result, practices vary widely from shareholder to shareholder. Select illustrative examples are included below.

Ministry of Agriculture

At Latvijas valsts meži, the Ministry of Agriculture states that it has only ever recruited members of the management board from within the company. Latvijas valsts meži’s management board members have stayed largely the same since the company’s establishment in 1999. Since then, the company has only ever had one head of the management board, Chairman and CEO Roberts Stripnieks.

Ministry of Finance

The Ministry of Finance exercises the state ownership function for two large Latvian SOEs: the newly created Attīstības finanšu institūcija (“Development Finance Institution”) and, on behalf of the Ministry of Economy, the former Latvenergo subsidiary, Augstsprieguma tīkli.

- **Attīstības finanšu institūcija**: The Development Finance Institution’s management board is made up of representatives from the three merged SOEs that form the new Institution, the Mortgage and Land Bank of Latvia; the Latvian Guarantee Agency; and the Rural Development Fund. Members of the management board were nominated by a nomination committee that included the State Secretary of the Ministry of Finance; the Legal Advisor of the Prime Minister’s Office; Deputy State Secretary of the Ministry of Economy; Deputy State Secretary of the Ministry of Agriculture; and the Member of the Board of Directors of the Financial Capital Market Commission (in an observer capacity), as well as a human resources recruitment specialist (also in an observer capacity).

- **Augstsprieguma tīkli**: According to the Ministry of Finance, members of the management board of this former Latvenergo subsidiary are selected by a selection committee made up of representatives from the Ministry of Finance, the Ministry of Internal Affairs, and the Ministry of Justice. Candidates can be recruited externally and internally, though management board members have not changed since 2011, when before Augstsprieguma tīkli was still a Latvenergo subsidiary.

Ministry of Health

There is no set process for selecting and nominating members of management boards at SOEs owned by the Ministry of Health. Historically, these boards have been staffed by medical professionals. In recent years, the Ministry says it has begun to recognize the benefit of recruiting more professional representatives to its SOEs’ management boards, recruiting externally through open competition for private-sector representatives, often from the pharmaceuticals industry. The Ministry of Health reports that, despite recent efforts to recruit from the private sector, most of its SOEs’ management board members have remained the same since their SOEs were established. Members are appointed and re-appointed for three-year terms, depending on the SOE’s performance.

Ministry of Transport

The Ministry of Transport states that it almost always fills management board positions with candidates from inside the company. However, it appears that there have been exceptions to this practice, including the November 2011 appointment of Air Baltic Chief Executive Officer and Chairman of the Executive Board Martin Gauss and the 2012 appointment of a new Latvijas Pasts management board staffed with mostly private-sector representatives prior to the 2013 liberalisation of the postal market.

In some cases, management board nominations by the Ministry of Transport have raised questions of transparency and corporate governance. One example includes the February 2014 decision of the Minister of Transport to change Riga International Airport’s articles of association to increase the number of management board members from five to six, in order to appoint as a member of the management board Ms. Olita Augustovska, office manager for former Latvian Prime Minister Valdis Dombrovskis. (The Ministry later decided to replace one of the existing management board members with Ms. Augustovska, keeping the number of board members to five.)

A second example includes the Ministry of Transport’s May 2012 decision to replace the management board of the passenger rail company, Pasazeru vilciens. The move was made in reaction to questions surrounding a public procurement contract the SOE planned to enter—against the Government’s wishes—with Spanish railway vehicles and equipment manufacturer Construcciones y Ayxiar de Ferrocarriles, whose provisions were contrary to EU procurement rules.
d. Centralisation of the ownership function

D. The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function.

The exercise of the ownership function in Latvia is decentralized, with 11 line ministries and three public institutions responsible for SOEs. As mentioned, state secretaries and heads of public institutions exercise the ownership function for SOEs in their ministry’s portfolio. Currently, Latvian authorities concede that there is no coordination between the different ministries and institutions responsible for SOE ownership. The Ministry of Finance, in its role as the general budget-setter for shareholders and their SOEs, fulfils the only centralized function in Latvia’s SOE sector.

e. Accountability of the co-ordinating or ownership entity

E. The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

There are no specific requirements for SOEs, nor their line ministries or institutions, to report directly to Parliament regarding the carrying out of their state ownership function. According to information provided by the Latvian authorities, the only formal opportunity Parliament has to review the corporate governance practices of Latvian SOEs is its review of the State Audit Office’s opinion for Parliament on the financial year report submitted by the Minister for Finance on the implementation of the State budget. Since 2009, the opinion must include an assessment of SOE corporate governance. As noted above (section A.4.a.ii), the State Audit Office’s opinion on the Government’s 2012 consolidated financial report criticized the overall lack of transparency in the Government’s management of SOEs. Criticisms included the lack of written clarification of the state’s enterprise ownership policy, unclear SOE objectives, as well as the methods employed by the State for ensuring that SOEs meet the objectives set for them.

f. State’s exercise of ownership rights

F. The state as an active owner should exercise its ownership rights according to the legal structure of each company.

Its prime responsibilities include:

1. Being represented at the general shareholder meetings and voting the state shares.
2. Establishing well-structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs’ boards.
4. When permitted by the legal system and the state’s level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.
5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.
In terms of state representation in general shareholder meetings (Chap. II, Rec. F.1), the official shareholder representative for SOEs owned by ministries is the state secretary of the responsible ministry. For SOEs owned by public institutions, the State shareholder representative is the head of the institution. (See Art. 12.1, for ministries, and 15.1, for institutions, of the Law on State and Local Government Capital Shares and Capital Companies.) Latvia reported that state secretaries and heads of institutions attending shareholder meetings are not allowed to receive written instructions when voting. However, in cases where the official shareholder representatives cannot attend a shareholder meeting, the state secretary or institution head must appoint a “responsible employee” to take decisions on the shareholder’s behalf (Art. 12.2 and Art. 15.3 for ministries and institutions, respectively). Responsible employees must vote in shareholder meetings according to written instructions from the official shareholder representative, as per Art. 17 of the Law on State and Local Government Capital Shares and Capital Companies.

Board nomination processes (Chap. II, Rec. F.2), for wholly state-owned enterprises with boards of directors are regulated under Art. 98 of the Law on State and Local Government Capital Shares and Capital Companies. Nomination criteria, provided under Art. 98(4), are broad: Candidates for appointment to boards of directors include those who are “fluent in the official language and whose work experience, education, and qualification ensure professional fulfilment of the tasks of a member of the council”.

As noted above (section A.5), the LPA has invited independent non-governmental organisations (NGOs) and academia to participate in the nomination and selection of boards of directors for SOEs in its portfolio with boards of directors. For example, Transparency International’s Latvia chapter participated in the selection of board members in 2012 at Citadele Bank, Lattelecom, and Latvijas Mobilais telefons. (The full text of LPA’s “defined principles for nomination of Supervisory boards” is included as Annex 2.)

On 23 September 2014, the Cabinet adopted a resolution with instructions to all SOEs on the procedures for selecting candidates for members of SOE boards of directors (where they exist) and members of the management board.149 The resolution responds to public backlash to the Ministry of Transport’s appointment in February 2014 of ex-Prime Minister Valdis Dombrovskis’ office manager, Olita Augustovska, as a member of the Riga International Airport’s management board without first holding an appropriate candidate-selection process (see section B.2.c.ii above). The resolution entered into force on 2 October, the day it was published in Latvia’s official gazette, the Latvijas Vēstnesis.150 The resolution and annexed instructions were immediately binding on all SOEs (there is no size threshold).

The resolution provides for: (1) criteria for selecting members of boards of directors and management boards; (2) launching a candidate-selection procedure and establishing nomination committees; (3) procedures for nomination committees’ selection of candidates; and (4) transparency and disclosure requirements regarding the acceptance or refusal of nominations to SOE boards of directors and management boards. According to the resolution, the line ministry or institution is responsible for proposing—and a nomination committee is responsible for finalizing—SOE-specific nomination criteria for candidates, based on baseline criteria that are provided in detail in an annex to the resolution. At a minimum, candidates must be: fluent in Latvian and at least one foreign language (to the extent necessary for the role), have a relevant educational and professional background, and must be of “good repute”. Candidates also cannot have been convicted of a crime.
The shareholder is responsible for establishing and coordinating with a nomination committee. The committee is made up of at least three representatives with voting rights and one independent observer. The Resolution does not clarify whether the nomination committee sits within the SOE or within the Government, nor does it clarify whether committee includes SOE or Government representatives. It remains to be seen how the resolution would complement parallel provisions on nomination committees included in the Public Persons Enterprises and Capital Shares Governance Law, once that law enters into force in January 2015. Candidates selected by the nomination committees can be rejected by the shareholder, but the rejection must be publicly justified.

Latvian authorities reported that it may be difficult, at first, to develop a sufficient pool of professional experts to be considered as potential candidates for SOE boards of directors and, in particular, full-time management board positions.

External reporting systems (Chap. II, Rec. F.3) provided for by current Latvian law include annual reports on SOE accounts and performance, quarterly financial reports, and reports by external auditors or the State Audit Office. Reports are made by individual line ministries and agencies on behalf of the SOEs in their portfolio. (More information on these reporting procedures is included in section B.5, below.)

Under Art. 52(1) of the Law on State and Local Government Capital Shares and Capital Companies, an auditor is entitled to request the convening of an EGM if considered necessary (Chap. II, Rec. F.4). An external auditor appointed by the shareholder is also required to participate in shareholder meetings (Art. 57(2)).

The current SOE legal and regulatory framework also includes specific measures regarding remuneration schemes for members of SOE boards of directors, where they exist (Chap. II, Rec. F.5). Latvian authorities explain that SOE executive remuneration is “substantially lower” in comparison to similar roles in the private sector. The low remuneration, coupled with onerous reporting and disclosure requirements (as members of SOE boards are considered public officials) make it difficult for SOEs to recruit professional, competent experts. The Ministry of Health, for example, cited particular difficulties in recruiting professionals from the pharmaceutical industry—instead of medical professionals—to staff management boards at state hospitals. As noted above (see section B.2.b), it remains unclear as to whether these restrictions also apply to the management boards of SOE subsidiaries.

Remuneration restrictions on SOE boards of directors and management boards include:

- **Remuneration** is set by the meeting of shareholders, within limits set by Cabinet-issued regulations. These regulations provide that remuneration for the chairman of the board can be set up to 20% of the remuneration of the chair of the management board, but not less than the minimum monthly wage in Latvia (EUR 320 in 2014). The monthly remuneration of members of boards of directors may be set up to 15% of the remuneration of the chairman of the management board, but not less than the minimum monthly wage.

- **Monthly remuneration limitations** for the board of directors and management board are set according to the average monthly work remuneration of the previous year of State employees, as published by the Central Statistical Bureau, multiplied by a maximum coefficient of 6.52

- **Bonuses** may not exceed the amount of a month’s wages and can only be paid to members of the management board if the two following conditions of the SOE are met: (1) there are no
tax debts; and (2) the SOE has concluded the financial year with a profit, or in case there is no profit, the losses were planned in advance as a result of investments.

- **Severance pay** cannot exceed two months’ wages in cases where a member of the management board leaves office before the expiry of his or her term and enters into a contract that also provides for severance pay or compensation of any other type. Severance pay is withheld in cases of “blatant infringement of authority, failure to fulfil or insufficient fulfilment of duties, as well as in case if harm has been caused to the interests of the company”. 153

- **Disclosure** rules that apply to public officials also apply to members of boards of directors and management boards, under Art. 4 of the Law on Prevention of Conflict of Interest in Activities of Public officials.

Efforts to reform remuneration of SOE employees have been difficult to advance, however, due to the perception that SOEs are an extension of the public sector, and therefore public sector remuneration policies should apply. For example, in December 2012, the Cabinet of Ministers approved changes to Latvian remuneration limits for SOE management for managers of SOEs with revenue over EUR 57 million. Immediately, the remuneration for members of the management boards at Latvenergo, Latvijas valsts meži, and Latvijas Dzelzceļš more than tripled. 154 Following public outcry, these SOEs’ shareholders lowered remuneration for the management board members of Latvia’s largest SOEs—but not to their original levels, in an effort to bring salaries closer in line with the private sector.

The remuneration for members of SOE boards of directors and management board members is rarely disclosed in SOEs’ financial reports. Latvenergo is one of the few SOEs to disclose this information. 155 Instead, this information can be gleaned from mandatory income disclosures to the State Revenue Service by management board members, who are considered public officials under the Law on Prevention of Conflict of Interest in the Activities of Public Officials. 156 This information is available on the State Revenue Service website, www.vid.gov.lv.

3. **Equitable treatment of shareholders**

   The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.

   a.  **Ensuring equal treatment**

   A. The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.

   SOEs in Latvia are subject to the Commercial Law’s requirement, under Art. 226, for equal treatment of all shareholders, including minority non-state shareholders in SOEs. Minority shareholders are guaranteed, by law, non-discrimination, access to information, and access to voting in shareholder meetings. The State is equal to all other shareholders. In addition, the State does not have access to priority shares (i.e., “golden shares”). One share or stock equals one vote.

   The treatment of minority shareholders rights is further regulated by shareholder agreements in companies whose shareholders include outside investors and strategic partners, such as Lattelecom and Citadele. (In both of these companies, there are only two shareholders.) In unlisted companies, the
details of shareholder agreements are confidential. Technically, this runs counter to the recommendations of the Guidelines, although where the non-State shareholders are all parties to the shareholder agreements, issues of minority protection do not in practice arise. Conversely, companies traded on the NASDAQ OMX Riga exchange are required to disclose shareholders’ agreements that are known to the capital company and are likely to restrict the transferring of shareholders’ shares or voting rights to other persons, including provisions that set out a prior confirmation of such transfer, as per Art. 56.1(7) of the Financial Instruments Market Law.)

b. Transparency toward all shareholders

| B. SOEs should observe a high degree of transparency towards all shareholders. |

Art. 194 of the Commercial Law states shareholders “have the right to receive information from the management board regarding the activities of the company and to become acquainted with all of the company’s documents.” The right for all shareholders to receive information from the management board may be restricted by a decision of a meeting of shareholders “if there is a justified suspicion that the shareholder may use the information acquired in contradiction to the aims of the company, and thus causing significant harm or losses to the company.”

Information-sharing between state secretaries and line ministries may be restricted under Art. 19 of the Commercial Law, which allows a company to classify certain “economic, technical, or scientific” matters as commercial secrets, and Art. 5.2.3 of the Freedom of Information Law, which could be interpreted to restrict the sharing of commercial secrets between state secretaries and other individuals (i.e., the Minister) of an SOE’s line ministry. Latvia stated that state secretaries would not share commercial secrets with “third parties”, but did not specifically clarify at the OECD Secretariat’s request whether commercial secrets would be shared with individuals in the responsible ministry, particularly the Minister.

c. Communication and consultation with shareholders

| C. SOEs should develop an active policy of communication and consultation with all shareholders. |

Under the Commercial Law, management boards must send a notification on the convening of a meeting of shareholders to shareholders and an auditor not later than two weeks before the meeting (for LLCs) or not later than 30 days before the meeting (for JSCs). The person who initiated the convening of the meeting—usually the Chair of the management board—is responsible for ensuring that shareholders and the auditor receive draft decisions and other materials not later than three days before the meeting.

Latvian authorities provide as an example of shareholder communication and consultation the publication on Reverta’s website of governance and shareholder meetings, in order to enable the participation of all shareholders in shareholder meetings. Another example is Air Baltic. The company ensures that information is available to all shareholders (including the minority non-state shareholders). This includes notice of the convening of a shareholders’ meeting, announced not later than 30 days before the planned meeting, with details on the meeting time, agenda, and voting decisions to be taken, as well as points of contact for shareholders’ questions on arrangements for the meeting and agenda issues. Air Baltic shareholders may also request copies of draft decisions free of charge up to 14 days before the announced shareholder meeting and may request the management board to submit information to the shareholder meeting on the company’s economic situation.
d. Facilitation of minority shareholders’ participation in shareholder meetings

According to Art. 212(3) of the Commercial Law, a shareholder in a LLC may participate in a shareholder meeting through a representative who has written authorisation. Similarly, for JSCs, shareholders may also participate through a representative under Art. 277(1) of the Commercial Law. The shareholder meeting minutes must include reference to the shareholder’s representation via proxy. Special authorisation in this case is also not necessary for a person who represents the shareholder on the basis of law.

As mentioned, there are few SOEs in Latvia with minority non-state shareholders, but the Latvian authorities state that non-state shareholder participation in these cases has been generally high. For example, EBRD is actively involved in Citadele and Reverta shareholder meetings and TILTS Communications is equally involved in Lattelecom shareholder meetings. Minority shareholders other than EBRD do not regularly participate in Reverta shareholder meetings. The Ministry of Transport also confirmed that the natural persons holding 0.2% of shares in Air Baltic participate in the company’s annual shareholder meeting.

4. Relations with stakeholders

The state ownership policy should fully recognise the state-owned enterprises’ responsibilities towards stakeholders and request that they report on their relations with stakeholders.

a. Recognition of, and respect for stakeholders’ rights

Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders’ rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.

Stakeholders are accorded the same legal rights as those that apply to private companies, and no specific rights are granted to SOE stakeholders. The rights of stakeholders are generally protected under Latvian law, which as assessed by the World Bank in 2002, generally reflect EU practices. These legal rights are established in the Constitution of Latvia and a number of other laws including, for example, the Consumer Rights Protection Law (which protects consumers’ rights when entering into contracts with manufacturers, traders or service providers), the Labour Law (regulating employment legal relationships), the Environmental Protection Law and the Law on Environmental Impact Assessment (regulating business’s impact on the environment), and the Insolvency Law (which protects creditors’ rights).

On the latter, a new Insolvency Law came into force in 2010, following the economic and financial crisis. The law was developed with technical assistance from the IMF as part of overall structural reforms Latvia enacted in compliance with the terms of its financial assistance agreement with the Fund. The law facilitates the settlement of situations between a viable performer of economic activity and its creditors, and it ensures effective legal protection proceedings and creditor rights. As a result of these reforms, Latvian authorities state that insolvency proceedings are simpler, faster, and more effective. They add that both the IMF and the World Bank recognized that the 2010 Insolvency Law meets internationally accepted insolvency standards, including UN Commission on International Trade Law (UNCITRAL) insolvency rights guidelines. In practice, however, the IMF has noted the
insolvency framework remains prone to abuse. Latvia’s Saeima adopted further amendments to the Insolvency Law on 25 September 2014, which will enter into force in January 2015. These amendments mostly address the Law’s personal bankruptcy provisions and stricter quality-control criteria for government officials operating as insolvency operators.

**b. Information about stakeholder relations**

Latvian authorities stated that there is no formal requirement for SOEs to report on stakeholder relations. However, Art. 55 of the Law on Annual Accounts requires large companies to include in the management reports submitted with their annual accounts information on “non-financial indicators”, including for example, employee relations. In practice, Latvian authorities state that some of Latvia’s larger SOEs disclose information on stakeholder relations. Citadele, for example, has included updates on stakeholder relations in the management report section of its annual reports. Latvenergo reports on stakeholder relations on its website and in its annual Sustainability Reports, which are prepared in accordance with sustainability reporting guidelines developed by the Global Reporting Initiative. The Ministry of Agriculture issues an annual forestry sector report that includes a report on engagement with stakeholders.

For note, listed companies traded on the NASDAQ OMX Riga exchange are required to apply Section 10 of the NASDAQ OMX Riga Principles of Corporate Governance, which focuses on investor relations and includes engaging with and informing “other interested parties: employees, creditors and business partners”.

**c. Compliance programmes for internal codes of ethics**

There is no formal requirement for SOEs to develop internal codes of ethics, though some SOEs have begun doing so on their own initiative. For example, Latvenergo has issued a comprehensive code of ethics on procurement practices and cooperation with suppliers that includes specific measures providing for education and training, whistleblowing measures, internal monitoring, and auditing and review procedures. Latvenergo has also developed specific tools for managing fraud and corruption risks and conflicts of interest. Other SOEs that have developed codes of ethics include: Augstsprieguma tīkli, Latvijas Loto, Latvijas Attīstības finanšu institūcija “Altm”, Pasažieru vilciens, Latvijas Gaisa satiksme, Latvijas Valsts ceļi, Air Baltic Corporation, and Latvijas Nacionālais Metroloģijas centrs, and Riga College of Tourism and Creative Industries. According to Latvian authorities, these compliance programmes sometimes include the establishment of a special ethics committee to review complaints and potential breaches of the code. For example, Pasažieru vilciens has an ethics committee that oversees application of the company’s code of ethics and investigates possible violations of the code. The committee’s three members are approved by the head of the management board and currently include representatives from Pasažieru vilciens’ management board, the legal department, and the quality and security assurance department.
5. Transparency and disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

a. Aggregate annual reporting on SOEs

To date, the Government has published one aggregate report on the SOE sector, the 2009 Annual Report on Latvian State-Owned Assets. There has been no follow-up to this report. At the time of writing, however, the Latvian authorities were planning to sub-contract to an external party the drafting of an aggregate SOE report based on publicly available administrative reports by SOEs and their line ministries. This report is expected to be published by the end of 2014.

Since 2012, individual line ministries have been responsible for providing to the Cabinet of Ministers two separate informative annual reports on each of the SOEs in their portfolio, including their subsidiaries (if any), as per Art. 30.1(1-2) of the Law on Budget and Financial Management. The first report is a forward-looking annual informative report covering plans for the upcoming year, including: financial indicators, including planned profitability and estimated returns on equity; forecasted operational results; future investments; and—if applicable—plans for using State subsidy or grant money. The second is a performance report on the preceding year that includes an assessment of the SOE’s fulfilment of financial and operational objectives, as well as the use of State subsidy or grant money, if applicable. These reports must also be published on the line ministry’s website, though this has not been done in some cases. The Ministry of Finance has developed guidelines for preparing these reports, though the Ministry is not responsible for enforcing compliance with these provisions.

The Government undertook a self-evaluation of its transparency and disclosure requirements for SOEs and concludes in the June 2012 policy planning document, Concept for Management of State Capital Shares, that the current SOE reporting practice in Latvia “fails to meet the requirements of the OECD guidelines”.

The Public Persons Enterprises and Capital Shares Governance Law stipulates that the Coordination Institution would be responsible for collecting and publishing information on the SOE sector, including the publication of an annual aggregate report and a public website. (See section A.7.a.)
b. Internal audit procedures

| B. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ. |

Internal audit procedures for SOEs are not mandated by law. Some large SOEs have voluntarily introduced internal audit procedures. For example:

- Reverta’s board of directors has established an Audit Committee that reports directly to the shareholders meeting. The company has also established an internal audit department that reports directly to the board of directors.

- Latvijas Valsts meži has established an internal audit division that reports directly to the head of the management board. The company has also established an Internal Audit Committee, which is made up of the head of the management board, the head of the internal audit division, a representative from the Ministry of Agriculture, and an independent expert. The committee convenes at least once per year to review the internal audit division’s performance and the results of the division’s internal audits.

- Latvenergo’s three-member audit committee was established in 2012 in compliance with Art. 541 of the Financial Instruments Market Law, which requires audit committees for all companies whose transferable securities (including issued debt) are admitted to trading on the regulated market. (See section B.1.f on Latvenergo’s issuing of bonds.) The committee supervises Latvenergo’s financial reporting process, internal control and risk management system, internal audit and external auditor activities, and implementation of the company’s Fraud Risk Management Plan. Members of the committee are selected through an external recruitment process and are nominated by and responsible to Latvenergo’s shareholder, the Ministry of Economy. The committee must report to the shareholders’ meeting at least once per year. Sitting committee members’ terms are valid until April 2015. Members include:
  - Mr. Torben Pedersen (Chair): A Danish citizen formerly with Deloitte and also a former member of the Danish Chamber of Commerce in Lithuania.
  - Ms. Inita Häne: Financial Director of legal, financial and accounting advisory firm Prime Holding SIA. Former senior manager at PriceWaterhouseCoopers and former auditor of Latvenergo AS.

For comparison, listed companies must comply with internal audit requirements under the Law on the Financial Instruments Market. Art. 541 of that law stipulates all listed companies must establish an audit committee. Section 11 of the NASDAQ OMX Riga Principles of Corporate Governance also requires listed companies to establish internal controls, including internal audit controls.
c. **Independent external audit**

| C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit. |

Art. 176 of Latvia’s Commercial Law requires all companies (including SOEs) to submit their annual accounts to an audit by a certified external auditor. Art. 62(1) Annual Accounts Law narrows the scope of companies subject to external audit under the Commercial Law to those that exceed two of the three following size criteria: (1) a balance sheet total of EUR 400,000; (2) net turnover of EUR 800,000; (3) an average of 25 employees in the accounting year.

Latvian authorities estimate that all Latvian SOEs would meet these large-company criteria and are therefore subject to external audit. The shareholders of SOEs subject to external audit requirements are responsible for appointing an external auditor from Latvia’s pool of 170 certified auditors. The selection of an external auditor is subject to public procurement procedures and certified auditors can participate in open tenders to audit an SOE’s books. Auditors’ activities are regulated by the Act on Auditing. Auditor independence is safeguarded under the Law on Sworn Auditors.

The State Audit Office may also conduct audits of SOEs, as per Art. 2 of the State Audit Office Law. The State Audit Office has undertaken 18 SOE audits since 2007, one third of which were audits of Ministry of Health SOEs and another third of which were audits of Ministry of Transport SOEs. The SOE audits undertaken by the State Audit Office are non-financial probity audits of SOEs’ performance and compliance with laws and regulations, though the Office can access the SOE’s accounts in the course of an audit. Audits are undertaken on an *ad hoc* basis, based on the Office’s annual risk assessment. For the last three to four years, SOE audits have included a specific focus on SOE corporate governance, using as benchmarks OECD’s SOE Guidelines as well as the BICG Baltic Guidance on the Governance of Government-Owned Enterprises. Annual audit plans are approved by the State Audit Office Council, which consists of the Auditor General and six members, all of whom are appointed by Parliament for four-year terms. (For note, the State Audit Office is an independent and autonomous government institution with funding allocated from the State budget.)

In the course of an audit, the Office can make recommendations for the rectification of discovered deficiencies. Recommendations are included in the State Audit Office’s audit report, which is published on the Office website. In the finalisation of the audit report, the Office and the audited bodies agree on a timeframe for implementing the Office’s recommendations. Following the audit, audited bodies report directly to the State Audit Office on progress made implementing recommendations. The State Audit Office continually monitors implementation of its recommendations and periodically informs the Public Expenditure and Audit Committee of the Parliament on progress made in this regard. The State Audit Office reports that it has performed 21 audits on the operations and management of state and local government capital companies, which have resulted in 408 audit recommendations, 335 of which are implemented and 14 of which are no longer applicable.
## Table 16. Highlights from recent State Audit Office audits of SOEs

<table>
<thead>
<tr>
<th>Audited SOE</th>
<th>Year</th>
<th>Audit objective</th>
<th>Highlights of findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOEs managed by the Ministry of Environmental Protection &amp; Regional Development (MoEP)</td>
<td>2012</td>
<td>To assure whether MoEP supervises SOEs in its portfolio in accordance with internationally accepted best practices and in accordance with Latvia’s legal and regulatory framework.</td>
<td>Poor shareholder supervision resulted in inefficiencies worth EUR 4.8 million.</td>
</tr>
<tr>
<td>Latvijas dzelzceļš (Latvian Railways, LDZ)</td>
<td>2012</td>
<td>Evaluate the Ministry of Transport’s (MoT) management of Latvijas dzelzceļš in the implementation of state policy on railway sector and Latvijas dzelzceļš’s compliance with Latvian laws and regulations.</td>
<td>Regarding state policy, the MoT did not have a long-term work plan nor financial forecasts. LDZ did not have a medium-term work strategy, and was not evaluated according to any commercial or other targets. MoT financial and operating reports on LDZ to the Cabinet of Ministers lacks information on LDZ’s performance, evaluation, nor does it include suggestions for improving performance.</td>
</tr>
<tr>
<td>Latvijas Valsts radio un televīzijas centrs (“the Centre”)</td>
<td>2009</td>
<td>Assess the lawfulness of the Centre’s use of revenues.</td>
<td>70% of the Centre’s revenue (EUR 24.2 million) was derived from dividends from its 23% ownership of LMT and interest earned from depositing these dividends in commercial banks—not from core services or State subsidies. Centre revenues totalling approximately EUR 881,000 were transferred by the MoT to cover losses incurred by Latvijas Pasts. The transfer was undertaken by shifting an unprofitable business service from Latvijas Pasts to the Centre, despite the Centre’s lack of resources and expertise to undertake the task.</td>
</tr>
<tr>
<td>Latvijas Valsts meži (Latvia State Forests; LVM)</td>
<td>2008</td>
<td>To ensure: (1) whether LVM is properly supervising State forest property; and (2) whether the Ministry of Agriculture (MoA) is properly supervising LVM and its transfer of revenues to the state budget.</td>
<td>From 2005-2007, LVM significantly decreased its dividend payment obligations to the State budget by ceasing to pay to the State a part of the revenues it received from the sale of state property (forestry products). The MoA did not assess or justify the amount of resources the State was entitled to from State forest production, nor the volume of profit share payable by LVM in the form of dividends. The MoA also approved non-transparent granting and utilization of donations during this period of EUR 4.6 million.</td>
</tr>
</tbody>
</table>

1. Latvian Environment, Geology and Meteorology Centre, referred to here as the “Centre”, and the Environmental Investment Fund
5. The Latvian authorities report that, since this audit was undertaken, LDZ has a new business strategy through 2030, which includes aims, objectives, and key performance indicators (KPI). Authorities add that the Ministry of Transport also approves annually a three-year business plan. The Ministry also evaluates LDZ’s performance and that of its management board, based on approved aims, objectives, and KPI.
6. See LMT’s ownership structure in section A.2.b.1 above.
8. The Ministry of Agriculture clarifies that, since this audit, the Ministry has approved a new donation strategy for LVM.

Source: State Audit Office and supplementary information provided by the Latvian authorities.
d. Accounting and auditing standards

### D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.

#### i. Legislation

SOE accounting requirements in Latvia are the same as those for private companies, as per Art. 1 of the Law on Accounting and Art. 1.1 of the Annual Accounts Law, which define the scope of these laws’ application. The Law on Accounting sets out general accounting practices in Latvia. Art. 2 of the Law on Accounting requires an entity to organise its accounts to clearly reflect all economic transactions and in a way that would allow a third person qualified in the area of accounting to obtain a true and clear representation of the entity’s financial position at the date of the balance sheet, the results of the activities thereof, the cash flow for a specific time period, as well as the beginning of each economic transaction and its course. Accounts should be truthful, comparable, timely, significant, understandable and complete. Articles 2 and 16 hold the heads of entities liable for maintaining and preserving the entity’s accounts. The head of a capital company is defined as the head of the management board.

The Annual Accounts Law defines how financial statements should be prepared, as well as report by company management regarding the development of the company during the accounting year (Art. 55). The annual accounts prepared under the Annual Accounts Law must provide a true and fair view of the assets and liabilities, financial position, profit or loss and cash flow of the company. As noted above (section B.5.c), the Annual Accounts Law also specifies which companies should be subject to external audit. The law does not apply to banks, savings and loan societies, insurance commercial companies in the form of stock companies, mutual insurance co-operative societies, private pension funds, investment broker companies and investment management companies.

Further, the Law on Consolidated Annual Accounts sets forth provisions for parent companies on the preparing, auditing, approving and publishing consolidated annual accounts and a consolidated report. A parent company must prepare consolidated annual accounts if the parent company, directly or indirectly has attained influence in at least one of the following conditions: (1) it has the majority of the stockholders’ or shareholders’ voting rights; (2) it has the right to appoint or remove the majority of the members of the supervisory or executive bodies of the subsidiary company, or (3) it has the right to exercise the rights in the previous two provisions under contract entered into with other stockholders or shareholders of the subsidiary company or in accordance with the charter of the subsidiary company. The law does not apply to banks, commercial insurance companies in the form of stock companies, mutual insurance co-operative societies, private pension funds, investment broker companies, investment management companies, and institutions that are financed from the State budget.

Annual accounts for all companies (including SOEs) must be disclosed publicly. This is done by depositing annual accounts with the State Revenue Service, which has five days to transfer the information to the Enterprise Register, which in turn has five days to publicly disclose the company information, as per Art. 66 of the Annual Accounts Law. Physical, archived company files are available at the office of the Enterprise Register or electronically through a fee-based online databases of Latvian enterprises, including www.lursoft.lv, www.crediweb.lv, and www.firmas.lv. The Enterprise Register is also responsible for publishing a notice in the newspaper Latvijas Vēstnesis on the accessibility of this information. The same disclosure system applies to consolidated annual accounts, under Art. 33 of the Consolidated Annual Accounts Law.
Finally, Art. 217 of Latvia’s Criminal Law makes it an offence for a person to violate provisions regarding the conducting of accounting documentation or of procedures regarding compilation of annual accounts or statistical reports, prescribed by law for an undertaking (company), institution, or organisation. It is also an offence to conceal or forge accounting documents, annual accounts, statistical reports or statistical information required by law regarding an undertaking (company), institution or organisation. These provisions may apply to legal persons (including, Latvian authorities argue, SOEs), as per Art. 70 of the Criminal Law (see section A.4.a.iii above).

**ii. Application of accounting and auditing standards**

Latvian authorities state that, as a Member of the European Union, Latvia’s accounting policy is subject to, and in line with, European Union directives, and they are generally based on International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). In general, international observers agree that, by and large, Latvia has implemented the cumulative body of European Community laws, or *acquis communautaire*, in terms of its accounting and auditing statutory framework.\(^{178}\)

First, regarding *international standards on auditing* (ISAs), auditors are legally obligated to apply ISAs under the Law on Sworn Auditors, which also includes provisions requiring auditor independence. The application of audit standards in Latvia is monitored by the Latvijas Zvērinātu revidentu asociācija (“Latvian Association of Certified Auditors”, LZRA)\(^{179}\), which is an independent professional corporation subordinated to the Ministry of Finance, established in 1994 under the Law on Certified Auditors. LZRA is a member of the International Federation of Accountants and represents 169 certified auditors and 141 firms of certified auditors in Latvia.

Second, regarding *accounting standards*, most companies in Latvia rely on a national version of generally accepted accounting principles (GAAP) that, by the government’s own admission (see next paragraph), is not consistent with international best practices. Only companies listed on the NASDAQ OMX Riga main list and companies in a group situation are required to apply IFRS, according to Art. 56.2-4 of the Financial Instruments Market Law and the rules for listing on the NASDAQ OMX Riga exchange (Rule 5.2).\(^{180}\) Financial institutions must also prepare their annual accounts according to IFRS. Most SOEs that do not fall under these rules apply Latvian GAAP. However, some SOEs in a group situation that should prepare accounts according to IFRS under the Consolidated Annual Accounts Law continue to prepare their accounts according to Latvian GAAP. These include Latvia’s largest SOEs, other than Latvenergo, Air Baltic, Latvijas Dzelzceļš, Latvijas Pasts, and Latvijas valsts meži.

LZRA explained to the OECD Secretariat\(^{181}\) that Latvian GAAP reflect IFRS,\(^{182}\) but there are a number of areas where Latvian GAAP deviate from the international standards. The biggest difference, LZRA stated, was in relation to the scope of disclosures required by IFRS. A similar assessment was made by the Latvian Government in its 2009 review of the application of Latvian GAAP by some Latvian state-owned enterprises, stating that these standards are “similar to IFRS, however certain differences exist that might affect the valuation of assets and liabilities. Latvian reporting standards have significantly lower requirements for the disclosure of financial information.”\(^{183}\) Presently, there are no plans for Latvia to move to a single-standard system requiring the application of IFRS by all companies.
e. Disclosure of material information

E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.

Examples of such information include:

1. A clear statement to the public of the company objectives and their fulfilment.
2. The ownership and voting structure of the company.
3. Any material risk factors and measures taken to manage such risks.
4. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE.
5. Any material transaction with related entities.

(i) Current disclosure framework

By way of introduction, SOEs, as commercial enterprises, are subject to disclosure requirements for all private companies under the Commercial Law, the Annual Accounts Law, and the Law on Consolidated Annual Accounts (for parent companies in a group of companies). SOE-specific disclosure requirements are also included in the Law on Budget and Financial Management. The specific requirements under these laws are discussed in further detail below.

Latvian authorities add that SOEs may be subject to disclosure requirements under the Law on Freedom of Information, which is meant to ensure public access to information that is under the control of State administrative institutions and local government institutions, and the Law on Remuneration of Officials and Employees of State and Local Government Authorities, which requires members of SOE boards of directors and management boards, as public employees, to submit declarations on their remuneration under the Law on Prevention of Conflict of Interest in Activities of Public Officials. Donations made by SOEs must also be disclosed under the Law on Prevention of Squandering of the Financial Resources and Property of the State and Local Governments.

Company objectives and their fulfilment (Chap.V, Rec. E.1)

First, in terms of objective-setting, all commercial enterprises in Latvia are subject to the Commercial Law, which states that a company’s articles of association should indicate “the goals of the activities of the company (if the company is founded for a specific period of time or to reach a specific goal)” (Art. 144.1.3), as well as “the main types of commercial activities of the company” (Art. 144.2.4).
Second, in terms of disclosing their fulfilment of their objectives, companies are required to submit annual accounts at the end of every accounting year, under Art. 174 of the Commercial Law. These accounts, as per Art. 4 of the Law on Annual Accounts, must include a financial report and a management report. (See also section B.5.d.i.) Management reports submitted with a company’s annual accounts must include (as per Art. 55.1 of the Law on Annual Accounts):

- financial results indicators;

- reference to sums specified in the financial statements and additional explanations about them; and

- for companies of a certain size, the main non-financial indicators characterising the company and the relevant industry, i.e., information on the impact of environmental protection requirements and information on employees (for instance, the applied employment policy, guarantees and support to employees) or other information.

The management report must also provide information on: any important events after the end of the accounting year; plans for the further development of the company; research and development measures, if applicable; branches of the company and representations abroad; use of financial instruments and, if necessary, the company’s risk management goals and policy.

All companies—including SOEs and their subsidiaries (if any)—must submit a copy of their annual accounts and a certified auditor’s report (if such exists) to the State Revenue Service, which is then required to transfer these documents to the Enterprise Register. The Enterprise Register then makes these documents public (Art. 66 of the Annual Accounts Law).

Specific to SOEs is the obligation under Art. 301(1 - 2) of the Law on Budget and Financial Management for line ministries to provide to the Cabinet annual reports on the previous year’s performance for SOEs in their portfolio, including their subsidiaries (if any), as well as objectives for the year ahead. (See also section B.5.a.)

There are no specific legal requirements for Latvian SOEs to disclose information on the fulfilment of social or public policy objectives, though the impact of meeting these objectives on the company’s financial position would presumably be described in the management and shareholder reports required under the aforementioned laws. Latvian authorities, however, have not provided specific information on the application in practice of the provisions described here.

Ownership and voting structure (Chap.V, Rec. E.2)

Information on which ministries or agencies are responsible for exercising State ownership rights is publicly available, and information on corporate control structures is usually published on the respective SOEs’ websites.

In addition, all SOEs operating in a group situation are subject to the ownership disclosure rules under the Group of Companies Law. Art. 6(1-3) of this law requires a shareholder to notify the company in writing if the total number of stocks owned by the shareholder and the voting rights associated with these stocks exceeds 10% of the company’s total shares. The shareholder must also notify the company of any further acquisition of stocks which increases the shareholder’s ownership above every next 5% of the company’s shares. Inversely, a shareholder must notify the company of a decrease in ownership whenever it decreases for every next 5% or becomes less than 10% of the
company’s total shares. This information should be included in an annex to the company’s annual accounts, as per Art. 8 of the Group of Companies Law.

Additional ownership disclosure requirements are required of companies listed on the NASDAQ OMX Riga exchange, under the Financial Instruments Market Law.

**Material risk factors (Chap.V, Rec. E.3)**

All companies, including SOEs, are subject to Art. 55 of the Annual Accounts Law, pursuant to which a company’s management report must provide material information on the development of the company, financial results, and significant risks and any unclear circumstances the company may face. Regarding material risk factors, specifically, the management report should include financial risk management goals and policies, the adopted risk management policy for each significant forecasted future deal for which a risk-limitation accounting system is applied, as well as an assessment of the company’s overall exposure to market risk, credit risk, liquidity risk, and cash-flow risk.

Listed companies are required under the Financial Instruments Market Law to further disclose in their quarterly reports significant risks related to a company’s operations (Art. 57.4.2).

**Financial assistance and commitments made on behalf of the SOE (Chap.V, Rec. E.4)**

As noted above, SOEs must report receipt of State subsidies as part of the annual reports made by line ministries to the Cabinet under the Law on Budget and Financial Management. Of note, Annex I of the Government’s policy planning document, Concept for Management of State Capital Shares, criticizes Latvia’s current SOE disclosure regime and says most SOEs do not report financial assistance received, nor do they regularly report related party transactions.

**Related party transactions (Chap.V, Rec. E.5)**

Legal provisions regulating related party transactions are the same for private companies and SOEs: Art. 139¹–139³ of the Commercial Law provides procedures for the conclusion of transactions between the company and the founder, shareholder, members of the board, or persons (natural or legal) connected to the aforesaid persons. According to these provisions, related party transactions must be approved by the board of directors or meeting of shareholders. Section 53¹ of the Annual Accounts Law requires large companies to disclose information on transactions with related parties in their annual accounts if such transactions are significant and do not comply with normal market conditions. ¹⁸⁷ Section 28.8 similarly requires parent companies to include information on related party transactions in an annex to their consolidated annual accounts. In the case of SOEs, and in the absence of boards of directors, state secretaries are individually responsible for reviewing and approving related party transactions.

The Latvian authorities add that, under Art. 30 of the Group of Companies Law, dependent or “controlled” companies in a factual group situation (i.e., a formal management contract has not been entered into between the parent company and the dependent company) must prepare a “report on dependency”. Under this provision, the dependent company must report on legal transactions concluded with the controlling enterprise or affiliated companies or at the request or interests of such companies.
Box 11. Provisions for the disclosure of related party transactions

A. Provisions applicable to all commercial enterprises, including SOEs:

Annual Accounts Law

- Section 53\(^1\) requires a company to include in an annex to its annual accounts information regarding its transactions with related parties if such transactions are significant and do not conform to normal market conditions, indicating the amount of such transactions, the type of relationship of the related parties and other information regarding such transactions, which is necessary in order to understand the financial status of the company. Listed companies must also include information on transactions with related parties if the company receives an external audit opinion of the company’s internal audit regarding these types of transactions.

Consolidated Annual Accounts Law

- Section 28(8) requires parent companies to include in an annex to their consolidated annual accounts information on transactions of the parent company of the group of companies or other companies involved in the consolidation with related parties (except for mutual transactions of companies involved in the consolidation), if these transactions are essential and do not comply with the normal market conditions indicating the amounts of these transactions, type of relationship of related parties and other information regarding these transactions, which is necessary in order to understand the financial position of the companies involved in the consolidation as a whole.

Group of Companies Law

- While not strictly a related party transaction, Art. 30 of the Group of Companies Law is relevant to this discussion. It requires dependent companies in a de facto group situation to submit annual dependency reports that include information on transactions concluded by the dependent company during the accounting year with the dominant undertaking or with another undertaking that is merged with the dominant undertaking in a group of companies, as well as the transactions concluded by the dependent company in the interests of such undertakings or as a result of an inducement, indicating in particular the transactions which are completely or partially disadvantageous to the dependent company or which involve a special risk for the dependent company or, also, which differ substantially from the entrepreneurial activities normally carried out.

B. Provisions applicable to listed companies:

Financial Instruments Market Law

- Art. 57(4.2) requires listed capital companies who must prepare consolidated annual accounts to include in their interim management reports the following information about the most significant transactions with related persons:
  
  o information about the transactions carried out with the related persons during the reporting period where these transactions have had a significant effect on the financial standing or the financial performance of the capital company during that time, and
  
  o information about any changes in the transactions with the related persons that were disclosed in the previous annual report/accounts and could have a significant effect on the financial standing or the financial performance of the capital company during the reporting period. Where a capital company whose shares are admitted to trading on the regulated market does not draw up consolidated annual accounts, it shall disclose information about its transactions with the related persons in accordance with the requirements of the regulatory provisions of the home member state.

- Art. 59(2.23) defines as a significant event, which must be reported publicly, instances where an internal auditor’s opinion identifies a transaction of significant volume between the issuer and a member of its
management board or supervisory council [board of directors] or between the issuer and the related person of a member of its management board or supervisory council [board of directors].

**NASDAQ OMX Riga Principles of Corporate Governance**

- Section 8.2 requires members of the management board to self-disclose to the board his or her conflict of interest (or the possibility of a conflict of interest) in any deal or agreement the company plans to conclude with a person to whom that member is related or connected. Section 8.2 imposes a parallel requirement on members of the supervisory council. In both provisions, a related party is defined as: “spouses, a relative, including kinship of second degree or brother-in-law of first degree, or persons with whom the board [or supervisory council] member has had a common household for at least one year.” A connection with a board or supervisory council [board of directors] member is defined as: “legal persons where the board [or supervisory council] member or a closely related to him/her person is a board or council member, performs the tasks of an auditor or holds another managing office in which he or she could determine or affect the business strategy of the respective legal entity.”

(ii) **Proposed disclosure requirements**

The Public Persons Enterprises and Capital Shares Governance Law outlines disclosure requirements for the Coordination Institution, line ministries and institutions, and for SOEs. First, as discussed above (section A.7.a), the Coordination Institution will be responsible for collecting and publishing information on the SOE sector on the web and in an annual aggregate report (Art. 29.1). Second, line ministries and institutions will be required to publish on their websites information on SOEs in their portfolio. This includes, for each SOE: the name, address, and volume of equity capital and size of the State’s ownership in the enterprise; the justification for the State’s interest in the enterprise; the SOE’s ownership in any other enterprises; the State’s shareholder representative; an annual report; dividends paid to the State budget; and information on the divestment of State shares and/or privatisation of part or all of the enterprise, its reorganisation or conversion into a public agency. Finally, Art. 58 of the law requires SOEs and their subsidiaries to publish on their websites:

- Financial and non-financial goals and progress made achieving them;
- Payments to the state budget (including dividends, deductions, tax payments);
- State funding and distribution of such funding;
- Dividend policy;
- Donation/grant strategy
- Non-audited quarterly, semi-annual and annual reports, as well as an audited annual report;
- Information on the SOE’s property structure, organizational structure, donations/grants made or received; purchases; and other material information unless classified as a business secret.¹⁸⁸
6. The responsibilities of the boards of SOEs

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

As noted, only six Latvian SOEs have boards of directors: Attīstības finanšu institūcija (Development Finance Institution); Reverta; Citadele; LMT; Lattelecom; and Air Baltic. All other SOEs operate with management boards that report directly to their respective line ministry or institution. As a result, this section addresses these two categories of SOEs separately, where necessary, as different considerations arise for SOEs with a formal two-tier system and those with a de facto single-board structure.

a. Mandate and ultimate responsibility for the company’s performance

The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company’s performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.

As noted, Latvia abolished the requirement for most SOEs to have boards of directors in 2009. For SOEs with boards of directors, Art. 9813(1) of the Law on State and Local Government Capital Shares and Capital Companies mandates responsibilities of boards of directors (see Box 12). These provisions for SOE boards of directors are largely in line with parallel provisions for boards of directors provided under Art. 292 of the Commercial Law.
Box 12. Responsibilities of SOE Boards of Directors

Law on State and Local Government Capital Shares and Capital Companies, Art. 98(1)

(1) The council [i.e., board of directors] shall have the following tasks:

1) to elect and withdraw members of the management board, to permanently control the activities of the management board;

2) to determine the amount of the monthly wage of members of the management board, social guarantees (benefits, compensations, insurance) and after the annual account is approved – on awarding a premium or other financial incentive;

3) to supervise that affairs of the company are organised according to the laws, articles of association, decisions of stockholders and meetings of stockholders;

4) to review the annual account of the company and proposal of the management board regarding the use of the profit and to submit them to the meeting of stockholders together with its report;

5) to represent the company in all claims brought by the company against members of the management board, as well as claims brought by members of the board of directors against the company;

6) to approve concluding of a transaction between the company and a member of the management board or an auditor;

7) to pre-examine all issues which are within the competence of the stockholder – State or local government – or within the competence of a meeting of stockholders, or which have been suggested for examination in a meeting of stockholders by members of the board of directors or management, and to provide an opinion on them.

(2) The board of directors shall submit a report to the meeting of stockholders, in which the operation of the company is assessed, and a report of the management board, as well as, if necessary, bring forward proposals regarding improvement of the operation of the company.

Under the Public Persons Enterprises and Capital Shares Governance Law, the responsibilities of SOE boards of directors are similar, though the Law also requires boards of directors to approve the SOE’s medium-term operational strategy.

The liability of SOE boards of directors and management boards is determined by the Commercial Law. Art. 169 of the Commercial Law states that a member of the board of directors or the management board shall be liable for losses they have caused to the company. However, they are not liable if they acted as an “honest and careful manager” would have. (The term “honest and careful manager” is undefined in Latvian law.) A member of the board of directors or the management board is also not liable for losses caused to the company if he or she acted in good faith and within the framework of a lawful decision of the meeting of shareholders. A parallel clause exists in the Law on State and Local Government Capital Shares and Capital Companies (Art. 34.2), which states members of SOE management boards “shall not be liable for losses caused to a capital company if they have acted according to a lawful decision of a shareholder (stockholder) or a holder of capital shares.” These provisions indicate that the “duty of care” of members of SOE boards of directors (where they exist) and management board members is defined purely as a responsibility toward shareholders, whereas the OECD SOE Guidelines (Chap. VI, Rec. A) and the OECD Principles of Corporate Governance (Chap. VI, Rec. A) recommend that they should also be directed toward the company. A similar provision is included in the Public Persons Enterprises and Capital Shares Governance Law (Section 51). To date, no members of an SOE board of directors or management board have been found liable under the current legal framework.
Members of the management board and boards of directors of all commercial enterprises may also be held for damages caused to the company under Art. 172 of the Commercial Law. This provision sets forth criteria for bringing an action against the founders, members of the management board, the board of directors, or the auditor, on the basis of a decision taken by a meeting of shareholders, which has been taken by a simple majority of votes of those present. (See also section B.1.d above.)

The Commercial Law also outlines specific cases in which shareholders have the right to release members of the management board or board of directors from liability (Art. 173). Under this provision, an individual may be exculpated from liability, or may enter into a settlement with the company, if they disclose specific acts of wrongdoing to the meeting of shareholders. Latvian authorities have not specified whether this provision has been applied to members of SOE management board members.

**Box 13. Commercial Law provisions on liability of members of the management board and board of directors**

**Section 169. Liability of the Members of the Board of Directors and Council**

(1) Members of the board of directors and council shall perform their duties as would an honest and careful manager.

(2) Members of the board of directors and council shall be solidarily liable for losses that they have caused to the company.

(3) Members of the board of directors and council shall not be liable in accordance with Paragraph two of this Section if they prove that they have acted, as would an honest and careful manager.

(4) A member of the board of directors and council shall not be liable for losses caused to the company if he or she has acted in good faith within the framework of a lawful decision of the meeting of shareholders. The fact that the council has approved the actions of the board of directors shall not release the members of the board of directors from liability to the company.

**Section 173. Release from Liability**

(1) A meeting of shareholders may release members of the board of directors or council from liability or take a decision to enter into an amicable settlement only for specific actions which were actually performed by them and were revealed at the meeting of shareholders, and as a result of which the company has incurred losses.

(2) A decision of a meeting of shareholders regarding the release from liability or to enter into an amicable settlement with the members of the board of directors or council shall not restrict the right of a minority of shareholders to bring an action in accordance with the provisions of Section 172, Paragraph two of this Law.

(3) A decision of a meeting of shareholders to approve the annual accounts shall not of itself release members of the board of directors and council from liability for their actions during the relevant accounting period.

Source: Latvia’s Commercial Law
b. Monitoring of management and strategic guidance

B. SOEs boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

Annotations to Chap. 6, Rec. B state that, in order to carry out their role, SOE boards should actively (i) formulate, monitor and review corporate strategy, within the framework of the overall corporate objectives; (ii) establish appropriate performance indicators and identify key risks; (iii) monitor the disclosure and communication processes, ensuring that the financial statements fairly present the affairs of the SOE and reflect the risks incurred; (iv) assess and follow management performance; and (v) develop effective succession plans for key executives.

Little information is available on the extent to which the boards of directors in the six SOEs who have them fulfil these tasks in practice. The LPA, which exercises the state ownership function in four of the six SOEs with boards (Citadele, Lattelecom, LMT, and Reverta), reports that it holds meetings with boards of directors monthly, usually to discuss management board performance, priorities, strategy, and financial performance. A question may also relate to the size of SOE boards. A recent review of national board practices (OECD, 2013) indicated that a typical board of directors would have around five to seven members. However, Latvia’s Law on State and Local Government Capital Shares and Capital Companies mandates that SOE boards of directors should only have three members (Art. 98\(14\)). Boards of this size could raise doubts about whether they are sufficiently resourced to fulfil their roles.\(^{189}\) (This provision applied to only one SOE at the time of writing: Attīstības finanšu institūcija.)

In all other SOEs without boards of directors, the state secretary or his or her representatives is in most cases singularly responsible for monitoring SOE management and for providing strategic guidance. Discussions with line ministries and members of SOE management boards indicate that the assessment of management board performance takes place during the general shareholder meeting review of an SOE’s annual reports and that performance is linked directly with the SOE’s ability to balance its budget and not to generate losses.

The annotations to Chap. 6, Rec. B also state that a key function for SOE boards of directors should be the appointment and dismissal of CEOs. On this point, the Latvian authorities state that appointments to SOE management boards are made by the shareholder representative, according to Art. 48(1)(3) (for LLCs) and Art. 76(1)(3) (for JSCs) of the Law on State and Local Government Capital Shares and Capital Companies. Art. 61(6) of the same law states that management board candidates must be “a natural person who is fluent in the official language and whose work experience, education and qualification ensures professional fulfilment of the tasks of a member of the board”.

Practice varies, however, as to how members of management boards are selected. Some shareholders will make public calls for nominations. (Examples include the public calls for management board applicants for the State Real Estate company, the Latvian National Opera, the Latvian National Symphonic Orchestra, and the Polyclinic of the Ministry of Interior. A similar call for applications was made in September 2012 to staff the LPA management board.) Others will select management board members from a pool of internal candidates already working for the SOE. The management boards of SOE subsidiaries are appointed or removed by the parent company. (See also section B.2.c, above.)
c. Board composition and exercise of objective and independent judgment

C. The boards of SOEs should be composed so that they can exercise objective and independent judgement. Good practice calls for the Chair to be separate from the CEO.

In choosing a board that is objective and independent, the annotations to Chap. 6, Rec. C underline the importance of first having a transparent nomination process with clearly stated duties of the board. In this respect, the minimum legal criteria for selecting members of the board of directors are quite basic: Candidates should be fluent in the official language and have appropriate professional and educational experience, as per Art. 98 of the Law on State and Local Government Capital Shares and Capital Companies, which applies only to SOEs operating as credit institutions, investment management companies, or financial institutions within the meaning of the credit institution law. The same provision states that boards of directors of these types of SOEs should consist of exactly three members, who are appointed and withdrawn by the general shareholder meeting or by the Cabinet, if provided for under law. The law makes no mention of any requirements to nominate competent and independent non-executive board members. (See also section B.2.f.)

As noted above, the LPA exercises the ownership function for four of the six SOEs with boards of directors. For these SOEs, the LPA has developed a detailed process for nominating members of the board that goes far beyond these minimum legal requirements (see Annex 2). This process includes measures for establishing a nomination committee and specific criteria for board members, including independence criteria. The Latvian authorities state that the Cabinet resolution with instructions for nominating members of boards of directors and members of management boards will also go further than the current legal requirements and will include similar provisions in order to bring board-nomination processes in Latvia closer in line with international standards like the OECD SOE Guidelines.

The annotations to Chap. 6, Rec. C state that the separation of the Chair from the CEO should be considered as a fundamental step in establishing efficient SOE boards in single board structures. Under Art. 221(4), Art. 304(3), and Art. 295(2) of the Commercial Law, the CEO of a company cannot simultaneously serve as a member on the board of directors. These provisions apply to SOEs that have boards of directors. In practice, however, most SOEs have de facto single board structures. The Chairs and CEOs of these management boards—whether they are separate positions or held by one individual—report directly to their shareholder, who, as mentioned above, is responsible for monitoring SOE management and for providing guidance.

d. Employee representation

D. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

Current legislation does not require employee representation on SOE boards of directors.

e. Board committees

E. When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.
There is no legal requirement for SOEs with boards of directors to establish specialized board committees. Some SOEs have established such committees voluntarily. For example, Latvenergo, Latvijas Valsts meži, and Reverta have established audit committees (see section B.5.b above).

In addition, Lattelecom has established a remuneration committee, a business planning and finance committee, and an audit committee. Where such committees have been established, their rules of operation are mutually agreed upon by the committee members. The Latvian authorities report that the committees have, over time, proven to be an effective way to improve and ensure proper corporate governance of the company and that they serve as a useful communications tool between the shareholders, the board of directors, and the management board. Each Lattelecom committee is made up of four representatives from the board of directors, who are elected by the board of directors. Examples of recent activities undertaken by Lattelecom’s specialised committees include: a review of Lattelecom’s risk management function (audit committee); a review of procurement, IT security, and due diligence procedures (audit committee); a review of internal audit reports (audit committee), and a review of remuneration issues (remuneration committee).

f. **Annual performance evaluation**

F. **SOE boards should carry out an annual evaluation to appraise their performance.**

There is no legal requirement for SOEs with boards of directors to carry out self-evaluations. Some large SOEs’ boards of directors, such as the boards at Citadele and Reverta, have chosen to conduct evaluations of their company’s management boards at the LPA’s recommendation. For SOEs in the LPA portfolio, the agency has developed an internal methodology for conducting board of director self-evaluations. This methodology has the following objectives: (a) to carry out annual, well-structured evaluations of the performance of the board of directors; (b) to improve co-operation between the LPA, stakeholders and the board, and (c) to provide the basis for LPA decisions if changes are needed in the composition of the board of directors.

Given that the shareholder representative (state secretaries or heads of public institutions) perform the function of the board of directors in most Latvian SOEs, it should be noted that there are also no legal requirements, regulations, or recommendations for state shareholder representatives to evaluate their performance. As a result, the extent of operational involvement and the level of professional expertise vary widely from shareholder to shareholder.\(^\text{191}\)
CONCLUSIONS AND RECOMMENDATIONS

At the request of the Republic of Latvia, this report reviewed Latvia’s SOE corporate governance framework against the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The Guidelines were developed by the WP SOPP to help governments ensure that the enterprises they own or control are more competitive, efficient, and transparent. The WP SOPP recognizes that, by requesting this review, Latvia has positively indicated a willingness to assess and improve the corporate governance laws, rules, and practices that determine how their SOEs do business. This is arguably more important for Latvia than for most other European countries, given the prominent role of SOEs in the Latvian economy.

This report finds that Latvia’s SOE corporate framework, as it was at the time of writing, diverges from the Guidelines in certain fundamental respects. Effectively and promptly addressing these shortcomings could help ensure that SOEs benefit to the fullest extent possible the Latvian economy and Latvian citizens. Priority areas for near-term reform should include:

- **Developing and issuing an ownership policy defining the objectives of state ownership.** This will help Latvia to avoid the situation where SOEs have no or excessive autonomy in defining the nature and extent of their public policy objectives.

- **Closer coordination of the exercise of the state ownership function.** Latvia’s current decentralized SOE ownership structure is ineffective and exposes SOEs to the risks of mismanagement and abuse. Ownership of enterprises needs to be conducted on a whole-of-government basis, rather than at the unchecked discretion of individual ministries.

- **Separating the state ownership function from other functions influencing SOE conditions.** The blurring of these roles hurts shareholders’ ability to properly manage their SOEs and hold them accountable; it hurts managers’ ability to efficiently run their companies’ operations; it undermines confidence and trust in SOEs; and it makes it difficult to ensure a level playing field when SOEs and private enterprises compete in some sectors of the Latvian economy.

- **Re-introducing boards of directors, at least in all economically significant SOEs.** Latvia is one of the only developed economies in the world where SOEs generally have no boards of directors. The role of boards is a keystone of the Guidelines, so unless this issue is effectively addressed, it would be difficult to conclude that Latvia’s legislation and policies are in conformity with the SOE Guidelines.

- **Establishing clear selection and nomination procedures for SOE board members.** The Government should develop clear instructions for nominating directors, with a special view to ensuring that members of boards have the requisite professional qualifications and are capable of objective and independent judgement. It should further establish safeguards to ensure that the implementation of these instructions is continually and consistently enforced.
Communicating the nature and extent of SOE commercial and non-commercial objectives and how they are financed, and establishing stronger monitoring mechanisms. This follows directly from the Guidelines and it is imperative to the Government’s ability ensure that SOEs’ operations are undertaken in the public interest.

Developing and publishing annual aggregate reporting. Aggregate reports are obviously a way to increase transparency, and they are also helpful in building public trust and holding those exercising the ownership rights accountable. The reporting should cover the State’s enterprise ownership, the State’s and the SOEs’ objectives, as well as their governance and financial and non-financial performance. Good practice calls for such reporting to be conducted subject to parliamentary accountability.

Ensuring at least large SOEs adhere to international accounting and auditing standards. This practice should be consistent with practices followed by first-tier listed companies.

The Public Persons Enterprises and Capital Shares Governance Law addresses a number of these issues. The law, adopted on 16 October 2014 and entering into force on 1 January 2015, may not bring Latvia’s SOE sector fully in line with the SOE Guidelines, but its effective implementation could represent a real improvement of the framework currently in force. In particular, the law includes key provisions related to the reintroduction of SOE boards of directors (albeit for only some SOEs). It remains to be seen whether bylaws and guidance developed over the next 18 months will clarify certain questions related to these provisions’ implementation, after they enter into force in January 2016. This includes the question of how the board nomination procedures under the new SOE law will be reconciled with those included in the September 2014 Cabinet resolution on procedures for selecting candidates for SOE boards of directors. The Government should also clarify the makeup and responsibilities of the board nomination committees foreseen under both the SOE law and the Cabinet resolution. Separately, the Public Persons Enterprises and Capital Shares Governance Law introduces a requirement to provide annual aggregate reports on the SOE sector, which is consistent with the SOE Guidelines.

The establishment of a Coordination Institution under the Public Persons Enterprises and Capital Shares Governance Law has the potential to more effectively coordinate Latvia’s state enterprise ownership function. A coordinated state ownership function, in turn, could result in the Government’s enhanced ability to separate the state ownership function from other functions influencing SOE conditions and to more effectively set, monitor, and communicate state enterprise ownership objectives. However, ambiguities in the law regarding the Coordination Institution’s resources and its authority vis-à-vis line ministries and institutions could hinder the Institution’s ability to effectively fulfil its functions.

The Government of Latvia is also encouraged to further consider draft amendments to its State Administration Structure Law, which may address concerns related to Latvia’s arguably ambiguous state enterprise ownership policy, currently set forth in Art. 88(1) of that law. These amendments should carefully consider, or be accompanied by Government guidance on, the definition of “strategically important assets” requiring state enterprise ownership.

For the sake of transparency and accountability of the SOE sector, the Government should also take measures to further clarify and monitor how SOEs’ commercial and non-commercial objectives are established and balanced against each other, as well as how they are supervised, reported and communicated upon, and revised. This could be a priority focus area for the Coordination Institution,
as part of the guidance it is responsible for developing by November 2015 under the transitional provisions of the Public Persons Enterprises and Capital Shares Governance Law.

Finally, the Government is also encouraged to require at least Latvia’s largest SOEs to apply IFRS financial reporting, in line with what is already required of Latvia’s first-tier listed companies.
Notes

1. In 2014, the OECD undertook a review of the Guidelines to take into account developments since their adoption and the experiences of the growing number of countries that have taken steps to implement them. This review evaluates Latvia’s SOE sector relative to the SOE Guidelines developed in 2005.

2. Mr. Hans Christiansen, Senior Economist, and Ms. Mary Crane-Charef, Policy Analyst, OECD Corporate Affairs Division

3. The European Commission expects Latvia to repay up to 75% of its EU loan by early 2015. The first tranche of EUR 1 billion, accounting for 34.5% of the EUR 2.9 billion disbursed by the Commission in 2009-2010, was repaid on 25 March 2014. See online here: European Commission, EU BOP Assistance to Latvia, Fifth Review under Post-Programme Surveillance, April 2014 (ec.europa.eu/economy_finance.eu_borrower/balance_of_payments/pdf/lv_efc_note_5th_pps_mission_en.pdf)


7. See online here: openknowledge.worldbank.org/bitstream/handle/10986/18481/828910Latvia0LVA0Box0382100B00_PUBLIC0.pdf?sequence=1


9. See online here: www.transparency.org/cpi2014/results

10. For further information, see the aforementioned report, EU BOP Assistance to Latvia, Fifth Review under Post-Programme Surveillance and the 2014 macroeconomic review of Latvia’s economy by the Ministry of Economy.


15. To be listed on the main list, issuers must have three years of operating history, an established financial position, market capitalization of not less than EUR 4 million, with reporting according to IFRS, and a free float of 25% or worth at least EUR 10 million.


18. Latvijas gaze shares are owned by German commodities trader E.ON Ruhrgas International GmbH (47.2%); Gazprom AAS (34%); and Itera Latvija SIA (16%), a subsidiary of Russian industrial holding conglomerate Itera International Group. The State owns 117 shares in Latvijas Gāze. The State is party to a confidential shareholders agreement with Gazprom and E.ON Ruhrgas International GmbH.

19. There is a slight discrepancy with the below Table 3, which contains end-2012 data collected for the WP SOPP.

20. While Latvia’s questionnaire responses and this report focus on SOEs under the control of the central government, it is worth noting that Latvia’s municipalities own or hold large shares of commercial enterprises, as well. In 2012, municipalities were the sole shareholders of 323 SOEs and had decisive influence in 39 SOEs. In 243 enterprises, municipal governments held less than 50% of capital shares. The main provisions for managing and governing capital shares and capital companies owned by municipalities are similar to those for the central government: the Commercial Law and the Law on State and Local Government Capital Shares and Capital Companies.

21. According to additional information from the Latvian authorities, the turnover by the SOE sector accounts for around 18% of annual GDP.


23. The Latvian Privatisation Agency, which is a joint stock company owned by the Ministry of Economy, the Social Insurance Agency, which is subordinate to the Ministry of Welfare, and the National Electronic Mass Media Council, which is an independent public body.

24. Latvian authorities state that acquisition or divestment of state-owned real estate property is governed by the Law on Alienation of the Property of a Public Person and the Law on Prevention of Squandering of the Financial Resources and Property of a Public Person. Property rights for state-owned real estate are governed by the Law on the State and Local Government Land Ownership Rights and Recording of Such Rights in Land Registers, as well as the Law on Recording of Immovable Property in the Land Registers. Finally, Cabinet Order No. 319 of 9 May 2006 requires ministries and other state governing bodies to eventually transfer state real estate to the State Real Estate Company, Valsts nekustamie ipašumi, which is an SOE owned by the Ministry of Finance.

25. See section A.6, below for more on privatisations in Latvia.

27. The tariff for household electricity consumption in Latvia is set by the Public Utilities Commission. Latvenergo’s recent annual reports (2011 – 2013) state that the company did not receive any financial assistance from the Government to compensate for losses incurred from the subsidization of household electricity consumption, which is considered to be a universal service obligation.

28. Latvenergo has stated it plans to sell its 25% share in Nordic Energy Link.

29. See online here: www.latvenergo.lv/portal/page/portal/Latvian/parvade/main/augstsprieguma_tikls/AKTUALITATE

30. Latvian authorities note that Latvijas Dzelzceļš does not provide any rolling stock repair or maintenance for Pasažieru vīciens; Pasažieru vīciens’s subsidiary, VRC Zasulauks, maintains the passenger rail company’s rolling stock. Latvijas Dzelzceļš does manage the passenger railway infrastructure, based on an access agreement with Pasažieru vīciens.

31. According to the Railway Law, the SRA maintains and supervises the register of rolling stock, where each railway cab has its own unique registration number. SRA also acts as a dispute-resolution body for issues related to rail infrastructure and capacity.

32. According to Air Baltic’s financial reports, the private sector investors are the Russian airline company, Transaero Airlines (0.228%); Riga-based sole proprietorship owned by former Air Baltic Senior Vice President Gunther Sollinger, SIA Frontier Enterprises (0.0002%); and a third undisclosed shareholder owning 0.001%.

33. Under the Postal Law, the PUC determines the obligations of the universal postal services, approves tariffs for providing these services, and the selection of post operators. For more on the role of the PUC, including in the postal sector, see section A.4.b.i below.

34. The remaining shares of Lattelecom are held by TILTS Communications A/S, which is indirectly owned by Swedish telecommunications operator TeliaSonera. (See p. 4 of Lattelecom’s 2013 Annual Report: lattelecom.lv/images/Par_Lattelecom/Par_mums/Gada-parskati/LTC_Group_ENG_IFRS_2013_FINAL_.pdf)

35. For more information on LMT ownership, see here: www.lmt.lv/lv/lmt-dalu-ispasnieki

36. See online here: www.hipo.lv/en/about_the_bank/jaunumi/20120622_hipoteku_bankas_komercdALAS_cetram_paketem_atrasti_pirceji

37. See more information here: www.hipo.lv/en/about_the_bank/jaunumi/20120622_hipoteku_bankas_komercdALAS_cetram_paketem_atrasti_pirceji

38. See online here (in Latvian only): www.fm.gov.lv/lv/aktualitates/jaunumi/afi/48967-izveidots-affikoncerns

39. According to the LPA statement, the State’s shares in Citadele will be sold to 12 international investors organized by U.S.-based Ripplewood Advisors LLC for EUR 74 million. According to the statement, the EBRD will retain its 25% share. (See: http://www.pa.gov.lv/english/citadele-bank/news/ripplewood-and-latvian-privatization-agency-sign-agreement-for-sale-of-citadele-bank/)
40. The Institute’s other owners include the Federation of Latvian Forestry (54%) and the Latvian University of Agriculture (6%).

41. The Ministry of Health directly owns 49% of Rīgas hematoloģijas centrs, which is 51% owned by Rīgas Austrumu kliniskā universitātes slimnīca, which in turn is 100% owned by the Ministry of Health.

42. The medical facilities operating as SOEs are: Paula Stradiņa kliniskā universitātes slimnīca; Bērnu kliniskā universitātes slimnīca; Piejūras slimnīca; Traumatologijas un ortopēdijas slimnīca; Slimnīca Ģintermuiža; Daugavpils psihoneiroloģiskā slimnīca; Strenču psihoneiroloģiskā slimnīca; Bērnu psihoneiroloģiskā slimnīca "Ainaži"; Aknīstes psihoneiroloģiskā slimnīca; Nacionālais rehabilitācijas centrs "Vaivari"; Rīgas psihiatrijas un narkoloģijas centrs; Rīgas Austrumu kliniskā universitātes slimnīca.

43. According to the World Health Organization, smaller hospitals and some larger regional hospitals are usually owned by municipal governments, while larger tertiary hospitals (university hospitals) and specialized hospitals (such as psychiatric hospitals) are owned by the Ministry of Health. All hospitals are LLCs governed by management boards responsible to the local or State governments. (See, World Health Organization, Latvia: Health system review. Health Systems in Transition, 2012, p. 38 [www.vmnvd.gov.lv/uploads/files/51a8679e033c2.pdf])

44. www.likumi.lv


47. The State Administration Structure Law defines “derived public person” as “a local government or other public person established by law or on the basis of law. Such public person has been conferred its own autonomous competence by law, which includes also establishing and approval of its own budget. Such a person may have its own property”.

48. See, for example, the laws and regulations posted on the websites of the Riga and Ventspils port authorities: Riga (www.rop.lv/en/for-clients-a-investors/laws-and-regulations.html); Ventspils: (www.portofventspils.lv/en/free_port_authority/).


50. Ibid, p. 4.

See the State Audit Office 2013 audit of the Riga port authority here: www.lrvk.gov.lv/upload/Compliance%20of%20the%20Activities%20of%20the%20Freeport%20of%20Riga%20Authority_May%202013.pdf


News reports, which have not been verified by the Secretariat, allege that Air Baltic’s return to profit may have less to do with Air Baltic’s operations and more to do with the company transferring debt to another Ministry of Transport SOE, Riga International Airport. News reports indicate that Air Baltic has not paid the airport for services rendered since 2009 and has an outstanding debt to the airport of more than EUR 20 million. (See for example: www.pietiek.com/raksti/airbaltic_sefs_gauss_pern_kopa_ar_bonusiem_nopelnijis_gandriz_800_000_eiro; www.pietiek.com/raksti/airbaltic_virs_udens_turas_nemaksajot_lidostai_parads_sasniedzis_22_miljonus_eiro; available only in Latvian.).


See names and titles of management board members online here: www.airbaltic.com/en/management

This includes litigation regarding allegations of mismanagement and corruption involving former Air Baltic CEO Bertolt Flick (see also Box 7, p. 47) and possible Air Baltic violations of EU state aid rules (see also Box 8, p. 54).

In Latvia, physical, archived company files are available at the office of the Enterprise Register or electronically, via fee-based online databases of Latvian enterprises, including www.lursoft.lv, www.crediweb.lv, and www.firmas.lv.

See section B.5.d.ii, below, on the difference between Latvian GAAP and International Financial Reporting Standards (IFRS).

Latvenergo ranked first in the 2013 ranking of Latvia’s most valuable companies, for the fifth year in a row in the list of Latvia’s 101 most valuable companies compiled by Kapitāls magazine, Prudentia financial advisers, Nasdaq OMX Riga, and Lursoft: prudentia.lv/public/33669.html

While difficult to make a direct comparison, it may be useful noting that the IMF estimates that the average return on equity for all non-financial companies in Latvia in 2010 was 8.4% and in 2009 was 1.7% (IMF, “Republic of Latvia: Fifth Review Under the Stand-By Arrangement and Financing Assurances Review, Request for Waiver of Nonobservance of a Performance Criterion, and Proposal for Post-program Monitoring”, February 2012 [www.imf.org/external/pubs/ft/scr/2012/cr1231.pdf])

See online here: www.nasdaqomxbaltic.com/market/?instrument=LV0000801090&list=1&pg=details&tab=security

Latvenergo’s strategy through 2016 is not publicly available, but its operational and strategic goals are described in the company’s annual reports.

Latvenergo’s strategy through 2016 is not publicly available, but its operational and strategic goals are described in the company’s annual reports.

According to the Latvian Central Statistics Bureau, the average gross wage rose 31.5% in 2007, year-over-year, and 20.5% in 2008.

In 2013, LDZ Cargo Ltd. paid Latvijas Dzelzceļš EUR 9.75 million, three times the previous year’s dividend payment. It is likely that this increase reflects LDZ Cargo Ltd.’s payment to Latvijas Dzelzceļš for the transfer of the management of Latvijas Dzelzceļš’s wagon fleet to the subsidiary.

Latvijas Dzelzceļš’s annual reports only began providing disaggregated financial reports for each of its subsidiaries in 2010.


As described in section A.7, below, a new SOE corporate governance law was passed by Latvia’s Parliament in October 2014, the Public Persons Enterprises and Capital Shares Governance Law, which will largely replace the framework set forth under the Law on State and Local Government Capital Shares and Capital Companies when it enters into force in January 2015.
Generally, a “capital company” is a limited liability or joint stock company. A “state capital company” is a fully state-owned enterprise, and a “private capital company” is a company in which the State owns shares.

“State capital shares” are defined as shares held by the State in a capital company.

A parent company is considered to have a “decisive influence” over a subsidiary if at least one of the following circumstances exist (Art. 3.3): (1) the parent company has the majority of voting rights in the dependent company; (2) the parent company has the right to appoint or remove the majority of the dependent company’s members of the management board or board of directors; (3) the parent company, exercising only its rights as a shareholder, appointed the majority of members of the management board or board of directors; or (4) the parent company, on the basis of a shareholder agreement, has sole control of the majority of the voting rights in the dependent company.

Latvian authorities cannot confirm the number of companies in a “factual” group situation, versus a contractual group situation. Based on submitted consolidated annual accounts, Latvian authorities estimate that there are 300 factual company groups in Latvia. There are 41 contractual groups of companies, according to group of company agreements registered with the Register of Enterprises.

Further information on identifying, costing, funding, and setting SOE commercial and non-commercial objectives can be found in Chapter 1 of the following report: OECD (2010), Accountability and Transparency: A Guide for State Ownership, Corporate Governance, OECD Publishing.


See section A.7, below.

Companies – including, but not limited to, SOEs – that do receive a “grant” or an “earmarked grant” for the performance of a specific State task or for the implementation of a specific purpose is considered to be financed directly from the public budget and subjected to the same financial management provisions as the State administration. See section B.1.c, for more information.

SOEs in the culture, healthcare, sports and education sectors are most likely to receive subsidies and, Latvian authorities add, in many of these cases, state budget grants make up a “substantial proportion” of the enterprises’ total revenue.

This is the latest year for which an English-language audit of the State budget is available on the Office’s website.


A company may be held liable under Art. 70 of the Criminal Law if the criminal offence was committed in the interests or for the benefit of the legal person, or as a result of lack of supervision or control by a natural person acting as an individual, or as a member of “the collegial institution” of the company: (1) on the basis of a right to represent the legal person or to act on behalf of such legal person; (2) on the basis of taking decisions in the name of such legal person, (3) realising control within the scope of the legal person.

OECD Report on the implementation and application of the convention on combating bribery of foreign public officials in international business transactions and the 2009 recommendations on further combatting bribery; pars. 31-35

More information on the PUC structure is available online here: www.sprk.gov.lv/lapas/Structure-and-Contacts#structure

From 1 January 2014, universal postal delivery services are defined in the Postal Law. However, the PUC continues to set basic requirements and quality targets.

More than one OECD body has been involved in competition policy reviews of Latvia. This section draws on information provided to various parts of the Secretariat.

Current and draft laws pertaining to the SOE sector in Latvia do not define the term “strategic”. This issue is addressed more fully in section B.2.a.

Further information on the structure of the Competition Council can be found online here: kp.gov.lv/en/about-competition-council/structure-staff-the-council

OECD Annual Report on Competition Policy Developments In Latvia
The Competition Council also reported that an additional four complaints involving SOEs were submitted to the Council since 1999, but these cases were closed at the pre-investigation stage.

The Riga Freeport Authority is not an SOE held at the national level. According to Article 7 (1) of the Law On Ports, a port authority belongs to the public administration established by the relevant local government city council and which is under the supervision of the Cabinet of Ministers.

The fines are based on 14 cases decided by the Competition Council between 2009 and 2014 for violations of Art. 13 of the Competition Law. Eight of these cases involved SOEs.

The Commercial Law lays down the minimum number of votes for adopting decisions at the shareholders’ meeting, including decisions on dividend payments. According to Article 216.1 of the Commercial Law, which applies to limited liability companies, a decision of the shareholders shall be considered adopted if it has received more than half of the votes represented at the meeting, unless the law lays down a larger number of votes. Article 284.1 of the Commercial Law, in its turn, applies to joint stock companies and stipulates that the shareholders’ meeting shall make decisions by a majority of the votes present unless the law or articles of association specify a larger number of votes.

For Latvenergo, the 2013 share of profit to be paid out as dividend was 90%, but not more than LVL 36 million (EUR 51 million), in accordance with Article 35 of the Law on the State Budget for 2013. In 2012, the share of profit for Latvenergo was 90%, but not more than LVL 39.9 million (EUR 56.5 million). In 2011, the share of profit for Latvenergo was set at 95%, but not more than LVL 35,000,000 (EUR 49.7 million). In 2012, the share of profit Latvijas Valsts meži had to pay out as dividend was also 90% of the remaining net profit in the possession of the company and an additional payment for utilisation of the state capital, including the undivided profit of previous years in the amount of LVL 8,386,898 (EUR 11.9 million) but not more than a total of LVL 51,600,000 (EUR 73 million). In 2011, Latvijas Valsts meži was ordered to make a payment of LVL 51,693,449 (EUR 73.5 million).

These included: Riga International Airport; Latvia Air Navigation; Latvian Railway; Latvia Post; and the National Rehabilitation Centre “Vaivari”. Three Ministry of Culture SOEs were also released from dividend dues in 2012.

The list of specific purchases for which additional supervision is required is fairly extensive and can be found in par. 16 of the company’s articles of association (www.latvenergo.lv/files/news/Statuti_ENG_27.01.2014_IR.pdf) and in par. 2.2.2 of the company’s Rules of the Management Board (www.latvenergo.lv/files/news/Valdes_nolikums_27.01.2014_ENG_IR.pdf).


As noted in A.5.a above, SOEs operating as credit institutions, investment management companies, or financial institutions are still required to have boards of directors.

Reverta, Citadele, and Air Baltic are joint stock companies and, as such, are required to have boards of directors under Art. 266 of the Commercial Law. Lattelecom and LMT are limited liability
companies, which under Art. 220 of the Commercial Law can choose to have boards of directors by including them in the company’s articles of association.

113. For note, according to Art. 296.4 of the Commercial Law, minority shareholders may nominate candidates to the board of directors if the candidate represents at least 5% of the total capital owned by shareholders with voting rights. (For more on minority shareholder rights, see section B.3.d., below.)

114. See Arts. 291-300 of the Commercial Law.

115. The enterprises for which the LPA is empowered to nominate board members and which have boards of directors have established boards according to Commercial Law, and not the Law on State and Local Government Capital Shares and Capital Companies


117. Of the 5 companies on the Nasdaq OMX Riga exchange main list and 25 companies on the secondary list, 29 are former SOEs that were privatised via listing. There has only been one private company that has undertaken an initial public offering in Latvia.

118. Members include representatives from the Prime Minister’s Office, the State Chancellery, Economy, Justice and Finance ministries, as well as the Latvian Association of Local Governments, Foreign Investors Council, Latvian Chamber of Commerce and Industry, Latvian Employers’ Confederation, Public Policy Centre ”PROVIDUS” and Latvian Free Trade Unions.

119. This assessment forms part of a broader reform agenda, described in section A.7, below.

120. The assessment did not include Latvijas Gaze “because the issue of this capital company was considered at the Cabinet sitting as confidential”.


122. Concept for Management of State Capital Shares, pp. 8, 19.

123. Large SOEs are defined in the draft law as those who meet the following criteria in a financial reporting year: net turnover exceeds EUR 21 million and balance totality exceeds EUR 4 million.

124. Again, the law defines “large” as those SOEs who meet all three of the following criteria in a financial reporting year: (1) net turnover exceeding EUR 21 million; balance totality exceeding EUR 4 million; and the average number of employees exceeding 50.

125. BICG, Governance of State-Owned Enterprises in Baltic States, 2012, pp. 10-11


127. This current review of Latvia’s SOE sector under the SOE Guidelines is organised and funded by Latvia separately from the OECD accession process but will provide important input to that process. The accession process will include an assessment of the corporate governance of Latvia’s SOEs vis-à-vis the SOE Guidelines (currently under review) in force at the time of accession. The process will build on the findings of this report.
“The President of Latvia and the Secretary General of the OECD discuss successful progress and accession of Latvia to the Organization,” Office of the President of Latvia, 12 September 2014 (www.president.lv/pk/content/?art_id=22495)

Latvia’s summary of Art. 3 of the Public Procurement Law is as follows: “according to Article 3 of the Public Procurement Law it is not applicable if a commissioning party enters into a contract regarding the works or supplies performed or services provided by such institution, which concurrently conforms to the following criteria: it is under complete control of one or several commissioning parties (such control manifests as the right to influence essential objectives and decisions of operation of the institution under control); at least 80% of its annual financial turnover consists of the implementation of specific tasks in the interests of the controlling commissioning parties or other commissioning parties, which are controlled by the commissioning parties controlling the institution; capital shares or stocks thereof completely belong to the commissioning parties controlling it.”

A discussion of the EU Public Procurement Directives and applicable exceptions to these rules can be found online in this European Commission Staff Working Paper (2011): http://ec.europa.eu/internal_market/publicprocurement/docs/public_public_cooperation/sec2011_1169_en.pdf


See section B.5.a for more on the Law on Budget and Financial Management reporting requirements. See B.6, below, for more information on issues related to transparency and disclosure.

For more information, see online here (in Latvian only): http://www.lvm.lv/par-mums/misija-un-vizija/strategija

An unofficial English translation of an extract from the 2009 State Audit Office recommendation on the SOE sector reads as follows:

In order to provide the public with information, how state and local government enterprises are managed and what the impact on national budget from management of these assets is, we recommend Ministry of Finance in collaboration with the ministries and local governments to develop national and local government asset management policy, the definition of public finance investment objective, the expected performance of state owned enterprises public limited liability companies and methods by which to achieve them, taking into account the national corporate governance guidelines in the Baltic States. (See online here [in Latvian only]: www.lrvk.gov.lv/uploads/reviziju-zinojumi/2009/5.1-2-29_2009/zin_konsol_06102010.pdf)


The Centre clarified to the OECD Secretariat that losses associated with the transfer of business services from Latvijas Pasts to the Centre may have actually been higher. In 2008 losses totalled EUR 43,680, and in 2009, losses totalled EUR 5,336,004. (Financial results, available only in Latvian, are available online here: www.lvrtc.lv/lat/par_mums/finansu_rezultati/)

See online here: www.nasdaqomxbaltic.com/market/?instrument=LV0000801090&list=1&pg=detsails&tab=security

See online here: www.nasdaqomxbaltic.com/market/?instrument=LV0000801165&list=1&pg=detsails&tab=security
According to Section 7 of the 2007 Nasdaq OMX Riga Rules on Listing and Trading of Financial Instruments on the Markets Regulated by the Exchange, companies applying to list debt securities with the Exchange must have been active for at least two years; must have prepared at least its last annual report in compliance with international accounting standards; and its total debt securities value must be at least EUR 200,000 (www.nasdaqomxbaltic.com/files/rga/rules/NQRiga_Eng/2014_01_01_RSE_Listing_KONSOLIDET_E_Euro_ENGLISH.pdf).


Latvijas Dzelzceļš’ consolidated financial reports state that net profits decreased from EUR 40,253 in 2007 to EUR -3,183 in 2010. Returns on assets and on equity decreased from 0.40% and 1% in 2009 (the earliest year this information is available), respectively, to -0.5% and -1.30% in 2010.


LPA presentation during the 21 February 2014 introductory mission to Riga, “Better Governance of State-Owned Enterprises: Key Aspects of Reforms and Further Steps” and during the 3 April 2014 presentation to the WP SOPP, “Ownership Policy and Governance of SOEs in Latvia”.

As noted in section A.2.b(i) above, the Latvian Government announced on 5 November it had signed a deal with a group of 12 international investors to sell its 75% stake in Citadele. (See: http://www.pa.gov.lv/english/citadele-bank/news/ripplewood-and-latvian-privatization-agency-sign-agreement-for-sale-of-citadele-bank/)

As for boards of directors, the nomination criteria for management boards are broad, as per Art. 61(6) of the Law on State and Local Government Capital Shares and Capital Companies, which states candidates should be fluent in the official language and have a relevant professional and educational background.


Ibid., p. 86. This assertion is also supported by conversations held by the Secretariat with representatives from the government and non-government sectors during the two missions to Riga undertaken as part of this evaluation exercise.


See online here: https://www.vestnesis.lv/op/2014/195.9

As noted in section A.7.a.ii above, the Public Persons Enterprises and Capital Shares Governance Law states that nominations to SOE boards of directors and management boards should be selected by a...
nomination committee, which is made up of representatives nominated by the line ministry, the SOE board of directors (if one has been established), and the to-be-established Coordination Institution. If necessary, the nomination committee can also include independent experts as observers (Art. 31).

30 March 2012 Cabinet of Ministers Regulation No.311 “Provisions Regarding Number of Members of the Management Board of State or Local Government Capital Companies and Remuneration of a Member of the Board, a Representative of a Local Government Shareholder and the Chief Employee”

Articles 62 (7) and 94 (4) of law “On State and Local Government Capital Shares and Capital Companies.

For instance, Latvijas valsts meži Management Board Chairman Roberts Stīpnieks’ monthly remuneration increased from EUR 3,984 to EUR 12,521 and Latvenergo Management Board Chairman Āris Žīgurs’ monthly remuneration increased from EUR 3,961 to EUR 12,499.

According to Latvenergo’s 2013 Sustainability and Annual Report, Chair of the Management Board Āris Žīgurs received in total remuneration EUR 106,319; Member Zane Kotāne received EUR 95,367; member Māris Kuņick EUR 95,645; Member Arnis Kurgs EUR 95,481; and Uldis Bariss EUR 95,991. (See also online here: www.nasdaqomxbaltic.com/upload/reports/elek/2013_ar_en_uni_con_ias.pdf.)

For note, State forestry company Latvijas valsts meži only publishes combined remuneration figures for all four members of the management board. In 2010, the last year for which remuneration information is available, this figure totalled EUR 404,000.

Under the Law on Prevention of Conflict of Interest in the Activities of Public Officials, a public official has a duty to submit the following declarations within the time period specified and in accordance with the procedures specified: 1) a declaration to be submitted upon assuming the office; 2) a declaration for the current year; 3) a declaration to be submitted upon ending the duties of office; 4) a declaration to be submitted after the performance of duties of office has been terminated.

The annotations to Guideline III.B and to Principle V.A.3 of the OECD Principles of Corporate Governance state that information on shareholder agreements should be disclosed.

Art. 5 of the Freedom of Information Law read as follows:

(1) Restricted access information is such information as is intended for a restricted group of persons in relation to the performance of their work or official duties and the disclosure or loss of which, due to the nature and content of such information, hinders or may hinder the activities of the institution, or causes or may cause harm to the lawful interests of persons.

(2) As restricted access information shall be deemed information:

(…)

3) which is a commercial secret, except in the case where a purchase contract has been entered into in accordance with the Public Procurement Law or other type of contract regarding actions with State or local government financial resources and property.

See Art. 214 for LLCs and Art. 273 for JSCs.

See online here: reverta.lv/en/investors/akcionaru_sapulces/Year-2013
An authorisation is not necessary for a person who represents the shareholder on the basis of law (e.g., the “ex officio” representative of a public authority). Such persons shall present a document certifying his or her right of representation.

TILTS Communications, which is indirectly owned by Sweden’s TeliaSonera, owns 49% of Lattelecom shares.


Large companies are defined under Art. 24.2 of the Annual Accounts Law as those that meet two of the following three size criteria: A balance sheet total of EUR 1.42 million; net turnover of EUR 3.42 million; and an average of 250 employees.

For more on disclosure requirements under the Annual Accounts Law in section B.5.e.i below.

See, for example, Citadele’s 2013 annual report, online here: www.citadele.lv/common/img/uploaded/doc/reports/annual_report_2013_en.pdf

See online here: www.latvenergo.lv/eng/corporate_social_responsibility/cooperation_with_stakeholders/

See reports online here: www.latvenergo.lv/eng/corporate_social_responsibility/sustainability_report/

See online here: www.mk.gov.lv/en/aktuali/annual-review/


The tasks of the committee are outlined in the Latvenergo Audit Committee Charter. Available online at: www.latvenergo.lv/eng/investors/corporate_governance/audit_committee/

Audit summaries are available online (in English and Latvian) here: irvk.gov.lv/index.php?id=2207. In addition, four audits were undertaken of enterprises owned at the municipal level during this period.


Art. 1 of the Law on Accounting states: “This Law applies to merchants, co-operative societies, foreign merchant branches and non-resident (foreign merchant) permanent representations, associations and foundations, political organisations (parties) and the associations thereof, religious organisations, trade unions, institutions financed from the State budget or local government budgets, the State or local government agencies and other legal and natural persons who perform economic activities (hereinafter – undertaking).”

Art. 1.1 of the Annual Accounts Law states: “This Law applies to commercial companies, co-operative societies registered in Latvia, European economic interest groups, European co-operative
societies and European commercial companies registered in Latvia, as well as to individual undertakings, farms and fishing undertakings, the turnover (income) of which from economic activity transactions in the previous accounting year exceeds 200 000 lats [EUR 285,000] (hereinafter also – company).”


179. www.lzra.lv/


181. The Secretariat’s meeting with LZRA was organized in the context of the review of Latvia under the OECD Principles of Corporate Governance.


184. See section A.4.a above for a description of the Group of Companies Law, which applies to companies operating in a group situation.

185. The size threshold for including non-financial indicators in management reports is provided under Art. 24.2 of the Annual Accounts Law, which defines a large company as one that meets two of the following size criteria: A balance sheet total of EUR 1.42 million; net turnover of EUR 3.42 million; and an average of 250 employees.

186. The State Revenue Service is “a direct administration authority under the supervision of the Minister for Finance, which ensures the accounting of tax payments and taxpayers, the collection of State taxes, fees and other mandatory payments specified by the State in the territory of the Republic of Latvia, as well as collects taxes, fees and other mandatory payments for the budget of the European Union, implements the customs policy and organises customs matters.” (Law on the State Revenue Service, Art. 1)

187. Large companies are defined under Art. 24.2 of the Annual Accounts Law as those that meet two of the following size criteria: A balance sheet total of EUR 1.42 million; net turnover of EUR 3.42 million; and an average of 250 employees.

188. A business secret, as defined in Section 19 of the Commercial Law, complies with the following features: “1) it is contained in the undertaking of the merchant or is directly related thereto; 2) it is not generally accessible to third parties; 3) it is of an actual or potential financial or non-financial value; 4) its coming at the disposal of another person may cause losses to the merchant; 5) in relation to which the merchant has taken reasonable measures corresponding to a specific situation to preserve secrecy.”
Based on a recent review of government practices in OECD and other countries for dealing with SOE boards of directors, it appears that the optimum board size is between five and eight members. (See pages 76-77, OECD (2013), *Boards of Directors of State-Owned Enterprises: An Overview of National Practices*, OECD Publishing.)

Art. 295.4 of the Commercial Law sets the minimum number of board members at three for private companies, and at five for publicly listed companies.

### Annex 1
The 32 largest Latvian SOEs<sup>1,2</sup>

<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
<th>Legal form</th>
<th>Size of company (including subsidiaries)</th>
<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latvijas Valsts meži <a href="#">www.lvm.lv</a></td>
<td>Forestry</td>
<td>MoA</td>
<td>JSC</td>
<td>AV: 450.4 BE: 406.8</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Latvijas Valsts meži) supervisory boards were abolished.</td>
</tr>
</tbody>
</table>

**Notes:**

1. Abbreviations employed in the table: AT = Annual Turnover; AV = Asset Value; BE = Book Equity; JSC = Joint Stock Company; LLC = Limited Liability Company; MoF = Ministry of Finance; MoE = Ministry of Economics; MoT = Ministry of Transport; MoH = Ministry of Health; MoC = Ministry of Culture; MoA = Ministry of Agriculture; MoJ = Ministry of Justice; MoEP = Ministry of Environmental Protection and Regional Development; NoE = Number of Employees; PA = Privatisation Agency; P/L = profit/loss (for the whole company); SC = Subsidiary Companies.

2. Data provided are for financial year of 2012 (there are no available data on 2013 yet). Amounts provided are millions of USD (exchange rate 1.00 USD = 0.531000 LVL according to the rate of the National Bank of the Republic of Latvia as of 31.12.2012.).
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
<th>Legal form</th>
<th>Size of company (including subsidiaries)</th>
<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% LLC „Jaunmoku pilis“</td>
<td></td>
<td></td>
<td></td>
<td>AT: 335.4</td>
<td></td>
<td>The number of management board was increased in 2013 from 1 to 3 members.</td>
</tr>
<tr>
<td>40.22% LLC „Meža koksnes produktu pētniecības un attīstības institūts“</td>
<td></td>
<td></td>
<td></td>
<td>NoE: 1,234</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.82% JSC „Latvijas finieris“</td>
<td></td>
<td></td>
<td></td>
<td>P/L: 72.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latvijas Nacionālā opera</td>
<td>Entertainment</td>
<td>MoC</td>
<td>LLC</td>
<td>AV: 5.0</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td><a href="http://www.opera.lv">www.opera.lv</a></td>
<td></td>
<td></td>
<td></td>
<td>BE: 1.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>AT: 12.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>NoE: 560</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>P/L: 0.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Privatizācijas aģentūra (Privatisation Agency)</td>
<td>Public service</td>
<td>JSC</td>
<td></td>
<td>AV: 278.8</td>
<td>100%</td>
<td>In 2012 number of the members of management board was decreased from 4 to 2.</td>
</tr>
<tr>
<td><a href="http://www.pa.gov.lv">www.pa.gov.lv</a></td>
<td></td>
<td></td>
<td></td>
<td>BE: 129.2</td>
<td></td>
<td>In 2009 in all SOEs (including Privatizācijas aģentūra) supervisory boards were abolished.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>AT: 1.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>NoE: 69</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>P/L: 7.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latvenergo</td>
<td>Power supply</td>
<td>MoE</td>
<td>JSC</td>
<td>AV: 4,655.9</td>
<td>100%</td>
<td>In 2012 one of the subsidiary companies – JSC “Augstsprieguma tīkli” - was divided from “Latvenergo” and operates as independent</td>
</tr>
<tr>
<td><a href="http://www.latvenergo.lv">www.latvenergo.lv</a></td>
<td></td>
<td></td>
<td></td>
<td>BE: 2,656.3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Subsidiaries and shareholdings:

- 100% JSC „Enerģijas publiskais tirgotājs“ (est. 26.02.2014)
- 100% JSC „Sadales tikls“
- 100% OU „Elektrum Eesti“
- 100% UAB „Elektrum Lietuva“
- 100% „Latvijas Elektriskie tikli“
- 51% LLC „Liepājas Enerģija“
- 48,15% JSC „Pirmais Slēgtais Pensiju Fonds“
- 25,00% JSC „Nordic Energy Link“ (sold in 2013)
- 0,01% JSC „Rīgas siltums“

### Financial services

**Name of the SOE and its subsidiaries:**
- Financial services

**Main sector of operations:**
- MoE

**Name and nature of the government body/bodies owning and exercising the ownership function:**
- LLC

**Legal form:**
- LLC

**Size of company (including subsidiaries):**
- AV: 233.8
- BE: 135.7
- AT: 1.2
- NoE: 18
- P/L: 1.6

**Share owned by the state:**
- 100%

**Changes within the last five years of the ownership and control structures:**
- In 2009 in all SOEs (including Latvenergo) supervisory boards were abolished.
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
<th>Legal form</th>
<th>Size of company (including subsidiaries)</th>
<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>67% limited partnership “Imprimatur Capital Technology Venture Fund”</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
BE – 12.3  
AT – 7.0  
NoE – 95 | 100% | MoEP is shareholder of the company since 2011 (before 2011 – Ministry of Transport).  
The name of the company was changed in 2011 (previously – “Elektronisko sakaru direkcija”).  
In 2009 in all SOEs supervisory boards were abolished.  
The number of management board was decreased in 2008 from 4 to 3 members. |
| VSIA Latvijas vides, ģeoloģijas un meteoroloģijas centrs  [http://www.lvgmc.lv](http://www.lvgmc.lv) | Environmental protection, (environmental information, management, quality and natural resources monitoring; dangerous waste management) | MoEP | LLC | AV – 30.0  
BE – 28.5  
AT – 5.4  
NoE - 291 | 100% | The number of board members has changed from 1 to 3 members in 2012. |
| Tiesu namu aģentūra  [www.tna.lv](http://www.tna.lv) | Real estate and IT services | MoJ | JSC | AV- 59.9  
BE- 39.8  
AT - 5.6  
NoE - 90 | 100% | In 2009 in all SOEs (including Tiesu namu aģentūra) supervisory boards were abolished. |
<p>| Augstsprieguma tīkls  <a href="http://www.ast.lv">www.ast.lv</a> | Electricity transmission | MoF (since 2012) | JSC | AV: 40.7 | 100% | Until 02.01.2012, the company was one of the subsidiaries of JSC “Latvenergo”. Due to |</p>
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
<th>Legal form</th>
<th>Size of company (including subsidiaries)</th>
<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
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<tbody>
<tr>
<td><strong>Shareholding:</strong></td>
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<td>requirements of the Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity governing it was divided from JSC “Latvenergo” and MoF was assigned by Cabinet as shareholder of the company.</td>
</tr>
<tr>
<td>• 1.85 % JSC „Pirmais Slēgtais Pensiju Fonds“</td>
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<tr>
<td><strong>Latvijas Hipotēku un zemes banka</strong> (currently – „Latvijas Attīstības finanšu institūcija &quot;Altum&quot;”)<a href="#">www.hipo.lv</a></td>
<td>Financial services and insurance</td>
<td>MoF</td>
<td>JSC</td>
<td>AV: 679.1</td>
<td>100%</td>
<td>The name of the company was changed in start of 2014 (previously – “Latvijas Hipotēku un zemes banka”). The board of was dismissed in 2013 following reorganization of “Latvijas Hipotēku un zemes banka”.</td>
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<tr>
<td><strong>Subsidiary:</strong></td>
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<tr>
<td>• 100% LLC „Riska investīciju sabiedrība“</td>
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<tr>
<td><strong>Valsts nekustamie īpašumi</strong><a href="#">www.vni.lv</a></td>
<td>Real estate</td>
<td>MoF</td>
<td>JSC</td>
<td>AV: 476.0</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Valsts nekustamie īpašumi) supervisory boards were abolished.</td>
</tr>
<tr>
<td><strong>Subsidiaries and shareholdings:</strong></td>
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<tr>
<td>• 100% LLC „VNĪ pilis“;</td>
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<tr>
<td>• 100% LLC „Veselības aprūpes nekustamie īpašumi“;</td>
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<tr>
<td>• 31,5% LLC „Biroju centrs Ezerparks“;</td>
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<td><strong>Latvijas Loto</strong><a href="#">www.latloto.lv</a></td>
<td>Lotteries</td>
<td>MoF</td>
<td>JSC</td>
<td>AV – 11.3</td>
<td>100%</td>
<td>None</td>
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<tr>
<td>Name of the SOE and its subsidiaries</td>
<td>Main sector of operations</td>
<td>Name and nature of the government body/bodies owning and exercising the ownership function</td>
<td>Legal form</td>
<td>Size of company (including subsidiaries)</td>
<td>Share owned by the state</td>
<td>Changes within the last five years of the ownership and control structures</td>
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<tr>
<td>Bērnu kliniskā universitātes slimnica</td>
<td>Health service</td>
<td>MoH</td>
<td>LLC</td>
<td>AV: 78.1</td>
<td>100%</td>
<td>MoH is shareholder of the company</td>
</tr>
<tr>
<td><a href="http://www.bkus.lv">www.bkus.lv</a></td>
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<td>BE: 10.0</td>
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<td>AT: 36.2</td>
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<td>NoE: 1,922</td>
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<td>P/L: -2.1</td>
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<tr>
<td>Daugavpils psihoneiroloģiskā slimnica</td>
<td>Health service</td>
<td>MoH</td>
<td>LLC</td>
<td>AV: 24.4</td>
<td>100%</td>
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<tr>
<td><a href="http://www.dpns.gov.lv">www.dpns.gov.lv</a></td>
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<td>BE: 1.2</td>
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<td>AT: 8.2</td>
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<td>NoE: 590</td>
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<td>P/L: 0.01</td>
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<tr>
<td>Slimnica “Ģintermuiža”</td>
<td>Health service</td>
<td>MoH</td>
<td>LLC</td>
<td>AV: 21.3</td>
<td>100%</td>
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<tr>
<td><a href="http://www.gintermuiza.idcomputer.lv">www.gintermuiza.idcomputer.lv</a></td>
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<td>BE: 2.4</td>
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<td>AT: 6.1</td>
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<td>NoE: 524</td>
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<td>P/L: -0.4</td>
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<tr>
<td>Name of the SOE and its subsidiaries</td>
<td>Main sector of operations</td>
<td>Name and nature of the government body/bodies owning and exercising the ownership function</td>
<td>Legal form</td>
<td>Size of company (including subsidiaries)</td>
<td>Share owned by the state</td>
<td>Changes within the last five years of the ownership and control structures</td>
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</tbody>
</table>
| Paula Stradiņa kliniskā universitātes slimnīca www.stradini.lv | Health service | MoH | LLC | AV: 137.6
BE: 11.1
AT: 104.2
NoE: 2,972
P/L: -4.7 | 100% | LLC „Valsts zobārstniecības un sejas kļūdāgās centrs“ (health services) was merged into the company in 2008. |
| Rīgas Austrumu kliniskā universitātes slimnīca www.aslimnica.lv | Health service | MoH | LLC | AV: 124.2
BE: 11.4
AT: 107.9
NoE: 4,528
P/L: -6.7 | 100% | LLC „Kliniskā universitātes slimnīca „Gaļezers““ (health services) was merged into the company in 2008.
Latvijas Infektoloģijas centrs un Tuberkulozes un plaušu slimību centrs (health services) was merged into the company in 2012. |
| Rīgas psihiatrijas un narkoloģijas centrs www.rpnc.lv | Health service | MoH | LLC | AV: 31.8
BE: 14.5
AT: 13.2
NoE: 872
P/L: 0.03 | 100% | LLC „Vecpiebalgas psihoneiroloģiskā slimnīca“ was merged into the company in 2008. |
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
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<th>Changes within the last five years of the ownership and control structures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Traumatoloģijas un ortopēdijas slimnica</strong></td>
<td>Health service</td>
<td>MoH</td>
<td>LLC</td>
<td>AV: 12.8 BE: 6.2 AT: 14.1 NoE: 514 P/L: 0.09</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Latvijas dzelzceļš) supervisory boards were abolished.</td>
</tr>
<tr>
<td><strong>Latvijas dzelzceļš</strong></td>
<td>Railway infrastructure management</td>
<td>MoT</td>
<td>JSC</td>
<td>AV: 1,026.0 BE: 411.4 AT: 629.0 NoE: 12,289 P/L: 32.0</td>
<td>100%</td>
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<tr>
<td>Name of the SOE and its subsidiaries</td>
<td>Main sector of operations</td>
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<tr>
<td>5,84% LLC „Strek”</td>
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<tr>
<td>3% LLC „Mirigo”</td>
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<tr>
<td>Air Baltic Corporation</td>
<td>Air transport (airline)</td>
<td>MoT</td>
<td>JSC</td>
<td>AV: 167.2</td>
<td>99,8%</td>
<td>In 2012 the number supervisory board was decreased from 6 to 3 members.</td>
</tr>
<tr>
<td><a href="http://www.airbaltic.lv">www.airbaltic.lv</a></td>
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<td>BE: 242.3</td>
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<td>AT: 366.7</td>
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<td>NoE: 1,302</td>
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<td>P/L: -41.1</td>
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<td>Subsidiaries and shareholdings:</td>
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<tr>
<td>• 100% LLC „Baltic Airlines”</td>
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<tr>
<td>• 100% JSC „Aviation Crew Resources”</td>
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<tr>
<td>• 100% LLC „Training Centre Holdings”</td>
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<tr>
<td>• 100% LLC „Baltijas kravu centrs”</td>
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<tr>
<td>Latvijas autoceļu uzturētājs</td>
<td>Road transport (construction and maintenance)</td>
<td>MoT</td>
<td>JSC</td>
<td>AV: 92.9</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Latvijas autoceļu uzturētājs) supervisory boards were abolished.</td>
</tr>
<tr>
<td><a href="http://www.lau.lv">www.lau.lv</a></td>
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<td></td>
<td>BE: 55.0</td>
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<td></td>
<td>AT: 99.7</td>
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<td>NoE: 1,489</td>
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<td>P/L: 3.5</td>
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<tr>
<td>Name of the SOE and its subsidiaries</td>
<td>Main sector of operations</td>
<td>Name and nature of the government body/bodies owning and exercising the ownership function</td>
<td>Legal form</td>
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<td>Share owned by the state</td>
<td>Changes within the last five years of the ownership and control structures</td>
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</tbody>
</table>
| Starptautiskā lidosta “Rīga” www.riga-airport.com | Air transport (airport) | MoT | JSC | AV: 117.2 | BE: 53.8  
AT: 56.8  
NoE: 1,088  
P/L: 2.6 | 100% | In 2009 in all SOEs (including Starptautiskā lidosta “Rīga”) supervisory boards were abolished. |
| Pasažieru vilciens www.pv.lv | Rail transport | MoT | JSC | AV: 59.2 | BE: 23.1  
AT: 85.6  
NoE: 946  
P/L: 0.3 | 100% | In 2009 in all SOEs (including Pasažieru vilciens) supervisory boards were abolished. |
| Latvijas Pasts www.pasts.lv | Postal service | MoT | JSC | AV: 99.5 | BE: 11.0  
AT: 72.2  
NoE: 4,470  
P/L: 6.4 | 100% | In 2009 in all SOEs (including Latvijas Pasts) supervisory boards were abolished. |
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
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<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
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</thead>
<tbody>
<tr>
<td>Ceļu satiksmes drošības direkcija <a href="http://www.csdd.lv">www.csdd.lv</a></td>
<td>Road transport (traffic safety)</td>
<td>MoT</td>
<td>JSC</td>
<td>AV: 48.6</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Ceļu satiksmes drošības direkcija) supervisory boards were abolished.</td>
</tr>
<tr>
<td>Latvijas Gaisa Satiksme <a href="http://www.lgs.lv">www.lgs.lv</a></td>
<td>Air Navigation Services</td>
<td>MoT</td>
<td>JSC</td>
<td>AV – 40.7</td>
<td>100%</td>
<td>In 2009 Supervisory Board was abolished.</td>
</tr>
<tr>
<td>&quot;Latvijas valsts un radio televīzijas centre&quot; <a href="http://www.lvrtc.lv">www.lvrtc.lv</a></td>
<td>ICT, TV and radio broadcasting</td>
<td>MoT</td>
<td>JSC</td>
<td>AV-76.9</td>
<td>100%</td>
<td>In 2009 in all SOEs supervisory boards were abolished.</td>
</tr>
<tr>
<td>Latvijas Valsts ceļi <a href="http://www.lvceli.lv">www.lvceli.lv</a></td>
<td>Road management</td>
<td>MoT</td>
<td>JSC</td>
<td>AV – 7.7</td>
<td>100%</td>
<td>In 2009 in all SOEs (including Latvijas Valsts ceļi) supervisory boards were abolished.</td>
</tr>
<tr>
<td>Latvijas televīzija <a href="http://www.ltv.lv">http://www.ltv.lv</a></td>
<td>Broadcasting and publishing services</td>
<td>National Council of Electronic Mass Media</td>
<td>LLC</td>
<td>AV – 17.7</td>
<td>100%</td>
<td>The number of management board was increased in 2013 from 1 to 3 members</td>
</tr>
<tr>
<td>Latvijas mobilais telefons <a href="http://www.lmt.lv">www.lmt.lv</a></td>
<td>Telecommunication</td>
<td>PA</td>
<td>LLC</td>
<td>AV – 291.8</td>
<td>5%</td>
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<tr>
<td>Name of the SOE and its subsidiaries</td>
<td>Main sector of operations</td>
<td>Name and nature of the government body/bodies owning and exercising the ownership function</td>
<td>Legal form</td>
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<td>Share owned by the state</td>
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<tr>
<td><strong>Subsidiaries</strong>:</td>
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<tr>
<td>• 100% LLC “LMT Retail &amp; Logistics”</td>
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<tr>
<td>• 100% LLC “ZetCOM”</td>
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<tr>
<td><strong>Lattelecom</strong></td>
<td>Broadcasting, telecom and IT</td>
<td>PA</td>
<td>LLC</td>
<td>AT – 243.3</td>
<td>NoE - 863</td>
<td>The number of supervisory board members was decreased in 2012 from 11 to 7 members.</td>
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<tr>
<td><strong>Subsidiaries and shareholdings</strong>:</td>
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<tr>
<td>• 100% LLC „Lattelecom Technology“</td>
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<tr>
<td>• 100% LLC „Lattelecom BPO“</td>
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<tr>
<td>• 100% LLC „Citrus Solutions“</td>
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<tr>
<td>• 23% LLC „Latvijas Mobilais Telefons“</td>
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<tr>
<td>• 50% JSC „Pirmais Slēgtais Pensiju Fonds“</td>
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<tr>
<td><strong>Citadele banka</strong></td>
<td>Financial services</td>
<td>PA</td>
<td>JSC</td>
<td>AV: 3,015.9</td>
<td>BE: 178.6</td>
<td>75 % minus 1 share</td>
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<tr>
<td><strong>Subsidiaries and shareholdings</strong>:</td>
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<td>• 100% IPAS „Citadele Asset Management“</td>
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<tr>
<td>• 100% AB „Citadele bankas“</td>
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<tr>
<td>• 100% LLC „Citadele Express Kredits“</td>
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<tr>
<td>• 100% JSC „Citadele atklātais pensiju fonds“</td>
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</table>

AS „Citadele banka“ was founded on 30 June 2010; and launched its activities on 1 August 2010 following the successful restructuring of JSC “Parex Banka”. There have been no changes in the ownership and control structures of the bank.
<table>
<thead>
<tr>
<th>Name of the SOE and its subsidiaries</th>
<th>Main sector of operations</th>
<th>Name and nature of the government body/bodies owning and exercising the ownership function</th>
<th>Legal form</th>
<th>Size of company (including subsidiaries)</th>
<th>Share owned by the state</th>
<th>Changes within the last five years of the ownership and control structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% AAS „Citadele Life”</td>
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<tr>
<td>100% OU „Citadele Leasing&amp;Factoring”</td>
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<tr>
<td>100% OOO „Citadele Asset Management”</td>
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<tr>
<td>100% LLC „E&amp;P Baltic Properties”</td>
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<tr>
<td>100% UAB „Citadele faktoringas ir lizingas”</td>
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<td>100% UAB „Citadele investīciju valdymas”</td>
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<tr>
<td>100% „AP Anlage &amp; Privatbank”AG</td>
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<tr>
<td>100% Calenia Investments Limited</td>
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<tr>
<td>100% LLC „Citadele līzings un faktorings”</td>
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<tr>
<td>100% LLC „Rīgas pirmā garāža”</td>
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<tr>
<td>100% LLC „RPG interjers”</td>
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<td>100% LLC „PR Speciālie projekti”</td>
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<tr>
<td>100% OOO „Citadele Investments Ukraina”</td>
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<td>100% LLC „Hortus Land”</td>
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<tr>
<td>100% LLC „Hortus TC”</td>
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Annex 2
Latvian Privatisation Agency Defined Principles for Nomination of Supervisory Boards

Latvian Privatisation Agency

LPA Defined Principles for Nomination of Supervisory Boards
(To be revised and updated when necessary)

1. Substantiation of the need for nomination

The order by LPA (to start nomination process) should specify the following information:

- Reference to the principles laid down in the GoL State Capital Shares Management Concept, OECD, NASDAQ OMX Riga and Baltic Institute of Corporate Governance guidelines / recommendations for the improvement of corporate governance in SOEs).

Example:
By the order No 246 of 4 June 2012 (min.No 27 19.§), GoL accepted the State Capital Shares Management Concept (hereinafter “Concept”), which lays down the procedure of nomination of board and board members of SOEs. The Concept envisages that board and board members are nominated using the database of candidates for board and board membership (reserve list) based on professionalism and competence criteria (education, experience, knowledge about the industry, finances, management, motivation methods, etc.), where political affiliation is not a factor. At the same time, the Concept provides that board members are nominated by the nomination committee established by the centralised management body. The centralised management body will be created after the entry into force of the Law On the Management of Capital Shares of Public Persons, which is currently under development.

The principles for the nomination of board and board members, which are laid down in the Concept as well as in the guidelines of OECD, NASDAQ OMX Riga and Baltic Institute of Corporate Governance regarding SOE corporate governance, should be implemented before the establishment of the centralised management body; therefore LPA establishes the Nominations Committee for the nomination of board members in _______( SOE).

- Why nomination is required (example, resignation of any existing board member, the need to change existing board members, etc.).

- Clarity about the outcomes of the nomination process (change all board, only individual board members - because requirements / criteria will depend on this matter).
2. Composition of the Nominations Committee

- The order by LPA (to start nomination process) should specify the authorities / officials: why they are involved in the work of the nominations committee.

Example:

In view of the significant role of the Ministry of Economics and the Ministry of Finance in the process of implementation of the restructuring plan approved by the European Commission with regard to Citadele bank, LPA encouraged the above mentioned ministries to delegate representatives for the work in the Nominations Committee. At the same time, when implementing corporate governance principles, it is crucial to ensure a professional and transparent nomination process of board members. LPA encouraged transparency international Latvia - Deina to work in the Nominations Committee as an observer without voting rights.

- Members of the Nominations Committee – include independent members and observers, when possible.
- It is very valuable to involve a HR expert (or other experts), who conduct interviews and assist in the process.
- It is important that the Nominations Committee includes sufficiently high level authorities, meanwhile who can devote time to the nomination process.
- The optimum number of members in the Nominations Committee is 3 to 5.

3. Tasks of the Nominations Committee

The tasks of the Nominations Committee are to organise nomination of board members, including:

- to approve the process of nomination of board members and requirements for the candidates;
- to create a long list of potential candidates based on appropriate recommendations of social partners and organizations, academia, members of the Nominations Committee, evaluating the compliance of potential candidates with the requirements;
- to create a short list of potential candidates for board membership and to interview the candidates on the short list, if appropriate;
- to prepare a recommendation to the holder of the capital shares (LPA executive board) about candidates for board, who should be nominated for approval to the shareholder meeting.

4. Operation of the Nominations Committee

- The operation of the Nominations Committee is ensured and managed by LPA Commercial Department. The functions of the secretariat of the Nominations Committee are ensured by LPA Commercial Department.
- The Nominations Committee is entitled to invite experts, if appropriate.
- Decisions of the Nominations Committee should be taken by simple majority of votes.
• Information about candidates for board membership is limited accessibility information which should not be disclosed to third persons.

• Information about the operations of and decisions taken by the Nominations Committee is publicly provided by LPA. Members of the Nominations Committee are entitled to answer questions from the mass media (if any) about the operations of and decisions taken by the Nominations Committee.

• Sessions (decisions) of the Nominations Committee are recorded and the minutes are signed by members of the Nominations Committee and the record-keeper of the session.

• If required, information exchange by e-mail is organised using a password, which will be informed by LPA.

• Members of the Nominations Committee certify their compliance with the requirements for prevention of conflict of interests in the work of the Nominations Committee by signing a certification form (attached to these principles).

5. Predefined requirements for the candidate for board membership

• Defined requirements for board members include criteria for education, experience, knowledge of the industry, finances, management, motivation methods, etc. (depending on the situation and field of operation of SOE)

• Aim is to select independent and professional board members, political influence / influence of politicians has to been prevented

• Significant: board members should jointly (as a team) have all the required professional skills (to balance, for example, legal, financial analysis, industry-specific and other abilities).

Example:

- At least 3 years of experience in management of a financial body and/or at least 5 years of experience in management of a medium or large enterprise.
- Determination, orientation to achievements, ability to take decisions and concentrate on the achievement of long-term goals, understanding of motivation methods.
- Good relations establishment skills.
- Higher education in engineering, economics, financial management, business administration or other related sector.
- Compliance with the requirements of the Credit Institutions Law, including reputation.
- Compliance with the requirements of the Law on Prevention of Conflict of Interest in Activities of Public Officials.
- A board member cannot be a person, who was punished or convicted of a malicious criminal offence or malicious bankruptcy (irrespective of whether the criminal record has been extinguished or removed) or who was deprived from the right to carry out certain or all types of commercial activities.
- Experience of work in a board of a capital company is desirable.
- Experience in planning and implementation of the restructuring process of a company is desirable.
- Experience in conducting of negotiations with the European Commission is desirable.
- Experience with regard to crediting, analysis of risks of operation and evaluation of compliance of a credit institution, as well as optimisation of expenditures is desirable.
6. Process of nomination of board members

- LPA conducts consultations with social partners and organizations, academia about potential candidates, who might be nominated to work in the board:
  
  [List to be defined]

**Example:**
*It can include Latvian Confederation of Employers, Latvian Chamber of Commerce and Industry, industry associations, universities, Foreign Investors’ Council, Baltic Institute of Corporate governance, NASDAQ OMX Riga, Providus etc.*

- Potential candidates should be initially informed that a board member is a state official (if appropriate).
- Social partners and organizations, academia and members of the Nominations Committee inform LPA about potential candidates for board, who have conceptually (for example, orally) agreed to become such candidates. To define that the following data should be provided about each candidate, if possible:
  
  - name and surname;
  - obtained education;
  - current workplace (workplaces) and position (positions);
  - contact information;
  - candidate’s curriculum vitae (CV).

- LPA contacts potential candidates to obtain assurance about their readiness to work in position of a board member, as well as get additional information for the purposes of evaluating compliance with the requirements for candidates for board membership *(if a board member will be state official, it is important to tell in detail what this means in practice, because many candidates refuse to further participate in the nomination because of this status)*

- LPA prepares an evaluation of compliance of the potential candidates for board membership with the formal requirements for candidates for board membership *(attached to these principles)*.

- LPA creates a long list of potential candidates for board membership, including the following data *(this can be supplemented / updated, if appropriate)*:
  
  - name and surname;
  - obtained education;
  - current workplace (workplaces) and position (positions);
  - contact information;
  - evaluation of the candidate according to formal requirements;
  - a more detailed profile of potential candidates, including description of professional experience for at least the last 10 years;
  - possible term in position of a board member;
  - information about positions in other capital companies, number of shares of capital companies owned by the candidate and other information.
- The Nominations Committee uses the system of points in the process of evaluation of potential candidates *(attached, if necessary).*
- The Nominations Committee creates a short list of potential candidates and interviews the candidates on it, if appropriate. The time scheduled for one candidate is up to one and a half hour.
- If the Nominations Committee states that none of candidates included in the short list can be recommended for approval as a board member, the candidates who are not on the short list (from the long list) are contacted or additional candidates will be searched.
- The Nominations Committee prepares a recommendation about candidates for board who should be nominated for approval in the shareholder meeting.
- LPA publishes information regarding nomination process.
## Annex 3

### Summary of procedures for changes to Latvian SOE capital structures

<table>
<thead>
<tr>
<th>Type of change</th>
<th>Applicable legal provisions</th>
<th>Summary of procedures according to law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquiring capital shares</td>
<td>Law on State and Local Government Capital Shares and Capital Companies</td>
<td>Purchasing capital shares of an existing company is the easiest way for the State to acquire shareholding. The Cabinet must take a decision on this matter. The reorganization of SOE and debt capitalisation of a private capital company are related to acquiring state shareholding as well.¹</td>
</tr>
<tr>
<td>Maintaining state shareholding</td>
<td>Not currently regulated by legislation.</td>
<td></td>
</tr>
</tbody>
</table>
| Increasing existing shares | • Commercial Law  
 • Law on State and Local Government Capital Shares and Capital Companies | SCS may be increased in an existing company where the state is one of the shareholders. In general, shareholding of a capital company may be increased in the following two ways: 1) by increasing the equity of the capital company, thus proportionally increasing the state shareholding; 2) by acquiring/purchasing capital shares owned by the shareholders of the existing capital company.  

According to the Commercial Law, the equity of both LLC and JSC shall be increased based on the decision of shareholders’ meeting and the existing shareholders have prior right to new capital shares/shares in proportion to the capital shares/shares already in their possession.  

According to the Law on State and Local Government Capital Shares and Capital Companies, the State may increase its shares in an existing capital company in one of the abovementioned ways: by acquiring capital shares from local government; by alienating capital shares from other person or through reorganisation; or by merging a private capital company where the state holds shares with a state-owned capital company. |
<table>
<thead>
<tr>
<th>Type of change</th>
<th>Applicable legal provisions</th>
<th>Summary of procedures according to law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alienating state capital shares (SCS)</td>
<td>• Commercial Law&lt;br&gt; • Law on State and Local Government Capital Shares and Capital Companies&lt;br&gt; • Law on the Privatisation of State and Local Government Property;&lt;br&gt; • Law on Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates</td>
<td>According to regulations of these laws SCS may be alienated in the following ways: 1) by privatising SCS; 2) by selling SCS; 3) by transferring SCS without compensation.</td>
</tr>
<tr>
<td>Privatisation of SCS</td>
<td>• Law on the Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates&lt;br&gt; • Law on State and Local Government Capital Shares and Capital Companies</td>
<td>See section A.6, above, on privatisation.</td>
</tr>
<tr>
<td>Sale of SCS</td>
<td>Law on State and Local Government Capital Shares and Capital Companies</td>
<td>The Cabinet shall make a decision on termination of decisive influence of the SOE over another capital company. The management board of an SOE needs a prior consent of the Cabinet for acquiring shares in another company, for increasing or reducing the shareholding. (Alienation is one of the types of reducing shareholding.) The sale of SCS is generally organised by the Latvian Privatisation Agency.</td>
</tr>
<tr>
<td>Transfer of SCS without compensation</td>
<td>Law on State and Local Government Capital Shares and Capital Companies</td>
<td>The State is entitled to transfer the capital shares in its possession to local government without compensation by a Decree of the Cabinet in accordance with provisions of the Commercial Law and the Articles of Association of the particular capital company. SCS may be transferred to the possession of local government if the local government has requested such transfer, and the board thereof has adopted a relevant decision. The transfer of SCS to the possession of local government is not be subjected to provisions regarding the alienation under the Law on State and Local Government Capital Shares and Capital Companies.</td>
</tr>
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</table>

1. Latvia notes that there are several other, less common ways to acquire capital shares in an existing company. (For instance, debt capitalisation in accordance with the procedure specified in the Commercial Law, acquisition of capital shares without heirs, etc.) These alternatives were not discussed due to their specific nature.

Source: Latvia’s questionnaire responses.
Annex 4
Further background on select large Latvian SOEs

This annex provides further background information on the current and past management at the five large Latvian SOEs highlighted in section A.3 of this assessment: Air Baltic, Latvenergo, the Latvian State Forestry Company, Latvian Post, and Latvian Railway.

A. Air Baltic

Current and past chairs of the management board

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<tbody>
<tr>
<td>Martin Gauss</td>
<td>✓</td>
<td>✓</td>
<td>From November</td>
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<tr>
<td>Bertold M. Flick</td>
<td></td>
<td></td>
<td>Until October</td>
<td>✓¹</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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</table>

1. Note: Air Baltic reports indicate that there was no management board at the company from 29 December 2009 until 1 April 2010. The company explains that this is due to reorganization in the management of the company.

- **Martin Gauss** is former CEO of the now-insolvent Malév Hungarian Airlines, former CEO of Germany’s regional airline, Cirrus Airlines, and former CEO of German low-cost airline DBA (DBA Luftfahrtgesellschaft mbH).

- **Bertold M. Flick** served as a member of the board of directors from 1999 to 2002 and then as CEO from 2002 to 2011. Little information is available regarding his background prior to joining Air Baltic.

Current and past members of the management board

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<tbody>
<tr>
<td>Vitolds Jekoļevs</td>
<td>✓</td>
<td>✓</td>
<td>From October</td>
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<tr>
<td>Martin Sedlacky</td>
<td>✓</td>
<td>From May</td>
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<tr>
<td>Laila Odiņa</td>
<td></td>
<td>Until March</td>
<td>From October</td>
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<tr>
<td>Mārtiņš Antonovičs</td>
<td></td>
<td></td>
<td>Until 29 December</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Jan Lundborg</td>
<td></td>
<td></td>
<td>Until 29 December</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Tero Pekka Juhani</td>
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<td>March to December</td>
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1. See note 1 to the table above. In 2010, the company reorganized its management structure

- **Vitolds Jekoļevs** is former chairman of the management board at SIA Holdinga kompānija Felix, a Latvian freight and shipping logistics company; and

- **Martin Sedlacky** is formerly of the Boston Consulting Group, where projects included restructuring airlines in Central and Eastern Europe, Scandinavia, Malaysia, Singapore, and in the United States.
• **Laila Odiņa** began working for Air Baltic beginning in 1995 and served as Chief Operations Officer from 2005 to 2012.

• **Mārtiņš Antonovičs** began working for Air Baltic in 1998 as a financial resources manager. In 2003, he became a member of the management board and Chief Financial Officer. In 2006, Mr. Antonovičs returned to Air Baltic as CFO after two years working for private-sector financial companies.

• **Jan Lundborg** has a professional background in the airline industry, including serving as Vice President of Corporate Strategy and Revenue Management at SAS.

• **Tero Pekka Juhani Taskila** served as a commercial director in Air Baltic from 2009 to 2011. Prior to joining Air Baltic, he worked for Finnair and for Lufthansa consulting.

### Current and past members of the board of directors

**Note:** The timelines included in the following table are composed based on news reports related to changes in Air Baltic’s board of directors from 2007 through 2014. A “■” denotes that the director held his or her position for all or most of that year. A “□” denotes that the director only held his her or her position for part of the year, due to changes made in board composition as a result of changes in company ownership.

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<td>Kaspars Briškens</td>
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<td>Andris Liepiņš</td>
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<td>Niks Bulmanis</td>
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<td>Valters Grīnvalds</td>
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<td>(Chair for part of 2011)</td>
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<td>Raitis Tukāns</td>
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<td>Karl Gunther Sollinger</td>
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<td>Jean-Charles Korsak</td>
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<td>Santa Glāzniece</td>
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<td>Amins Mužnieks</td>
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<td>(Chair for part of 2009)</td>
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<td>Mats Jansson</td>
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1. For part of 2010, the board of directors was disbanded, following BAS’ buyout of SAS shares, and there was no board.
Backgrounds of current members of the board of directors:

- **Andris Liepiņš** (Chair) is deputy state secretary in the Ministry of Economy.
- **Kaspars Briškens** is currently an adviser to the Ministry of Transport and a former Deputy State Secretary in EU and industry issues at the Ministry of Transport. He is also currently Executive Director at the Latvian Logistics Association.  

- **Niks Bulmanis** is former chair of the management board at Riga Freeport (until 2006). He is former chair of the management board of Latvia’s Māras bank, which has since been acquired by Finland’s Sampo Group.

**B. Latvenergo**

Current and past chairs of the management board

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</thead>
<tbody>
<tr>
<td>Āris Žīgurs</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
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<td></td>
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<tr>
<td>Uldis Bariss</td>
<td>✓</td>
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<td>✓</td>
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<td>✓</td>
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<tr>
<td>Kārlis Miķelsons</td>
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</table>

- **Āris Žīgurs** was elected Chair of Latvenergo’s Management Board in 2010 via a competitive selection process. Previously, Mr. Žīgurs worked for 15 years as head of the management board of the Riga-based heat and energy supply company Rīgas siltums AS. His prior experience also includes the position of Commercial Director of the former Latvenergo VAS Thermofication Department, as well as work at municipal companies.

- **Uldis Bariss** has been a member of Latvenergo’s management board since 2005 and has been with the company since 2002. Before joining Latvenergo, Mr. Bariss worked at Lattelecom for nine years, focusing on financial aspects of the company’s operations.

- **Kārlis Miķelsons** served as Latvenergo management board Chair from 2000 to 2009. Previous to this, he served as a business development manager (1992-1996) and then as an associate director (1996-2000) at Statoil.

Current and past members of the management board

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<tbody>
<tr>
<td>Zane Kotāne</td>
<td>✓</td>
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<td></td>
<td>From August</td>
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<tr>
<td>Uldis Bariss</td>
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<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Māris Kuņickis</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Arnis Kurgs</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Arnis Daugulis</td>
<td></td>
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<td></td>
<td>Until August</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Aigars Meļko</td>
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<td>✓</td>
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<td>✓</td>
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<tr>
<td>Olafs Vītols</td>
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<tr>
<td>Ilmārs Stūklis</td>
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• **Zane Kotāne** served as Head of the Unit for Business Analysis and Reporting at the Commercial Department of Air Baltic Corporation, before joining Latvenergo. She was a financial director at an international investment group for five years, after spending eight years working at an international audit and consulting company, specialising in finance and risk management, which included two years of experience in Hungary.

• **Uldis Bariss** (see above)

• **Māris Kuņickis** joined Latvenergo in 2010. Prior to that, he served as director of Rīgas Gaisma (Riga city lighting), where he worked for ten years on issues related to technology and development.

• **Arnis Kurgs** joined Latvenergo in 1995. A lawyer, Mr. Kurgs has handled Latvenergo’s legal affairs and has been on the company’s management board since 2006. Prior to his employment at Latvenergo AS, Mr. Kurgs worked as a legal advisor for the Ministry of Maritime Affairs, the Riga City Council and the Saeima.

• **Arnis Daugulis** served as Chief Information Officer at Latvenergo from 1999 to 2011, overseeing the provision of IT and telecommunications services within the Group. He is also a former deputy secretary of state of information and communications technologies in the Ministry of Environmental Protection and Regional Development.

• **Kārlis Miķelsons** (see above)

• **Aigars Melko** served as a Latvenergo management board member from 2006 to 2009. Little information is publicly available on his professional experience prior to joining Latvenergo in 2000.

• **Ilmārs Stuklis** served as a production director at Latvenergo and served on the management board from 2003 to 2005.

• **Ilafs Vītols** has also served on the management boards of a number of local companies in Latvia.

C. **Latvijas valsts meži**

**Current chair of the management board**

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<tbody>
<tr>
<td>Roberts Stīpnieks</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
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<td>✔</td>
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</table>

• **Roberts Stīpnieks** has served as the SOE’s management board Chair since the company’s foundation. Before joining Latvijas valsts meži, Mr. Stīpnieks worked for the Latvian State Forest Service as a project director.

**Current and past members of the management board**

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<tbody>
<tr>
<td>Gints Bumbieris</td>
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<tr>
<td>Arnis Melnis</td>
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<td>✔</td>
<td>✔</td>
<td>✔</td>
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<tr>
<td>Edvīns Zakovics</td>
<td>✔</td>
<td>✔</td>
<td>From March</td>
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<tr>
<td>Kārlis Boldiševics</td>
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<td>Until Dec.</td>
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<tr>
<td>Andrejs Brūvelis</td>
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<td>Until Dec.</td>
<td>✔</td>
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<tr>
<td>Modris Grantiņš</td>
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<td>Until Oct.</td>
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<tr>
<td>Aivars Tiesnesis</td>
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<td>Until Oct.</td>
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</table>
• **Gints Bumbieris** has served as a member of the management board since 1999. Little to no information is publicly available regarding his professional experience prior to joining Latvijas valsts meži.

• **Arnis Melnis** has also served as a member of the management board since 1999. From 1997 to 1999, he served as a main forestry controller (Director General, State Forest Service) in the Latvian State Forest Service.

• **Edvīns Zakovics** joined Latvijas valsts meži in 2011. Little information is publicly available regarding his professional experience prior to his position with Latvijas valsts meži, other than that he served as a member of the management board of the Hunters Association of Latvia from 2004 to 2008.

• **Kārlis Boldiševics** simultaneously served as a member of Latvijas valsts meži’s management board and as secretary-general of the Latvian political party, the Union of Greens and Farmers, until 2010, when he withdrew his political position and remained with Latvijas valsts meži to comply with Latvia’s new conflict of interest legislation.

• **Andrejs Brūvelis**’s professional history includes serving as chair of the management board of the Latvian Buckthorn Growers Association.

• **Modris Grantiņš** served as a member of the management board until October 2010, when he passed away in a car accident. His professional background included serving as director of professional forestry secondary education in the city of Ogre.

• **Aivars Tiesnēsis**’s professional history includes serving as secretary-general of the conservative Latvian political party, Tautas Partija (“People’s Party”) until 2009. He also served as a deputy in the Saeima from 1998 to 2002; as a member of the Ventspils Nafta board of directors from 2005 to 2006; and as a member of the Ventspils Freeport from 2004 until June 2012, representing the Ministry of Finance.

D.  **Latvijas Pasts**

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<tbody>
<tr>
<td>Arnis Salnājs</td>
<td>From August</td>
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<tr>
<td>Māris Kleinbergs</td>
<td>Until May</td>
<td>From January</td>
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<tr>
<td>Agars Vītols(^{1})</td>
<td>Until January</td>
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<td>From December</td>
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<tr>
<td>Aivars Vies</td>
<td>Until December</td>
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<td>From October</td>
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<tr>
<td>Amiga Derive</td>
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<td>July to October</td>
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<tr>
<td>Raitis Avows</td>
<td>April to July</td>
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<tr>
<td>Ivars Karakuls</td>
<td>Until April</td>
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<td>From February</td>
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<td>Gints Skidoos</td>
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<td>Until February</td>
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</table>

1. Former chair of the management board Agars Vītols is not the same individual as the current member of the management board, Mr. Agars Vītols, below.
- **Arnis Salinas** brings to the management board experience in the banking sector and has served in several large legal offices in Latvia.

### Current and past members of the management board

<table>
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<tr>
<th>Name</th>
<th>Start Date</th>
<th>End Date</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
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<tr>
<td>Arnis Gulbis</td>
<td>From Oct</td>
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<tr>
<td>Arnis Salnājs</td>
<td>January to August</td>
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<td>Aigars Vītols</td>
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<tr>
<td>Egons Straždiņš</td>
<td>From Jan</td>
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<td>Ilze Aleksandroviča</td>
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<tr>
<td>Andrejs VI cups</td>
<td>Until Jan</td>
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<td>Ivo Leis</td>
<td>Until Jan</td>
<td>From Feb</td>
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<td>Toms Nabors</td>
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<td>Imams Mantis</td>
<td>Until Dec</td>
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<tr>
<td>Raitis Avows</td>
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<td>From Feb</td>
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<td>Until Jul</td>
<td>From Feb</td>
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<td>Liga Antae</td>
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<tr>
<td>Data Danovska</td>
<td>July to Oct</td>
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<tr>
<td>Inga Šīna</td>
<td>July to Oct</td>
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<tr>
<td>Arnis Kalvešs</td>
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<td>Leva Rozenberga</td>
<td>Until Jan</td>
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<td>Jānis Pitrāns</td>
<td>Until Feb</td>
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<tr>
<td>Miks Stūrītis</td>
<td>Until Aug</td>
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- **Arnis Gulbis** is the newest member of Latvijas Pasts’ management board, at the time of writing. His previous work experience includes serving as a member of the management board at Swedbank subsidiary SIA Hipolīzings and former head of the credit department and head of the SME lending department at Parex bank. Mr. Gulbis has also served on the management board of AS Sampo līzings, a subsidiary of Finland’s Sampo Group.

- **Aigars Vītols** currently serves as executive director of the Valmiera City Council. (He is not the same individual as the former chair of the management board from 2010 – 2012.)

- **Egons Straždiņš** formerly served as head of the currency department at Swedbank Latvia.
E. Latvijas Dzelzceļš

Current chair of the management board

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<tbody>
<tr>
<td>Uģis Magonis</td>
<td>✔</td>
<td>✔</td>
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<td>✔</td>
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</table>

- **Uģis Magonis** has served as Chair of the management board since 2005. Prior to joining Latvijas Dzelzceļš, he served on the board of directors for Air Baltic, was Vice-Chair of the Board of Directors of Latvijas Mobilais telefons (LMT), and worked as an Adviser to the Minister of Transport. Mr. Magonis has also served as a member of the board of directors for the Latvian Shipping Company, Riga Commercial Port, and the Latvian Privatization Agency. From 2003 to 2005, he chaired Latvijas dzelzceļš’s board of directors.

Current and past members of the management board

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</thead>
<tbody>
<tr>
<td>Ēriks Šmuksts</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>From Dec.</td>
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- **Ēriks Šmuksts** has been a management board member since 2008. He serves as Vice-President of Technical Operations and former served as director of the company’s freight transport department. From 2007 to 2008, he was Chair of the management board of LDZ Cargo. He was employee of the former Soviet Baltic Railway traffic units in Šiauliai and Gulbene.
- **Edvīns Bērziņš** is Vice-President of Real Estate Management, Legal and Administrative Issues. He is the former head of the international relations department for Latvia’s Police Academy, former head of the legal department at the Latvian Shipping Company, and a former member of the management board of Latvijas kuģniecība.
- **Aivars Štrakšas** has served on Latvijas Dzelzceļš’s management board since 2005 and serves as Vice-President of Finance. He is a former adviser to the Ministers of Agriculture and Finance, and a former member of the boards of directors at JSC Hipotēku un zemes banka and Latvijas Pasts. Mr. Strakšas also served as chair of the board of directors of the Lotteries and Gambling Supervision Inspection.
Annex 5
Selected references

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Puce, Juris (2011), *Policy Reforms for Effective Management of SOEs in Latvia – Transition Period to Dual Model*


This report evaluates the corporate governance framework for the Latvian state-owned enterprise sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The report was prepared at the request of the Republic of Latvia. It is based on a review involving all OECD countries.